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on the LONG TERM

Short-termism: Insights from business leaders

Findings from a global survey of business leaders commissioned by McKinsey & Company and CPP Investment Board

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Executives and board members report increasing pressure to produce short-term results, which hinders their ability to make strategic decisions.

The pressure on business leaders to deliver financial results in the short term has increased considerably since the economic crisis, according to a survey jointly commissioned by McKinsey and Canada Pension Plan Investment Board (CPPIB)[1] on time horizons in executive decision making.[2] More than three-quarters (79 percent) of the respondents told us the time frame in which they personally felt the most pressure to deliver financial results was 2 years or less. And while 73 percent said their companies should look at least 3 years ahead in their strategic planning, just over half said their management teams actually did so.

In this survey, we asked senior executives and board directors about the ways they balance short- and long-term priorities, the time frames they use to decide on strategy and investments, and the potential benefits from taking a longer-term approach to decisions.

We found the respondents – all of whom were C-level executives or board members[3] – most often cited their own executive teams and boards (rather than investors, analysts, and others outside the company) as the greatest sources of pressure to perform. They most frequently attributed the increased pressure to economic uncertainty, and they believed this pressure was affecting decisions on a range of

[1] McKinsey and CPPIB commissioned this survey as co-founders of *Focusing Capital on the Long Term,* a collaborative initiative that is developing practical tools and approaches to help institutional investors and corporate directors enhance long-term value creation. Further information is available at www.FCLT.org.

[2] The online survey, *Looking toward the long term,* ran from April 30 to May 10, 2013, and garnered responses from 1,038 executives representing the full range of industries and company sizes. Of these respondents, 722 identified themselves as C-level executives and answered questions in the context of that role, and 316 identified themselves as board directors and answered accordingly. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[3] At the beginning of the survey, we asked respondents to identify themselves as either C-level executives or board members at the company with which they are most familiar and to answer all the following questions in that role. Some respondents were both C-level executives and board members, and some were board members serving at multiple companies, but they answered the survey questions in their capacity in one of these two roles and for just one company.

issues, from M&A to managing externalities, that could benefit their companies in the long run. The largest share of respondents reported that the most helpful ways to reorient their companies toward a long-term view would be to create strategy-focused board committees and to ensure that boards spent most of their time on long-term issues. Encouragingly, these two actions were also those that business leaders most often identified as the ones their companies could easily implement today.

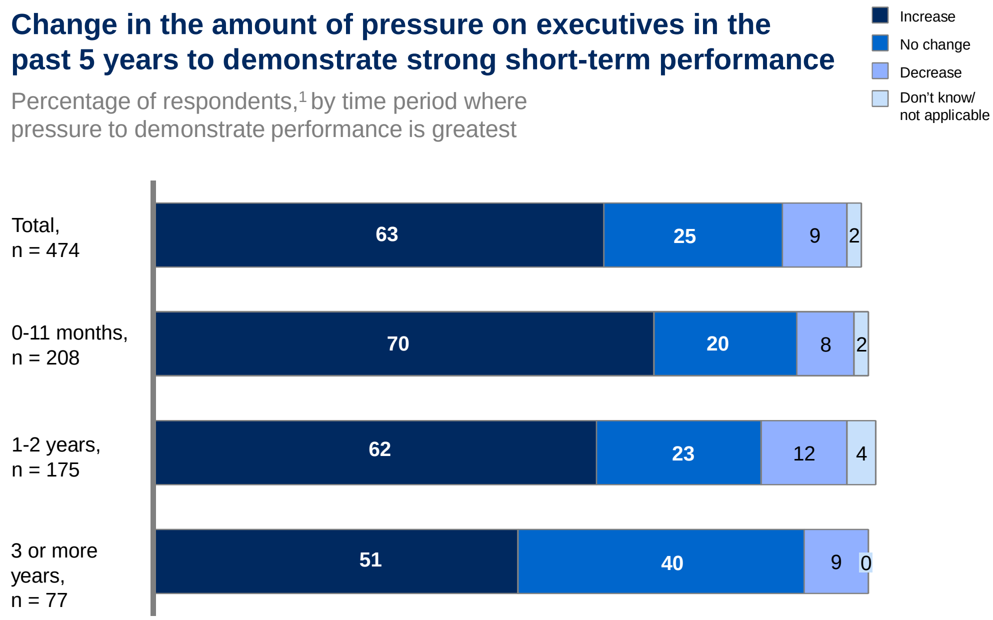
The pressure to perform

Nearly two-thirds (63 per cent) of the respondents said that the pressure on their companies' senior executives to deliver short-term financial performance had increased over the past 5 years. And, as mentioned, 79 percent said they felt the most pressure to produce results within 2 years or less. In both cases, those answering in their capacity as senior executives experienced the pressure more acutely: they were more likely than board members to report increased pressure and to say they felt it over shorter time horizons.

Across regions, respondents in European and North American companies were more likely (64 per cent) than those in emerging-market companies (54 per cent) to say that pressure had grown since the crisis. Those who reported feeling pressure to demonstrate results faster were also likelier to say the pressure had increased (Exhibit 1).

CEOs were more likely to report feeling an increase in short-term pressure over the last five years than board members (65 per cent vs 57 per cent). CEOs who self-reported that their companies had performed the same or worse than their competitors over the previous five years were significantly more likely to report increased short-term pressure (74 per cent), but a majority of CEOs whose companies had outperformed their competitors still reported an increase in short-term pressure (58 per cent).

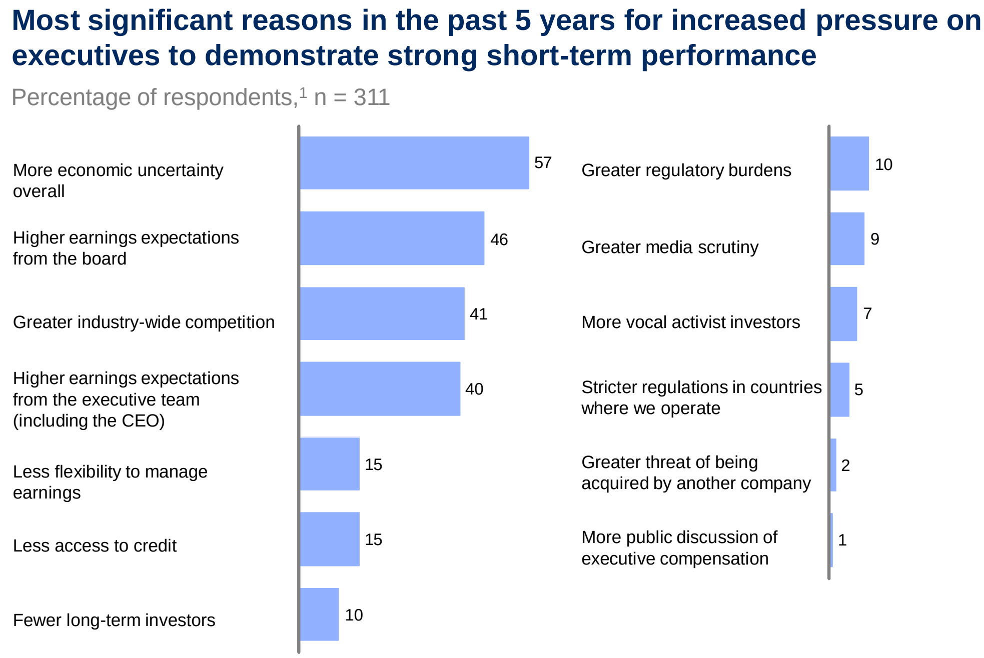
EXHIBIT 1



1 Figures may not add to 100% because of rounding

When asked where the pressure came from, a majority of respondents who said the pressure had increased cited economic uncertainty as the reason (57 per cent), whereas investor-related issues, such as fewer long-term investors and more vocal activist investors, were cited less often (Exhibit 2). Among respondents at public companies, 46 percent cited higher earnings expectations from the executive team as an underlying cause compared with 33 percent at private companies.

EXHIBIT 2



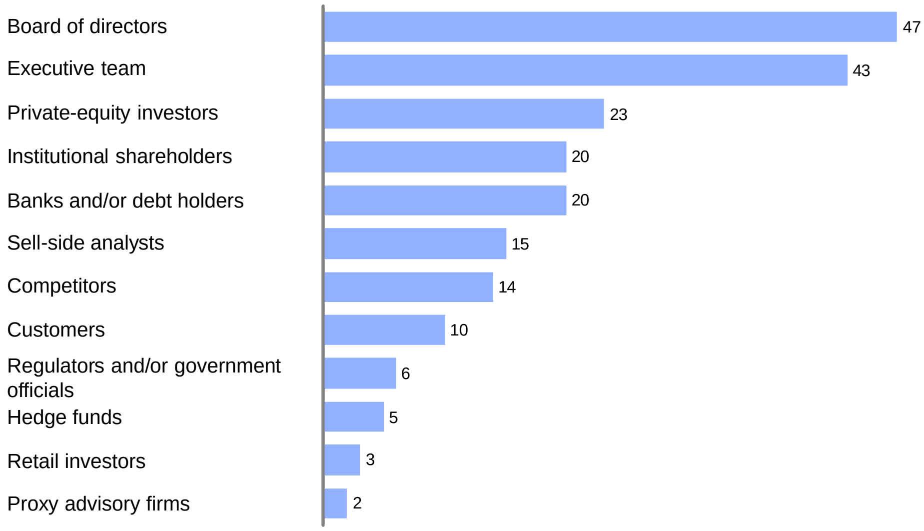
1 Respondents who answered “other” or “don’t know” are not shown

The greatest sources of pressure to demonstrate short-term results, respondents said, were themselves: board members and C-level executives (Exhibit 3). Surprisingly, Board members were just as likely to identify themselves as a source of increased short-term pressure. Respondents who reported that over 50% of their investor base had held the stock for more than 2 years were less likely to report that the Board or sell-side analysts were the main source of short-term pressure. This finding implies that the Boards of companies who are most under pressure from short-term oriented investors and sell-side analysts are likely not doing enough to shield management from excessive short-term pressure.

EXHIBIT 3

Greatest sources of pressure to demonstrate strong short-term performance

Percentage of respondents,[1] n = 474



1 Respondents who answered “other,” “none,” or “don’t know/not applicable” are not shown

Timing strategic decisions

Not only do the survey’s results affirm that pressure to perform is felt strongly over the short term, but they also highlight how this pressure influences the way business leaders approach strategy. Nearly half (44 percent) of the respondents said that when their companies’ management teams conduct a formal review of strategy, the primary time horizon is no longer than 2 years (Exhibit 4). When asked what that time horizon *should* be, 73 percent said 3 years or more.

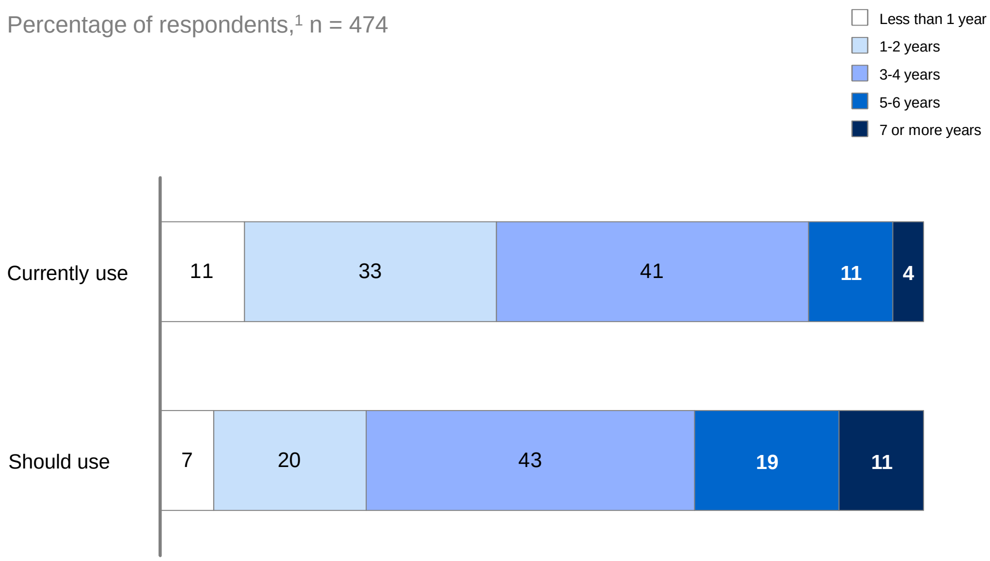
Responses did vary between regions with more than 80% of North American and European respondents stating that a horizon of 3 years or more was ideal, while only 58% of respondents from emerging economies felt the same way.

Executives who reported that they spent more of their time with internal stakeholders (e.g., the Board, wider management team, colleagues) were more likely to select 3-4 years as the optimal time period for strategic planning, while those who spent a similar amount of time with internal and external (e.g., customers, regulators, competitors, non-governmental agencies, industry bodies, investors, sell-side analysts) were more likely to select 5-6 years.

EXHIBIT 4

Primary time horizons management teams use in future strategic planning

Percentage of respondents,[1] n = 474



1 Respondents who answered "don't know" are not shown

In a hypothetical scenario, we asked respondents how much of their quarterly earnings or revenue targets their companies would miss to pursue an investment with positive net present value that would boost profits by 10 percent over the next 3 years. Confirming our suspicion that many companies have a short-term bias, a majority of respondents would not be willing to miss quarterly earnings by very much to boost profits by 10 per cent over the next 3 years. At public companies, responses varied by company size: only 49 percent of respondents at larger companies[4] and 35 percent at smaller companies[5] said they would miss earnings of up to 5 percent in pursuit of this deal.

We also asked about several other business decisions and the extent to which a focus on short-term financials affects companies' willingness or ability to make each type of choice: whether to pursue investments with uncertain long-term outcomes, to manage earnings, and to look after risks and externalities. For uncertain investments and earnings management, the majority of respondents said the short-term focus has

4 With annual revenues of at least $1 billion.

5 With annual revenues of less than $1 billion.

some effect on decision making: 49 percent said short-term pressures lessen their companies' willingness to pursue investments with less certain returns.

Impact on performance

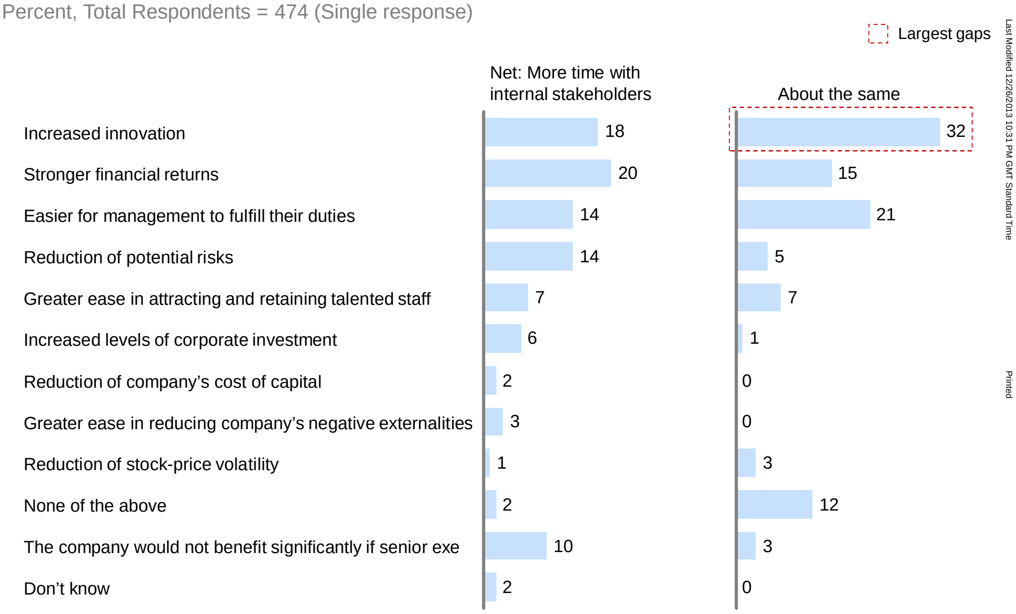
Most respondents (86 per cent) agreed that it would serve their companies well if senior executives took a long-term approach to business decisions more often. The largest percentage said their companies would benefit most from increasing innovation, strengthening their financial returns, and making it easier for managers to perform their duties effectively. Just 9 percent said their companies would not significantly benefit from executives taking a long-term perspective.

Executives who reported that they spent more of their time with internal stakeholders were less likely to see the potential for increased innovation or a reduction in business risks (Exhibit 5).

EXHIBIT 5

Respondents believe a longer-term focus would increase innovation and financial returns

Percent, Total Respondents = 474 (Single response)

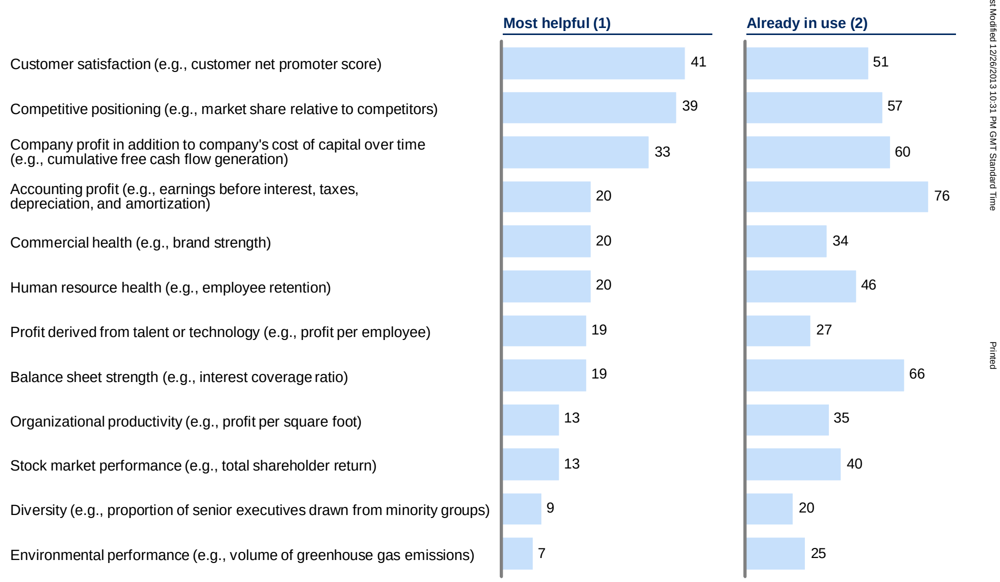


If their companies did take a longer-term view in their decision making, directors and executives would need regular access to information that is notably different from what they now see. The largest share of respondents (41 per cent) said metrics related to customer satisfaction and competitive positioning would be most helpful in making long-term decisions. At the moment, however, business leaders rely most often on financial metrics (such as accounting profits, balance sheet strength, and company profits) to aid decision making (Exhibit 6).

EXHIBIT 6

In order for senior executives and board members to make this shift, companies need to provide them with different information

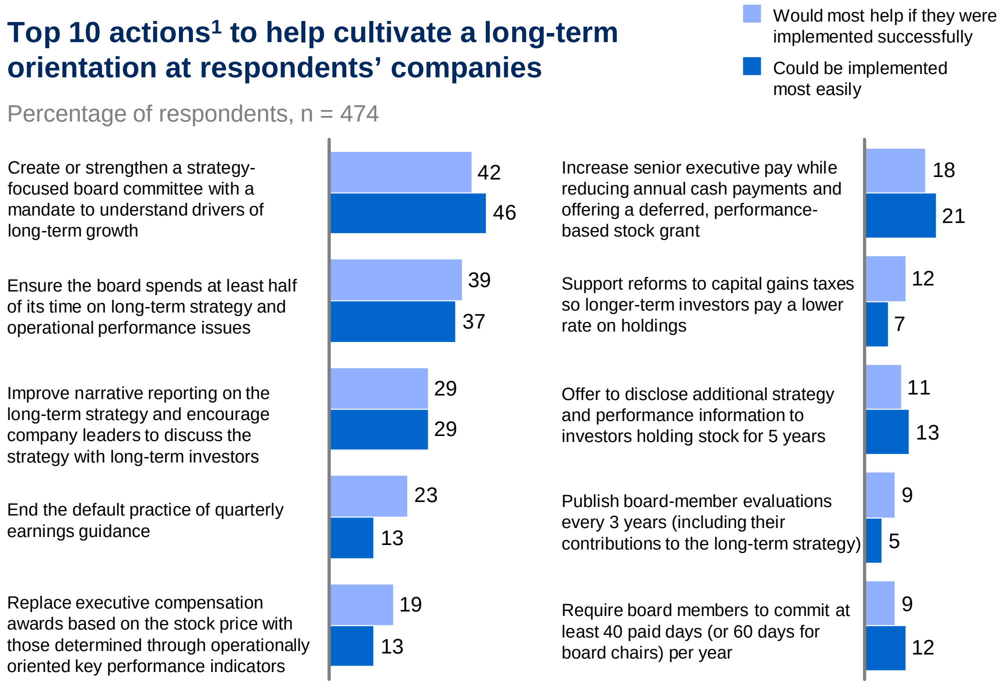
Percent, Total Respondents = 474 (Multiple response)



Seeking solutions

Business leaders said that developing a strategy-focused board committee, ensuring that the board spends at least half of its time on long-term issues, and improving narrative reporting on long-term strategy would be most likely to help cultivate a longer-term orientation at their companies. Encouragingly, respondents cited these three actions as the ones their companies could most easily implement (Exhibit 7). Yet the fact that executives and board members have not taken these steps suggests they may not be giving enough thought to how they can reduce the excessive short-term pressures at their companies.

EXHIBIT 7



1 Out of 14 total answer choices in the question

Board members and senior executives expressed different opinions about potential solutions. For example, 51 percent of directors said it would be most helpful to spend at least half of their board time on long-term strategy and performance issues. (Indeed, in another recent survey of board directors,[6] respondents reported that just one-quarter of the decisions they make relate to long-term company matters.) In contrast, just 34 percent of C-level respondents cite more board time on long-term issues, with the largest share (44 percent) saying a strategy-focused board committee would most help.

6 See Chinta Bhagat, Martin Hirt, and Conor Kehoe, "Improving Board Governance: McKinsey global survey results," August 2013, McKinsey.com