

FOCUSING CAPITAL ON THE LONG-TERM

Investing for the short-term destroys value, yet institutional investors are key sources of short-term pressure. How do we fix this?

A long-term approach makes sense for both asset owners and companies, because it allows for increased focus on long-term value drivers and management of different forms of capital, including physical, financial and human.

Active equity asset managers who held their stocks for more than 6 months on average saw considerably higher returns net of fees over the last twenty two years (McKinsey analysis using Strategic Insights datasets).

Companies with a long-term culture and a focus on sustainability outperformed matched companies in terms of total shareholder return by 4.8% per year for a total of 18 years according to an [HBS study](#).

Yet the shadow of short-termism has continued to advance—and the situation may actually be getting worse.

The main source of the problem is the continuing pressure on public companies from financial markets to maximize short-term results.

While it's true that humans are wired to focus on the short-term, the world's largest asset owners are not. Pension funds, insurance firms, mutual funds and sovereign wealth funds invest on behalf of long-term savers, taxpayers, and investors. In many cases their fiduciary responsibilities stretch over generations. Today they own 73% of the top 1,000 companies in the U.S., versus 47% in 1973. So they should have both the scale and the time horizon to focus capital on the long term.

The single most realistic and effective way to move forward is to change the investment strategies of the players who form the cornerstone of our capitalist system: the big asset owners.

To support the goal of long-termism, CPPIB and McKinsey recently launched “Focusing Capital on the Long Term,” a joint initiative to move from discussion to action. In a recent [HBR](#) article, Mark Wiseman and Dominic Barton suggest four practical approaches for institutional investors that are serious about focusing more capital on the long term.

1. Invest the portfolio after defining long-term objectives and risk appetite;
2. Unlock value through engagement and active ownership;
3. Demand long-term metrics from companies to change the investor-management conversation; and
4. Structure institutional governance to support a long-term approach.

This is broadly consistent with two major projects by the [UN-backed Principles for Responsible](#) aimed at:

1. Operationalizing long-term responsible investment mandates into manager appointment processes; and
2. Influencing public policy frameworks to support long-term responsible investment.

Key questions for investors include:

- *How do we define the long-term and appetite for risk?*
- *How do we ensure incentives throughout the investment chain are aligned for the long-term, while steering clear of unintended consequences?*
- *How do we define and obtain the long-term sector-specific company metrics that provide the most insight into value creation?*
- *What public policy interventions offer the most value?*

In the meantime, Global Compact LEAD and the UN PRI have outlined recommendations (please see attachment) for how companies can alleviate the impacts of investor short-termism by:

1. Coping with short-term focused investors (communicating how/where sustainability helps short-term financial performance);
2. Shifting (to investors with long-term horizons); and
3. Changing public policy to better align capital market markets with long-term value creation.

Some of the core questions for companies:

- *When it comes to embedding sustainability into strategy and capital decisions, what are the most important things we can do to cope, shift and change to deal with the negative impact of investor short-termism?*
- *What are the sweet spots where creating sustainable long-term value is also good in the short-term?*
- *How do we align part of remuneration incentives with these sweet spots?*
- *Should companies stop producing quarterly earnings reports, and instead produce regular integrated reports on issues and metrics that are relevant to the longer-term success of the business?*
- *What role can organisations such as the Global Compact and the PRI play, in concert with companies and investors, to align markets with global priorities and unlock the potential of the private sector?*

Getting these –and other- questions right offers a significant opportunity to create a new and better relationship between companies and investors.

Imagine a world in which investors with long term obligations invested as if the long term mattered and the companies that they owned acted accordingly. Asset owners would define exactly what they mean by long-term investing, their risk appetite and what practical consequences they intend. Capital would be shifted to more illiquid asset classes such as infrastructure and real estate. Investment managers would be hired and compensated on their ability to align with long-term objectives, and paid based mostly on their long-term value-add. Investors would focus on investing and engaging with companies with the most potential to create long-term wealth. Public companies would implement strategies to optimize long-term value creation, report the relevant performance metrics, and align them with executive compensation. Quarterly reporting would end. Integrating reporting providing insight into long-term value creation would take hold. Business would create more jobs, innovation and wealth with less externalities. Adam Smith would smile.

The good news is that none of this is blue-sky. Leaders from the corporate and investment world are taking the long-term bull by the horns. The key is to scale this leadership.

Further Reading:

[Focusing Capital on the Long Term, Building a Long-term investor base, Sustainable Capitalism](#)