Are markets and company boards too focused on the short-term? Are activists a source of long-term value creation or are they short-term asset strippers? How should the weaknesses of corporate governance along the investment chain be addressed? Are public or private markets better at creating value? These issues were at the heart of a debate we held recently to celebrate Schroders’ membership of Focusing Capital on the Long Term (FCLT), a think tank set up to promote long-term decision-making across businesses and the investment industry.

Here is a summary of our discussion:

How big a problem is short termism? And is it located more amongst corporates and investors, or is it all along the chain?

SKW There are people and entities with long-term needs on each end of capital markets, whether it be companies investing in new products and markets at one end, or investors saving for a pension at the other. The problem really is us, the asset managers, the asset owners and the corporations, whose capital allocation decisions have become short term. A study by McKinsey commissioned by FCLT¹ has shown that if more companies took a long-term outlook, the benefits over the last 15 years would have been tangible in the form of five million more jobs, 1% higher US GDP and $1 trillion of increased asset values. We think the problem is soluble, which is why FCLT is putting together owners and managers to discuss how things can change.

MM At CPPIB, we invest for multiple generations and have a very long-term horizon. We are seeing “intense” pressure on the 2,560 companies we invest in to respond to short-term influences. Breaking this pattern of behaviour will require all involved, from the asset management industry to analysts and the financial press, to better communicate with each other to overcome the current “dissonance”.

On our panel were:

Sir Win Bischoff
Chairman of the UK’s Financial Reporting Council (WB)

Jessica Ground
Global head of Stewardship at Schroders (JG)

Mark Machin
President and Chief Executive Officer of the Canada Pension Plan Investment Board (CPPIB) (MM)

Sarah Keohane Williamson
Chief Executive Officer of FCLT Global (SKW)

Huw van Steenis
Global Head of Strategy at Schroders, who chaired the discussion (HvS)

JG We certainly don’t want to run companies and haven’t lost sight of the fiduciary role of the board. However, we think there are things shareholders can do. For instance, we believe quarterly reporting is a distraction, we think there is a need for better key performance indicators against strategic objectives, and succession planning is a vital part of our engagement with companies.

Are there particular sectors that are prone to short-term behaviour?

MM Short termism is not universal. Although certain sectors may seem to have an inherent need for a longer-term focus by management teams – due to R&D, product development cycles and so on – from an investor perspective, there are also underlying drivers that cut across industries and sectors which can help identify opportunities over a longer investment horizon. Moreover, geography makes a difference: about 20% of US companies still offer quarterly earnings guidance, whereas the figure is only 3% for Europe.

WB My view is that there is a greater short-term emphasis in the US, where quarterly guidance remains closely watched. However, my experience of US boards is that it is possible to plan for the long-term without compromising quarterly guidance. In Europe, there is perhaps more understanding of the need to look towards a more distant goal.

Sarah Keohane Williamson on capital markets: “One of the important things for us, broadly, is having the public markets be a place where companies want to be, yet the number of public companies has been falling dramatically over the last decade and that is an issue I think we need to work on.”

SKW In Silicon Valley there is now a strong feeling against going public because of the pressure it exerts on companies to think short term and innovate less. This is a dangerous idea for capitalist societies if it means companies largely remain private. In the US, for instance, it would restrict investment to “qualified purchasers”, often wealthy or large ones, which would lead to a narrower concentration of capital invested in growing, innovative companies.

JG We have seen various cases where there have been “problematic junctures” for companies. One is when a chief executive has stayed on too long and has let their focus on their legacy get in the way of important decisions. Another is where companies give insufficient thought to the long term when planning mergers and acquisitions. And in cyclical industries there is often a misplaced belief that “this time it’s different” when really the cycle is about to turn. We spend a lot of time making sure boards are giving enough weight to the long term in all these situations.

What are the benefits and disadvantages of activist investors?

SKW Some can be useful. The test is whether they are interested in long-term value creation or short-term value extraction. My suggestion for activists: if they are really in it for the long term, they should be willing to lock up their shares for five or even seven years.

WB At one company in which I was involved a well-known activist encouraged us to do something rather more quickly than we had planned, which helped lift the shares by about 30% before they sold out. Had they stayed around for another five years, however, they would have benefited from a further quadrupling in the share price.

JG We don’t see the distinction between “activist” and “engaged” as very helpful. I recognise that sometimes our interventions can raise eyebrows, but we only go public after polite private engagement has failed. Sometimes it is difficult to get others involved to agree, which is why we helped establish the UK’s Investor Forum2 to develop a more collective approach to such issues. We have a long way to go in the UK, but we are ahead of areas like, say, Japan.

MM We believe in the role of “creative destruction” in capitalist markets. Active shareholders can be a catalyst for useful change, but we recognise that sometimes we get it wrong. That’s why we have written a set of company engagement principles that set out guidelines for when we intervene. We are sufficiently confident in the benefits of long-term investing to have committed $1 billion to a fund tied to a new index, the S&P Long-Term Value Creation Global Index, which focuses on companies that take a long-term approach to sustainability and drivers of long-term investment returns3.

Is there a tension between public and private markets? How do you persuade the “unicorns” that it’s better to be in a public than in a private domain?

SKW Part of the issue is getting both the unicorns and the private equity world to see that the public markets are important to them. For private equity, it is important to have a way of realising an investment and often that can only be through public markets. They need the public markets to buy companies from and to sell companies to. It’s not private versus public equity: there’s a symbiotic relationship and they need both so that companies can move back and forth between the two.

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2 The Investor Forum was established to encourage better stewardship of companies by bringing together institutional investors and individual companies: https://www.investorforum.org.uk/

The discipline of the public market can be very useful. It would be a retrograde step if certain companies, say in the technology sector, were put off going public. Speaking personally, rather than for the Financial Reporting Council, I am not against allowing differential voting rights if it meant that owners of these companies felt happier that they would not lose control on flotation.

Huw van Steenis on activists:
“Activists have an important role in markets and can play a key role in spurring long-term thinking. The best study, by Harvard professor Lucian Bebchuk, showed operating performance was improved even three to five years after their intervention.”

One needs to be careful here: stewardship of companies will become more difficult if there is a race to the bottom in terms of governance standards. In terms of differential voting, investors need to do their due diligence and be careful who they are getting into bed with. There are, for instance, founding families that have treated minority shareholders well and there are ones who have behaved less well. It is important for there to be accountability when things go wrong. The problems of Uber, the online taxi company, illustrate the difficulties that can arise very quickly.

One of the benefits of going private is the ability it gives companies to restructure and plan for the long term without being distracted by the “noise” of the public market. In this, private equity can be useful. We agree that public markets are necessary for the public good and the discipline they instil, but half of CPPIB’s portfolio is private. We can weather the higher risk, the increased leverage and the limited liquidity due to the long-term nature of our pensions business.

Through the chain there are a series of incentives that may not be aligned. Are there better ways of framing incentives?

In every step, people need to be measured over the long term, rather than quarter by quarter, starting with the fund manager. At CPPIB, we have started this process by moving the basis for employees’ remuneration from three to five years. We push for a similar long-term framework for the management of the companies in which we invest. Research suggests the typical period just now is only one-and-a-half years.

Complexity has become a real problem in many companies, with even recipients of remuneration not really understanding how it is worked out. At the Financial Reporting Council we believe that there should be more simplicity. One way would be to award shares that vest over a period. This would provide a built-in performance factor, so existing performance conditions would fall away, and the way the share price performs over time would provide the long-term incentive. The only additional element might be to include a necessity for management to comply with certain conduct standards.

What about the impact of indexation on long-term engagement?

There are many ways to manage money, ranging from index funds, active public equity, activist public equity to private equity. Each type of manager needs to look at the tools they have at their disposal to influence managements to make markets think longer term.

I worry about the future of the creative destruction inherent in capitalist markets and of price-setting with the rise of passive investment. We engage as fundamental investors, thinking about the economics of the business and longer-term value, not as box tickers. Crucially, effective engagement needs to be based on analysis.
Are people avoiding capital markets because managers are no longer accountable to the pensioners and other investors who ultimately own the capital?

**SKW**  In the US, with defined contribution pensions having overtaken defined benefit pensions, there is no longer anyone fulfilling that intermediate fiduciary role looking after people's savings. But individual savers tend to make very poor investment decisions. A recent Dalbar study\(^5\) has confirmed a huge annual shortfall of more than 6% over 30 years that individual investors are likely to have suffered against the index. The US has a huge problem with financial decision making, compounded by the loss of a sophisticated asset owner that stands between each end of the investment spectrum.

Are we able to properly assess and improve the impact of engagement on long-term value creation?

**JG**  We have found that it takes at least two years to effect any change, so an investor has got to be long term. But it is sometimes hard to see an automatic performance benefit. We think this is because we are explicitly focusing on laggards and it is hard to know what would have happened had we not got involved.

**MM**  Our Head of Sustainable Investing sits on the Financial Stability Board's taskforce on financial reporting on climate change. We are looking forward to the enhanced disclosure this will bring so that we can better understand the risks across the 2,560 securities in our portfolios. We hope it will be broadly accepted and adopted, because there is neither sufficient disclosure nor consistency at the moment.

**SKW**  One of our projects is to look at risks in the context of a very long-term time horizon. At the moment, measures of risk – such as one-year volatility – make no sense if you have a 75-year timeframe or even a 5- or 10-year timeframe. It's pretty obvious that, if you are investing in a bridge, you need to know where the water level's going to be in 20 or 25 years to know whether that investment is going to be worth anything or not.

**Further reading**

"In praise of activist investors", by Huw van Steenis, Financial Times, 26 June 2017, https://www.ft.com/content/c7549d3a-57fd-11e7-80b6-9bf4c18b3d2


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\(^5\) Dalbar’s 22nd Annual Quantitative Analysis of Investor Behaviour reported that while the Standard & Poor’s 500 Index has generated 10.4% annually over the 30 years to December 2015, the typical equity mutual fund had produced just 3.7%. See https://www.dalbar.com/QAIB/index.

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