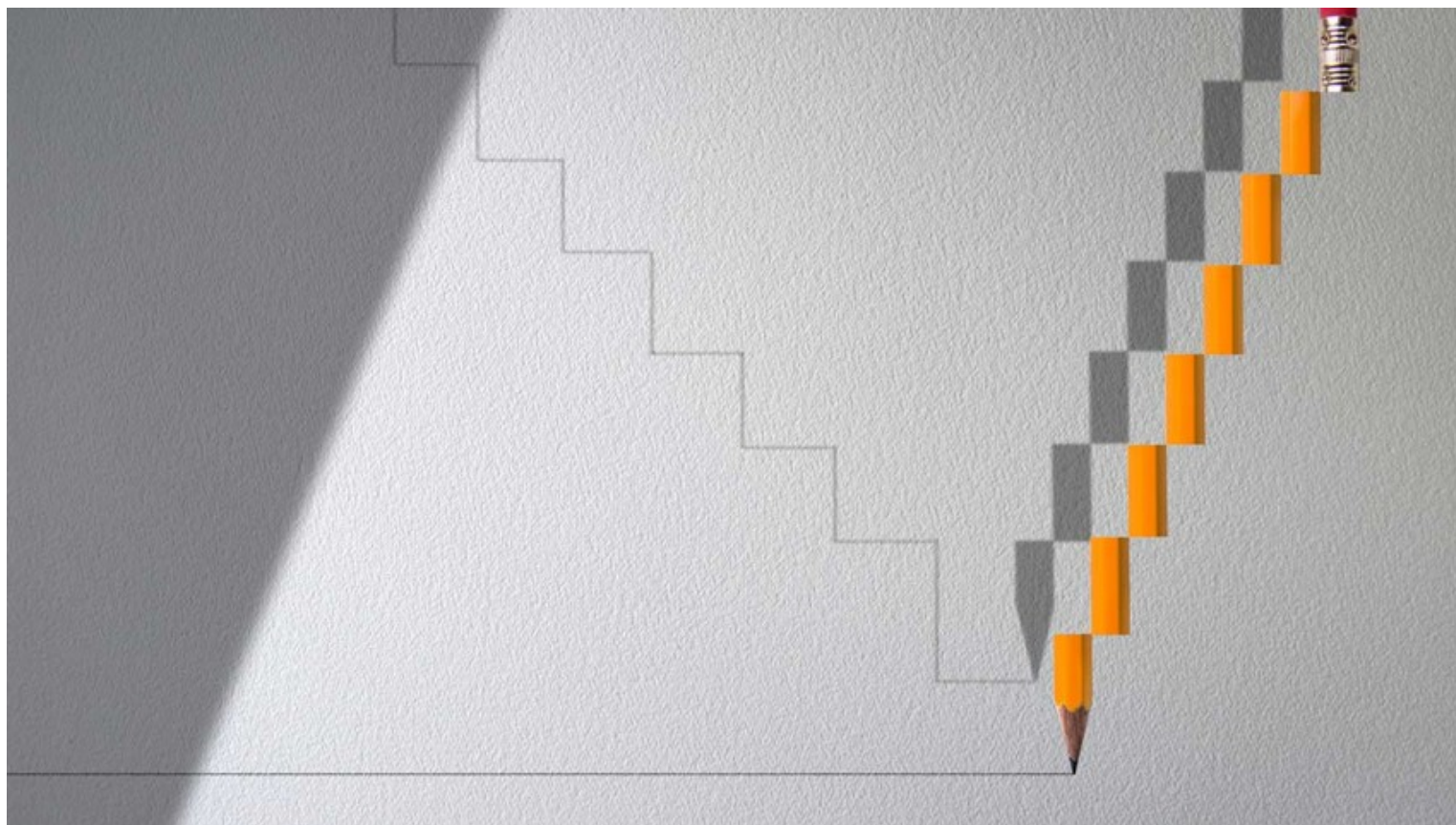


4 Ways CEOs Can Conquer Short-Termism

by Kate Isaacs, David Langstaff, and Russell Eisenstat

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In a recent survey, 70% of respondents said that CEOs focus too much on short-term financial results, and nearly 60% said that they don't focus enough on positive long-term impact. These findings mirror the growing chorus of voices in business and academia that point to short-termism as being a major threat to business.

It's easy to fault CEOs for being too fixated on the short term. However, we believe that most CEOs don't lack good intent. Rather, they're missing a practical road map to beat back short-termism and build enduring firms – ones that deliver superior economic returns, make positive contributions to society, and inspire public trust.

We offer such a roadmap here, the outcome of a research project, at the Center for Higher Ambition Leadership, with 25 CEOs and their practices for mastering short-term pressures and creating long-term social and economic value, even in the toughest conditions. Here are four practices that stand out:

Tell a Story That Is Bigger Than Quarterly Earnings

The CEOs in our study were adept at telling their company's story. Great stories are credible, simple, consistent, and use both financial and nonfinancial metrics to link a long-term vision and firm values with a distinctive business strategy and focused operational priorities. Essential to the story is the company's purpose.

Fred Lynch, CEO of Masonite, a 92-year-old company that manufactures interior doors and entry door systems, created a long-term value creation thesis that he called the Masonite "blueprint." The blueprint included the company's purpose, vision, values, and strategic goals, and fits on a single page. Purpose is the *why*, says Lynch: "Why do people get up and come to work in the morning?"

For people at Masonite, it's not just about building doors; it's about breaking down barriers. The company's stated purpose is to "help people walk through walls." Masonite fulfills that purpose not only with its door products but also by breaking down barriers to development for employees, through the company's intensive training and leadership development programs, and in the larger community, by helping local high school students and newly immigrated workers find well-paying work and connect to resources that can help them thrive.

CEOs in our study repeated their companies' stories often and consistently to all their stakeholders – employees, boards, customers, business partners, communities, and the general public. As Doug Conant, former CEO of Campbell's Soup, put it, "I declared what we needed to do, and I was incredibly, obnoxiously consistent." Keeping it simple, with five core strategies in his long-term plan, helped people remember his message.

A purpose-driven story of value creation that is clearly and powerfully told is a CEO's first line of defense against short-term pressures. Once in place, it both generates commitment of employees and customers and puts the short term and the quarter in context as the immediate building blocks to longer-term goals. The story can then be referenced to justify business decisions that build, rather than erode, the fundamental assets that underlie long-term value creation: trust-based relationships and distinctive firm capabilities.

Muster the Courage to Set Realistic Targets

The quickest way to spring the short-term trap is to set overly ambitious targets – the kind that make the CEO a hero with investors in the short term, but threaten the long-term plan by, for instance, skimping on scheduled maintenance, cutting R&D investment, and shrinking travel and training budgets.

Mark Bertolini, CEO of Aetna, began his tenure, in 2010, by lowering targets by over one-third, in a single bold move. Bertolini observed that many of his peers had been promising 15% earnings per share (EPS), even during the financial crisis of 2009. Bertolini knew that such unrealistic targets would create problems. “If you promise those kinds of returns, you’re going to do stupid things to your company and to your fundamentals to make that 15% work.”

Bertolini and his team studied the industry and concluded that low double digit operating EPS growth over time was an appropriate target for the enterprise. By telling Wall Street not to expect unrealistic growth, he could focus on investing in future growth and better supporting customers and employees. In 2015, for instance, he raised the base employee wage by 33%, to \$16 an hour, and introduced an enhanced benefit program for employees with household incomes under 300% of the federal poverty level, potentially saving them thousands per year in health care costs. Aetna's growth and employee investment strategy has paid off: Its stock rose threefold in the last five years, and it posted record revenue and earnings in 2016.

CEOs have a great deal of control over the financial targets they set. However, once the targets are decided on, the company must live up to them in order to build and retain credibility with investors. Setting them high – too high to sustain for long – is a tempting way to drive performance. But the

pursuit of those performance goals may drive bad decisions and harm the company's long-term prospects. Setting realistic targets is only possible after thoughtful analysis, and requires the board's agreement along with a good measure of courage from the CEO.

Adopt a Both/And Performance Mindset

The CEOs in our study saw no contradiction between short-term performance and long-term value. They operated with a both/and mindset, seeking to deliver on immediate goals in a way that also built a sustainable future. Dick Gochnauer, the former CEO of United Stationers (Essendant), put it succinctly: "Most leaders come to realize that you can't overfocus on one or the other."

The challenge faced by all our study CEOs was how to instill that both/and mindset throughout the entire organization.

Doug Conant got his senior team aligned around a both/and outlook using positive peer pressure. He developed a three-year plan for his turnaround vision, which was translated into annual and quarterly operating plans, and biquarterly responsibilities for his executive team. "And then," Conant described, "my team had to send me postings every Friday on how they were doing against quarterly expectations, followed by a group meeting every Monday morning. The power of that process was that I got their attention. And the beauty was that it became a self-governing system. After a little while, the guy in International was saying to the person running North America, 'Last month didn't you say that the project was going to be done by now? Has something changed?' And all of a sudden my whole team had an appreciation for our long-term plan and how we were going to get there."

Many CEOs in our interviews emphasized the importance of choosing the right metrics to support both/and decision making. Brad Hewitt, CEO of Thrivent, has developed leading indicators for his long-term strategic intent that are organized in layers, from short term (one to three years) to medium term (three to five years). Shorter-term metrics are designed to be leading indicators for long-term strategic intent, and are integrated into the company's incentive plans. The key to getting this system to work is ongoing reflection and adjustment to ensure that the short-term and medium-term metrics are truly the right leading indicators for a long-term strategic intent, and aren't motivating unintended short-term behaviors.

Stay True to Your Values

The CEOs in our study made clear that the demands to deliver short-term results can be brutal and unrelenting, and that standing up to them requires a tough skin and a strong moral center.

Consider, once again, the case of Fred Lynch. Before Lynch's arrival, the private equity firm KKR bought Masonite for more than \$2.7 billion. Masonite began to struggle shortly after the deal was completed, in 2005, and then declared bankruptcy in 2009.

Lynch, who came on board as CEO in 2007, steered the company through that bankruptcy, cutting costs dramatically and laying off nearly half the company's workforce. No matter how difficult, with every move he made, Lynch aimed to act with integrity. In keeping with Masonite's values of transparency and fairness, the entire senior team froze their own pay and took furloughs. They were completely candid with workers about the company's situation and the need for layoffs. All employees were given at least two months' notice prior to a layoff, and a severance package.

This value-based leadership paid off. Rather than destroying morale, Masonite built stronger trust with workers through the downsizing – trust that laid the foundation for a return to profitability. As Lynch put it, "We might have had to burn some furniture to survive, but we couldn't pull the studs out of the walls." Preserving the company's culture and the trust of its workers was what kept the walls up in the short term, steadying them to support Lynch's longer-term plan.

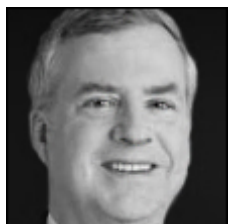
As Masonite regained financial health, the company's hedge fund investors pushed for a short-term approach, urging the board to load the company up with debt and approve a dividend recapitalization. With his long-term vision in mind, Lynch found the courage to push back, putting his job on the line in the process. "As the leader of the company, I said there was no way were we going to put ourselves in that position again. If the board was going to do that, then they should find another CEO, because that's not what I wanted to do. Thankfully, our board members were all on the same page."

These four practices operate together as a system. Purpose motivates and inspires people to work toward building long-term relationships based on trust and mutual commitment. Realistic targets make it possible to deliver both short-term performance results and long-term value creation. Internal practices, led by the CEO, reinforce the both/and mindset. But these three elements can

only work if people inside and outside a firm believe that its leaders will protect company values and uphold their trust in good times and in bad. Short-termism can be conquered, one quarter at a time.



Kate Isaacs is the Director of Research and Practice Development at the Center for Higher Ambition Leadership. She has worked for over fifteen years helping companies and multi-stakeholder collaboratives create social and economic value through trust-based relationships. Dr. Isaacs holds a PhD in Organization Studies from the MIT Sloan School of Management and an M.S. degree in Technology and Policy from the MIT Engineering Systems Division. In addition to her work at the Center, she is affiliated with the MIT Center for Biomedical Innovation.



David Langstaff is an Executive Fellow at the Center for Higher Ambition. His work centers on corporate purpose and short-term versus long-term value creation. Mr. Langstaff is a business and community leader with extensive experience as Chief Executive Officer and Director of advanced technology and professional services companies. He is a seminar moderator on values-based leadership with The Aspen Institute, and is a senior moderator of the Aspen Global Leadership Network. He also chairs the Advisory Board of the Aspen Institute Business and Society policy program and is on the boards of several non-profit organizations in the arts, education and environment.



Russell Eisenstat is Executive Director of the Center for Higher Ambition Leadership and a former member of the Harvard Business School faculty. Russ has written extensively for *Harvard Business Review* and other publications and is co-author with Michael Beer, Nathaniel Foote, Tobias Fredberg, and Flemming Norrgren of *Higher Ambition: How Great Leaders Create Economic and Social Value*. For more information, visit www.higherambition.org.

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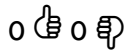
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1 COMMENTS

Eric McNulty a month ago

This is an interesting article with great examples. I particularly like the idea of the both/and mindset--short-term and long-term goals should not be mutually exclusive. If the former isn't in service of the latter, what's the point? Unfortunately, most reporting is on short-term results which helps reinforce that mindset.

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