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# The Economic Significance of Long-Term Plans

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## What is the problem with corporate communications and how can we solve it?

Short-termism in capital markets has increasingly become a concern for both companies and the investor community. Several factors, such as the shrinking of investor holding periods and the tying of investment managers' compensation to short-term performance, seem to have influenced the existing structure of corporate communications. As a consequence, the current communications avenues have become highly short-term oriented, resulting in an inefficient allocation of resources.

The vitality of public markets also appears to be suffering at the hands of short-termism. The number of public companies in the U.S. has been in rapid decline. From a peak of over 6,000 in 1996, this figure has fallen by nearly 50% in the past two decades; fewer companies are going public, and those that do are listing later in their life cycles.[3] Management teams seem to fear the perceived impatience of the public markets. Academic evidence also suggests that those sectors with the most severe short-term pressures have seen disproportionately fewer listings.[4] Reorienting our capital markets toward the long-term is part of a broader public policy mission to revitalize the public markets—and so ensure that the wealth creation opportunities offered by the public markets are available to all.

Many market participants have called for companies to curb short-term disclosures in an effort to reduce corporate and investor short-termism. For example, last October saw the release of the Commonsense Principles 2.0,[5] a document signed by the likes of Warren Buffett, Jamie Dimon, and Larry Fink that provides guidelines for effective, long-term focused corporate governance. One practice that has been subjected to intense scrutiny for exacerbating pressures for short-term performance is quarterly earnings guidance. Research by FCLT Global has shown that quarterly guidance pushes companies to focus management on quarterly targets rather than long-term goals.[6]

Nevertheless, previous studies have found that investor short-termism is unlikely to be discouraged by companies switching to long-term earnings guidance, and have concluded that instead of changing the frequency and time horizon of their disclosures, it would be more effective to alter the kinds and mix of available information.[7] In other words, investors can be persuaded to take a longer-term view—or, more likely, companies can attract longer-term holders—by rebalancing the existing mix of disclosure and lengthening the horizon of the corporate reporting landscape. More specifically, providing capital markets with more long-term strategic information

1 Roberge M.W., Flaherty J.C., Almeida, R.M., and Boyd, A.C. (2017). *Lengthening the investment time horizon*. MFS White Paper Series. Available online at: https://www.mfs.com/content/dam/mfs-enterprise/pdfs/thought-leadership/us/mfse_time_wp.pdf.

2 The Generation Foundation and KKS Advisors (2015). *Implementing Integrated Guidance: case studies in communicating value-relevant information*. Available at: https://static1.squarespace.com/static/5143211de4b038607dd318cb/t/563b5827e4b0efe399a2fc00/1446729767673/Implementing+Integrated+Guidance_November+2015.pdf.

3 Doidge, C., Karolyi, G.A., and Stulz, R.M. (2015). *The U.S. Listing Gap*. NBER Working Paper No. 21181 Issued in May 2015. Available at: https://www.nber.org/papers/w21181.

4 Asker, J., Farre-Mensa, J., and Ljungqvist, A. (2011). *Comparing the Investment Behavior of Public and Private Firms*. NBER Working Paper No. 17394. Available at: https://www.nber.org/papers/w17394.

5 Available at http://www.governanceprinciples.org/.

6 FCLT Global (2017). *Moving Beyond Quarterly Guidance: A Relic of the Past*. Available at: https://static1.squarespace.com/static/5143211de4b038607dd318cb/t/59f2226c2774d1b6f78ab0f5/1509040812294/moving-beyond-quarterly-guidance-whitepaper.pdf.

7 Call, A. C., Chen, S., Esplin, A., and Miao, B. (2016). *Long-Term Earnings Guidance: Implications for Managerial and Investor Short-Termism*. Working Paper. Available at: https://www.hbs.edu/faculty/conferences/2016-imo/Documents/LTMF_May%2022%202016.pdf.

may be the most reliable and effective way for companies to reduce the negative impact of short-term pressures on management, corporations, and the wider economy. Consistent with this possibility, studies have shown that senior managements that focus mainly on short-term results in earnings calls tend to attract a more short-term oriented investor base while companies with a longer-term focus in their calls tend to have a larger proportion of long-term shareholders.[8]

For most companies, the most common form of communication with investors takes place quarterly in their 10-Q and earnings calls—though some companies use more infrequent communication channels such as sustainability reports and industry conferences. However, until recently there has been no communication platform whose primary focus is long-term sustainable value creation and the major themes and issues associated with it.[9]

To address this deficiency, CECP in early 2017 launched the Strategic Investor Initiative (SII). The mission of SII is to create a framework and a platform for CEOs to present their companies' long-term strategic plans to an audience of long-term investors in a Reg FD forum. The content guidelines for such long-term plans are set out in SII's Letter to CEOs from Institutional Investors.[10] Signed by Bill McNabb, former chairman of Vanguard, and nine leading institutional investors, the letter describes the main components of a long-term plan that is designed to help CEOs address issues of enduring investor interest—and, in so doing, to respond to an unmet market need for information with a long-term time horizon.

There are a number of reasons CEOs should share their long-term plan with large investors.[11] As suggested, the way a corporation communicates with the market influences the composition of its investor base. By signaling management's long-term outlook, the presentation of a long-term plan, when combined with other steps such as ending quarterly earnings guidance, can help companies attract longer-term shareholders. When surveyed by SII, companies that have presented long-term plans have identified three main motives for so doing. One is frustration at the constraints and limited scope of the earnings call format, with its failure to encourage or even accommodate consideration of the strategic policy and planning questions that drive business long-run value. A second common motive for presenting long-term plans is the opportunity it provides for extending the work of existing initiatives, such as expanded reporting on sustainability themes. And a third reason for long-term plans often cited is to demonstrate leadership on issues of critical concern to the company's non-investor corporate stakeholders as well as its shareholders.[12] But that said, there has been little evidence to date on the market response to the presentation of long-term plans.

In this article, we summarize the findings of our first attempt to demonstrate the market's responsiveness to this kind of information, along with the potential for such plans to become even more effective in communicating management's long-range strategy for creating sustainable value.

## Our Research Approach

The first goal of our study was to shed light on the economic significance of the information presented by CEOs to investors at the CECP's CEO-Investor Forums by providing the first examination of the capital market reaction to long-term plan announcements. Second, we wanted to understand what constitutes an effective long-term plan—the building blocks, if you will—and then use that understanding to create a framework that can be used both for building effective corporate long-term communications and for evaluating them. We combined these two objectives when trying to determine the extent, if any, to which the "quality" of the long-term plan is linked to the market reaction.

Given the limited sample size available—there had been only 17 long-term plans presented when we conducted our study—we consider our results preliminary. Nevertheless, they provide a suggestive early indication of what more evidence is likely to tell us, and can be used as a starting point when analyzing larger numbers of long-term disclosures and assessing the long-term effects of the presentation of these plans.

### *Do Capital Markets React to Long-Term Plans?*

### Findings

Our analysis finds that investors do care about long-term information.

- The results show abnormal market reactions both for stock prices and trading volume for three and five days after the presentation.

8 Brochet, F., Loumioti, M., and Serafeim, G., (2015). "Speaking of the short-term: Disclosure horizon and managerial myopia." *Review of Accounting Studies*, 20(3), pp. 1122-1163.

9 Tomlinson, B. (2018). *Emerging Practice in Long-Term Plans.* CECP, Strategic Investor Initiative, White Paper Series 2. Available at: http://cecp.co/wp-content/uploads/2018/10/CECP_Emerging-Practice-in-LTPs_Final.pdf.

10 Available online at: http://cecp.co/cecp-investor-letter/.

11 See Youmans, T. and Tomlinson, B. (2017). *Six reasons why companies should start sharing their long-term thinking with investors*. MIT Sloan Management Review. Available at: https://sloanreview.mit.edu/article/six-reasons-why-companies-should-start-sharing-their-long-term-thinking-with-investors/.

12 Tomlinson, B. and Krzus, M. (2018). *The Method of Production of Long-Term Plans: How and Why Corporations Choose to Talk About the Long-Term*. CECP, Strategic Investor Initiative, White Paper Series 3. Available online at https://corpgov.law.harvard.edu/2019/02/16/the-method-of-production-of-long-term-plans/.

• We find no significant difference in sell-side analyst revisions of their forecasts in response to a long-term plan, which is consistent with them being more focused on the short term.

We performed an event study that examined the market reaction to the CEO long-term plan presentations given at the CEO-Investor Forum. The analysis was designed to show how stock prices, turnover (trading volumes), and analyst forecasts are affected by the information communicated to investors by these presentations. If the long-term plans contain no new information—that is, they are just marketing tools, or the same information has already been communicated to investors elsewhere or through other means—then we would expect the presentations to have no discernible effects on analyst reports or stock prices. But if the long-term plan presentations do provide new information to *some* influential investors, we would expect abnormal movements in the market around the time of the event as a result of investors processing and acting on the new information.

We analyzed the stock market reactions to the long-term plan presentations by the CEOs of 17 different companies at the first four CEO-Investor Forums (and in so doing, established a process by which more observations can be added as more Forums are held). We were careful to screen our 17 cases for other roughly contemporaneous, and possibly confounding, announcements or events—such as earnings calls or M&A deals—that could contaminate our results, and to ensure that our methodology adjusts properly for general market movements.

After making those adjustments, our findings show "abnormal" reactions to the events:

• When looking at the stock price reactions for presenting companies, we found an absolute abnormal company return of 1.83% within three days after the event. This is essentially the cumulative excess company return compared to the market during the timeframe specified. When we applied even stricter conditions and adjusted for historic abnormal returns, we found that the absolute abnormal return was 0.53% higher than the expected historical abnormal return.

• We also analyzed share turnover to see whether the percentage of shares traded during and just following the event differed from the past percentage of shares traded. After defining share turnover as trading volume divided by shares outstanding, we found share turnover that was 7.6% higher than the median share turnover before the event.

• When analyzing the analyst forecasts, we looked at whether the number of analyst forecast issuances changes during the event and in the days following. (We looked, specifically, at five- and 10-day windows after the presentations.) Our results showed that the average number of analyst forecast revisions actually decreased by 1.2 following the events.

Our stock price and share turnover findings suggest that the long-term plans presented at the CEO-Investor Forum provide information that investors find relevant and meaningful. In other words, investors are trading on the information presented in the long-term plans. And this supports the argument that long-term plans are not mere marketing presentations or "cheap talk." As for the analyst forecasts, we find this consistent with the primary focus of sell-side analysts on the near-term financial results that are communicated through earnings calls.

Overall, then, our findings suggest that the long-term plan is providing decision-relevant information to segments of investors with longer time horizons. Given our limited sample size, it is surprising that we find any signal in the market. Although we consider this early evidence, it does lend support to our hypothesis that long-term information is value-relevant. We expect to further validate this relationship as more data is gathered; and as stated, our framework provides the basis for processing that data as more companies present their plans.

What's more, our findings are consistent with the results of a study by Ralph Whittington and two colleagues of the market reactions to overall strategy presentations by CEOs. They report a same-day average stock value increase of 2%.[13] And Brian Bushee and colleagues also find evidence of a positive market reaction to, and increases in share turnover following, senior management/CEO conference presentations.[14]

### *What Constitutes a Good Long-Term Plan?*

#### Findings

A good long-term plan contains specific, actionable disclosures —but companies are struggling to reach this level.

• There is variation in the quality of disclosure around the issues that are important for a long-term plan. Becton Dickinson and Medtronic are among the companies that provide most forward-looking and specific metrics on the issues.

• There is variation across themes and issues: companies disclose more forward-looking information on trends,

13 Whittington, R., Yakis-Douglas, B., and Ahn, K. (2016), "Cheap talk? Strategy presentations as a form of chief executive officer impression management," *Strategic Management Journal*, 37(12), 2413-2424. Available at: https://onlinelibrary.wiley.com/doi/abs/10.1002/smj.2482.

14 Bushee B. J., Jung M. J., and Miller G. S. (2009), "Conference Presentations and the Disclosure Milieu," *Journal of Accounting Research*, Vol 49, No 5: 1163-1192. Although the market reaction reported by Bushee et al, is larger than what we find, this can be explained largely by our small sample size, and we can expect larger reactions once more companies take the podium and the number of observations increase.

*Figure 1*
**Nine Themes and 22 Underlying Issues to Guide an Effective Long-Term Strategic Plan**


financial performance, and competitive positioning, whereas disclosure around plans for corporate governance and assessments of financially material issues were in general missing or only descriptive.

• Plan content seems to be correlated with capital market reactions to the long-term plan.

## Framework for Quality Long-Term Plans

To find the most important building blocks of an effective long-term plan, we carried out an extensive analysis of relevant literature and also invited feedback from relevant stakeholders. We compiled broader themes and specific issues from a wide range of sources, including the following: investor feedback from the CEO-Investor Forums; McKinsey[15] and FCLTGlobal reports[16] on long-term plans; SII's Letter to CEOs from Institutional Investors;[17] industry-specific issues from the Sustainability Accounting Standards Board (SASB); and the Integrated Guidance framework.[18] We made a preliminary list of themes and issues and after several iterations between the research team and a selected group of investors, we came up with a long-term plan content framework that consists of the nine overarching themes and 22 underlying issues shown in Figure 1.

15 McKinsey Global Institute (2017). *Measuring the Economic Impact of Short-Termism*. Available at: https://www.mckinsey.com/~/media/mckinsey/featured%20insights/long%20term%20capitalism/where%20companies%20with%20a%20long%20term%20view%20outperform%20their%20peers/mgi-measuring-the-economic-impact-of-short-termism.ashx.

16 FCLT (2017). *Moving Beyond Quarterly Guidance: A Relic of the Past*. Available at: https://static1.squarespace.com/static/5143211de4b038607dd318cb/t/59f2226c2774d1b6f78ab0f5/1509040812294/moving-beyond-quarterly-guidance-whitepaper.pdf; FCLT (2015). *Rising to the Challenge of Short-Termism*. Available at: https://www.fcltglobal.org/docs/default-source/default-document-library/fclt-global-rising-to-the-challenge.pdf; FCLT (2015). *Straight Talk for the Long Term*. Available at: https://www.fcltglobal.org/docs/default-source/default-document-library/straight-talk-for-the-long-term_summary-vfo2263494db5326c50be1cff0000423a91.pdf?sfvrsn=5651258c_2.

17 Available online at: http://cecp.co/cecp-investor-letter/.

18 The Generation Foundation and KKS Advisors (2015). *Implementing Integrated Guidance: case studies in communicating value-relevant information*. Available at: https://static1.squarespace.com/static/5143211de4b038607dd318cb/t/563b5827e4b0efe399a2fc00/1446729767673/Implementing+Integrated+Guidance_November+2015.pdf.

We see this framework as dynamic and evolving over time as more companies communicate their long-term thinking and more investors request information on topics they consider material. For example, the feedback provided at the CEO-Investor Forum plays a crucial role in informing (and keeping current) our understanding of what investors find valuable, and how we can use that understanding to improve the content, volume, and impact of long-term plans.

Our analysis identified disclosure focused on the following themes and issues as relevant and potentially valuable for investors, but only if the information is specific enough to provide a basis for action.

**Financial Performance:** The metrics and disclosure in this theme concern corporate profitability and efficiency in using capital (as reflected in measures such as ROE, EPS, EBITDA, ROIC, ROTCE, CAGR, and RONA), leverage, and predicted revenue growth.

• **Example:** 3M provided a diagram that showed targets of 20% ROIC, EPS growth of 8%-11%, Free Flow Cash Conversion of 100%, and 2%-5% Organic Local Currency Growth for the time period 2016-2020.

**Capital Allocation:** The underlying issues include the provision of metrics used to guide and evaluate the effectiveness of the company's capital allocation plan and the framework underlying its long-term allocation strategy. What are the elements of M&A discipline? What are the plans for investing in R&D projects and CAPEX? And what is the plan for distributing excess cash?

• **Example:** BD outlined its capital allocation framework, including its ongoing investment in the business, increases in dividends, its plan to return to its 3x gross leverage target (by March 2017), evaluation of M&A opportunities, and distributions of excess cash to shareholders. The company's FY 2016-2019 figures provided the following breakdown of projected uses of its $11 billion operating cashflow: $3 billion capital expenditures; $2.6 billion dividends; $1.4 billion debt paydown; and $4 billion remaining cash. In addition, BD disclosed that it invests $700 million annually in capacity, new technologies, product quality, and driving efficiencies.

**Trends:** These disclosures are split into market trends and megatrends. Market trends involve projections of the future market place and sources of competitive advantage in the new market place. Mega-trends are those that affect people and operations, such as automation, climate-related risks, and the transition to a low-carbon economy.

• **Example:** UPS provided extensive discussion and metrics that reflect ongoing changes in its markets, including the following: the sharp rise in deliveries to residences from only 10% just 20 years ago to 50% today; growth of international logistics expected to double the growth of global GDP over the next five years; emerging markets, with China in particular expected to have 17 of the world's 50 largest cities, by 2030; dramatic increase in weekend pickups and Monday deliveries, with an imminent shift to a seven-day week.

**Competitive Positioning:** These issues are disclosure of value drivers and how actions are linked to progress in achieving strategic milestones and goals. The value drivers are broken down further into long-term value drivers (more than seven years' time horizon, relating to strategic health), medium-term value drivers (between a two- and seven-year horizon, and focused on commercial/cost structure and asset health), and short-term value drivers (less than two-year outlook, relating to sales, operating cost, or capital productivity).

• **Example**: GSK showcased its new vaccine SHINGRIX and its prospects for driving significant growth for the company; in the U.S. alone, 100 million people are eligible to receive it. The forecast for the adjuvant used in the SHINGRIX vaccine was upgraded for this year to £600-£650 million in its first year of launch.

**Risks and Opportunities:** Our analysis finds that the assessment of financially material ESG issues and frameworks for managing risks and opportunities are important. Investors have identified material ESG issues as potential sources of long-term performance and value. For that reason, disclosures on whether a materiality assessment has been conducted (based, for example, on SASB criteria of strategic relevance to the business) is a key element in a long-term plan. Likewise, management's plan for managing material ESG risks and responding to ESG opportunities is valuable information.

• **Example:** 3M stated that they have conducted two materiality assessments to date and presented their 2016 materiality matrix with highlighted focus areas. The CEO discloses that they adhere to GRI requirements and SASB principles, and that their materiality assessment helps to inform their long-term sustainability goals.

**Corporate Governance:** The issues here include whether executive compensation is aligned with the long-term strategy, how the composition of the board is expected to help management realize long-term strategic goals, the role of the board in setting corporate strategy and providing strong incentives for (as well as monitoring) management, and the CEO's plan for engaging shareholders.

• **Example:** NRG Energy's CEO was one of the few who openly discussed his executive team's compensation, stating that transparency about these strategies inspires trust and encourages an honest dialogue. The CEO argued that the fact that 80% of NRG's executive pay is tied to long-term performance should send a strong positive signal to the market.

## Scoring Method

**ND** – No Disclosure (0). The company does not mention the issue at all.

**B** – Boilerplate (1). The company mentions this issue and provides basic narrative around it.

**MB** – Metrics Backward (2). The company discusses issue and provides metrics on performance, processes or frameworks, but these are past/current metrics and do not mention the future.

**MF** – Metrics Forward (3). The company discusses the issue and provides metrics on performance, processes or frameworks, and these are forward-looking.

**Corporate Purpose:** Clear articulation of corporate purpose can help companies improve their financial performance by strengthening their employees' emotional allegiance and commitment to their organization.[19] And for this reason, the effectiveness of such disclosure depends less on the precision with which the company's purpose is communicated, and more on how effectively the stated purpose is aligned with the company's long-term strategy and goals. To the extent that a company's purpose and strategy and goals are mutually consistent and reinforcing, employees are more likely to feel that the work they do has meaning.

• **Example:** Humana stated that its employee engagement score remained at a remarkably high 90% throughout a prolonged merger. The company's Well-Being Index measures how employees perceive their job across social, financial, and health dimensions. The CEO mentioned that the company's health-focused business model informs and drives its corporate purpose.

• **Example:** Aetna stated its purpose and discussed how investing in people is a key priority in accomplishing it. The CEO explained how the introduction of wellness programs for and engagement with front-line employees created shareholder value. As one point of evidence, he noted that since Aetna's introduction of its wellness programs, the company's engagement scores increased by 1,400 basis points.

**Human Capital:** How does the company plan to manage its human capital over the long-term?

• **Example:** The CEO of Becton Dickinson discussed the company's Leadership Development Programs (from early career all the way to executives) and cited the role of its new set of associate resource groups in building a better company. Also contributing to that end, the CEO cited the company's creation and use of metrics for evaluating the effectiveness of its development programs, including quarterly monitoring of the company's goal to be in the top tier in terms of diversity in five years. The CEO also presented their diversity and inclusion strategy.

**Long-Term Value Creation:** The issues underlying long-term value creation include the value of the company's strategic partnerships and how the company is improving its operational ecosystem.

• **Example:** GSK outlined several partnerships and their potential for improving the company's operational ecosystem. Specific examples cited were the prospect of using partnerships with NGOs to help reach an additional 12 million people by 2025 in developing countries, a goal that is expected to help drive core business performance through increased access to products. The CEO mentioned GSK's use of new models of engagement with health care professionals to understand their needs and ensure transparency. Additionally, GSK discussed how its support programs in developing countries prevent disease and increase awareness and access to health services through HIV programs and in partnership with Save the Children.

### Scoring Method for Long-Term Plans

We developed a scoring method to be able to assess the quality of a long-term plan's disclosure on each of the 22 issues in our framework. Our method draws heavily on SASB's classification of disclosures on material sustainability topics into one

19 For evidence in support of this argument, see Gartenberg C. M., Prat A., and Serafeim, G. (2018). "Corporate Purpose and Financial Performance." *Organization Science*, Forthcoming. Available at SSRN: https://ssrn.com/abstract=2840005.

*Table 1*

**Frequency of Companies' Disclosure per Score: Lack of Forward-Looking Metrics Example**

| Theme | Issues | MF | MB | B | ND |
|---|---|---|---|---|---|
| **Corporate Governance** | Executive compensation: alignment with long-term strategy | 0 | 7 | 2 | 13 |
| **Corporate Governance** | How will composition of board guide long-term strategic goals | 0 | 7 | 3 | 12 |
| **Corporate Governance** | Role of board in setting corporate strategy, setting incentives for and overseeing management | 0 | 5 | 6 | 11 |
| **Corporate Governance** | Plan for shareholder engagement | 0 | 2 | 8 | 12 |

**MF** – Forward-looking metrics **MB** – Backward-looking metrics **B** – Boilerplate description **ND** – No disclosure

of three categories: (1) "no disclosure"; (2) "boilerplate"; and (3) "metrics." We then split metrics into two further categories: "backward-looking metrics" (MB), which applies to companies that provide information about the past right up until the present; and forward-looking metrics (MF), which assigns the highest scores to those companies that provide specific actionable disclosures with a future time-horizon. Most corporate reporting is of course backward-looking, consisting of lagging indicators. A long-term plan presentation is an opportunity to disclose specific and actionable forward-looking information about issues critical to the company's ability to create long-term value.

This scoring method gives us a way to quantify our assessments of the quality of current long-term strategic plans, and to evaluate the progress of companies in improving such plans. Perhaps most important, this analysis provides better guidance for companies about the kinds of information that are likely to be most relevant to their own long-run value and thus of greatest interest to their investors.

### Evaluation of CEO long-term plans

Our analysis found considerable variation in the quality of companies' disclosure around the issues that are important for a long-term plan. For instance, Beckton Dickinson, and Medtronic were among the companies that provided most forward-looking and specific metrics in our framework of nine themes and 22 issues.

We also found variation in coverage of different themes and issues. Companies seemed more willing and able to disclose specific and forward-looking information on issues involving trends, financial performance, and competitive positioning, whereas disclosure of corporate governance policies and assessments of financially material issues tended to be missing and, when provided, at best "descriptive." A number of companies discussed their corporate purpose and efforts to engage employees, but failed to provide specific or forward-looking information (see Appendix 1 for complete distribution of scores across issues).

Companies have long assessed and provided metrics bearing on future trends, financial performance and competitive positioning as part of their standard corporate reporting. And so it's not surprising that these are the themes on which companies seem to be disclosing the most forward-looking and specific information.

At the other extreme, companies have failed to get high marks for disclosures about corporate governance. In fact, not one of our 17 companies provided forward-looking metrics on any of the following issues:

• **How executive compensation is aligned with long-term strategy:** Although CEOs generally feel uncomfortable discussing their own compensation plans, NRG Energy's CEO Mauricio Gutierrez noted in his LTP presentation that it could be valuable for CEOs to provide detail on the processes in place that determine how they and other senior executives are paid. Such disclosure provides a potentially effective way of increasing transparency, building trust, and opening or expanding a dialogue with investors. CEOs can also provide

*Table 2*
**Frequency of Companies' Disclosure per Score: No Disclosure Example**

| Theme | Issues | MF | MB | B | ND |
|---|---|---|---|---|---|
| **Financial Performance** | How leveraged will company be in years ahead? | 1 | 0 | 0 | 21 |
| **Risks and Opportunities** | Assessment of financially material ESG issues | 1 | 4 | 0 | 17 |

**MF** – Forward-looking metrics **MB** – Backward-looking metrics **B** – Boilerplate description **ND** – No disclosure

information about whether remuneration is linked to sustainability performance and, if so, the extent to which such performance affects overall compensation.

• **How composition of board will guide long-term strategic goals:** Disclosure on how the composition of the board can guide long-term strategic goals is still uncommon, despite growing investor interest in information about how board members can bring the right mix of relevant skills and experience to enhance long-term value. One key change investors have been calling for is an increase in boards' competence on climate change, given the urgency of effectively addressing climate-related risks and opportunities. Attesting to the skills gap, a recent analysis by Ceres and KKS Advisors showed that although 62% of Forbes 500 companies now oversee sustainability at the board level, only 17% of such companies have any demonstrable expertise in environmental, social, and governance matters.[20]

• **The role of the board in setting corporate strategy and monitoring (and setting incentives for) management:** It is important that the role of the board in overseeing long-term strategy is well defined. Some CEOs provided metrics on the oversight responsibilities of the board in relation to long-term value and sustainability (such as setting up the relevant committees) and the amount of time spent on strategic issues versus short-term tactical issues. These disclosures could be forward-looking if they discussed topics the board expects to oversee in the future or the process for aligning strategy development with sustainability.

• **Plan for shareholder engagement:** Investor engagement on environmental, social, and governance issues is on the rise, with boards increasingly being sought after for dialogue on long-term strategic issues. Although several CEOs mentioned shareholder engagement in their long-term plans, only a couple managed to provide metrics and these were backward looking. More guidance may be needed on best practices for communicating engagement responsibilities and activities. Notwithstanding the actual approach, providing clarity on the plan for shareholder engagement gives investors the opportunity to coordinate their efforts.[21] Going forward, we expect companies to improve their ability to talk about shareholder engagement plans, for example by discussing the profile and key concerns of their investor base, the extent to which the board and management will be made available for dialogue with investors, and the issues that have been or will be prioritized for engagement. CEOs could also discuss their aims and motives for participating in forums that seek to improve the effectiveness of corporate-investor dialogue.

In general, CEOs appear to be struggling most with the corporate governance theme, especially when it comes to providing forward-looking information and commentary on strategy formation and oversight.

Finally, there are some issues that companies are not discussing very much at all. The following issues were rarely even mentioned:

• **How leveraged will company be in years ahead?** Integrating financial performance metrics into long-term strategy plans is an advanced step, showing that long-term

20 Ceres and KKS Advisors (2018). *Systems Rule: How Board Governance Can Drive Sustainability Performance*. Available online at: https://static1.squarespace.com/static/5143211de4b038607dd318cb/t/5afc5e271ae6cf3092ecd7ed/1526488627169/Systems+Rule_Final.pdf.

21 Tomlinson, B. (2018). *Emerging Practice in Long-Term Plans*. CECP, Strategic Investor Initiative, White Paper Series 2. Available at: http://cecp.co/wp-content/uploads/2018/10/CECP_Emerging-Practice-in-LTPs_Final.pdf.

*Table 3*
**Differences in Size of Market Reaction between Top Five and Bottom Five Companies in Terms of Quality of Disclosure on These Issues**

| Corporate Purpose: | | |
|---|---|---|
| **Abnormal return** 1.9% | **Adjusted abnormal return** 1.2% | **Turnover** 26.8% |

| Competitive Positioning: | | |
|---|---|---|
| **Abnormal return** 1.1% | **Adjusted abnormal return** 0.9% | **Turnover** 23.8% |

sustainability is deeply integrated in the core business model. CEOs may view questions about their capital structure as having little bearing on their long-term strategy. Or they may choose to avoid discussing their leverage in the context of their long-term plans to maintain the financial flexibility to adjust their plans in response to new opportunities, such as possible acquisitions. But to the extent their capital structures are viewed as complementing and supporting their strategic plans, CEOs' efforts to communicate their leverage targets, and the rationale for them, can help reassure investors about the companies' ability to fund the investment required by their long-term strategies. Besides providing valuable insights into the long-term sustainability of the business model, such communication could also serve to prepare investors for the possibility of transformational changes in the business model over the long term that are likely to have implications for corporate debt levels.

• **Risks and Opportunities—Assessments of financially material ESG issues:** Materiality is a relatively new concept for companies to consider and put in practice. And for that reason, forward-looking information about such issues may not be as readily available or well understood. Nevertheless, an overwhelming body of research has shown that good performance on financially material ESG issues is clearly associated with higher returns.[22] Also, the fact that SASB has provided a framework that encourages and enables companies to take account of the interests of their internal and external stakeholders by integrating financially material sustainability issues into their reporting should be a major source of encouragement.

Notably, those companies with the higher scores and more advanced long-term plans also proved to be harder to score against the separate issues in the content framework. The best long-term plans appear to have elements of long-term thinking embedded throughout their presentations and across all themes. In this sense, the most effective disclosure may not involve intensive focus on discrete issues viewed in isolation, but rather a weaving together of approaches that recognizes the interconnections among the important ESG issues addressed by an overarching long-term strategy. As for the presentations that score at the lower end of our range, their discussions of individual issues, though easier to assess, were generally little more than narrative accounts with little, if any, effort to integrate, quantify, or analyze the issue in question.

### *Capital market reactions to better quality plans*

To take the analysis further, we explored whether there is any correlation between better quality disclosures on specific themes and the size of the abnormal market reaction. We therefore looked at disclosure per theme and compared the market reactions of the five companies with the highest scores to the market reaction of the five companies with the lowest scores. To the extent there was a (positive) difference, it suggests that good disclosure on that specific theme is correlated with a higher market reaction.

Interestingly, we did find a connection between higher-quality plans and higher market reactions. More specifically, our results showed that the companies that provided more specific and actionable information on the themes of Corpo-

22 Khan M., Serafeim G., and Yoon A. (2016). "Corporate Sustainability: First Evidence on Materiality" (November 9, 2016). *The Accounting Review*, Vol. 91, No. 6, pp. 1697-1724. Available at SSRN: https://ssrn.com/abstract=2575912 or http://dx.doi.org/10.2139/ssrn.2575912.

rate Purpose and Competitive Positioning also experienced more positive market reactions. As reported in Table 3, better disclosure on Competitive Positioning was correlated with roughly 1% higher positive abnormal returns, as well as an increase in turnover of 23.8% (compared to the median turnover over the past 60 days before the event).

Our results also suggest that more effective disclosure of financial performance, trends, and human capital were associated with higher volume, but not more positive price reactions. Conversely, companies that scored high on disclosures bearing on long-term value creation experienced more positive price reaction, but no discernible changes in volume. These findings provide suggestive evidence that investors do find the forward-looking disclosures relevant to value, with higher content scores on certain issues associated with larger positive price reactions.

***Implications of Our Research***

Our results contribute to a growing literature that examines the effects and significance of voluntary disclosures. Although we consider our findings preliminary, they do provide meaningful early evidence on the market reaction to long-term plan disclosures and suggest that investors do trade on long-term information. Together with the existing literature showing the limitations of earnings guidance and the value of changing the overall mix of information available, our results provide further emphasis of the potential value of providing high quality, actionable, specific long-term information.

Our findings also reinforce the suggestion that the best long-term plans do not consider issues in isolation, but rather aim to address them as part of an attempt to embed the long-term thinking throughout and across all themes and issues. In addition, our results suggest that these plans do provide value relevant information to some—though clearly not all—investors. For example, although we find clear evidence of increases in stock prices and turnover, sell-side analysts do not seem to revise their forecasts in response to the information provided by the CEOs in their long-term plan presentations. Nevertheless, this information clearly appears to be important for investors with longer time horizons, who are likely to pay attention to focused disclosure on topics such as relevant megatrends and a company's long-run competitive positioning and capital allocation plans.

Such findings also suggest that the CEO Investor Forums can be a valuable addition to the investor relations' toolkit while providing in many ways a unique opportunity for CEOs to communicate effectively with long-term investors. We encourage companies to reflect on their current communications practices. The most effective corporate communication of long-term strategy is likely to take place when companies provide a high degree of specificity in their discussions along with detailed and credible projections of the future. Through such communications, CEOs can expect to attract a longer-term capital and investor base by providing the kind of information that those investors are basing decisions on. Our framework provides guidance on the issues that are value relevant and how disclosure on such material issues can be the most effective.

We will continue to analyze long-term plans with the aim of creating a database of the content—one that we envision as eventually providing a resource for companies, investors, and researchers to create the greatest possible impact while reframing the corporate communications landscape. The scoring and content frameworks can be used to guide the long-term plan presentations to include the kinds of information that will benefit all corporate stakeholders and help reorient our capital markets toward the long term.

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## About CECP's Strategic Investor Initiative (SII)

*The Strategic Investor Initiative (SII) is a coalition of leading companies and investors committed to re-orienting capital markets toward the long term. SII convenes CEO-Investor Forums to provide a venue for CEOs to share their long-term strategic plans with audiences of long-term investors. Through leading research, SII assists companies in developing and communicating long-term plans that help inform the decisions of institutional investors.*

## About KKS Advisors

*At KKS, we advise leading organizations on bold and effective strategies that pave the way to a sustainable society. Formed with the vision to reshape markets, we enable clients to create long-term value through the integrated management of environmental, social, and governance factors. Applying our unique, research-backed approach, we work with corporations, foundations, NGOs, and investors on sustainable strategies that deliver lasting impact. For more information, visit www.kksadvisors.com.*

## Appendix

### Appendix 1. Distribution of Company Disclosures per Themes and Issues (number of companies).

| Theme | Issues | MF | MB | B | ND |
|---|---|---|---|---|---|
| Financial Performance | Capital efficiency and profitability | 9 | 7 | 3 | 3 |
| | How leveraged will company be in years ahead? | 1 | 0 | 0 | 21 |
| | Revenue growth | 2 | 4 | 5 | 11 |
| Capital Allocation | Capital allocation plan/framework underlying the long-term strategy | 3 | 7 | 8 | 4 |
| | M&A discipline | 0 | 7 | 5 | 10 |
| | Investments in R&D and CAPEX | 1 | 4 | 3 | 14 |
| | Plan for excess cash | 4 | 7 | 5 | 6 |
| Trends | Market trends | 12 | 7 | 2 | 1 |
| | Mega-trends | 4 | 3 | 10 | 5 |
| Competitive Positioning | Long-term value drivers (>7 years) | 9 | 0 | 13 | 0 |
| | Medium-term value drivers (2-7 years) | 9 | 0 | 6 | 7 |
| | Short-term value drivers (<=2 years) | 9 | 9 | 3 | 1 |
| Risks and Opportunities | Assessment of financially material ESG issues | 1 | 4 | 0 | 17 |
| | Risks: how are financially material risks managed/overseen? | 1 | 7 | 3 | 11 |
| | Opportunities: how are financially material opportunities seized? | 6 | 7 | 9 | 0 |
| Corporate Governance | Executive compensation: alignment with long-term strategy | 0 | 7 | 2 | 13 |
| | How will composition of board guide long-term strategic goals | 0 | 7 | 3 | 12 |
| | Role of board in setting corporate strategy, setting incentives for and overseeing management | 0 | 5 | 6 | 11 |
| | Plan for shareholder engagement | 0 | 2 | 8 | 12 |
| Corporate Purpose | What is the corporation's purpose/is it aligned with LT strategy and goals? | 2 | 3 | 14 | 3 |
| Human Capital | How is human capital managed over the long term? | 5 | 7 | 7 | 3 |
| LT Value Creation | Value of strategic partnerships / improving operational ecosystem | 3 | 5 | 12 | 2 |

### Appendix 2. Technical Documentation

*Quantitative Analysis – An Event Study*

Our quantitative analysis seeks to assess the capital market reaction to the long-term plans presented at the CEO Investor Forums. There is a vast literature examining market reactions to earnings calls and other company announcements or presentations at conferences. We base our methodology on Fama[23] and are in line with Bushee[24] when creating our abnormal return and turnover variables.

Our analysis excludes the companies that presented on the 20th of September and does not include Telia or Welltower. CECP SII has held five CEO-Investor Forums to date, with the following CEO presentations:

23 Fama, E.F., Fisher, L., Jensen, M.C., and Roll, R. (1969). "The Adjustment of Stock Prices to New Information." *International Economic Review 10* (1): 1-21.

24 Bushee B. J., Jung M. J., and Miller G. S. (2009). "Conference Presentations and the Disclosure Milieu.: *Journal of Accounting Research*, Vol 49, No 5: 1163-1192.

**27th February 2017**
- Becton Dickinson
- Humana
- IBM
- Nielsen
- PG&E
- Welltower

**19th September 2017**
- 3M
- Aetna
- Allstate
- CA Technologies
- Delphi
- Telia
- Voya

**26th February 2018**
- Medtronic
- Merck
- Unilever
- UPS

**19th April 2018**
- PG&E
- Wells Fargo

**20th September 2018**
- GSK
- NRG Energy
- IBM

Because the CEO presentations cover several topics and (should) include specific metrics on all of these, it is hard to isolate which of the announcements the market is reacting to, e.g., if it was because the CEO discussed their M&A discipline in detail, or if it was because of their vision for their current and future partnerships. This type of assessment could be made when the sample size becomes large enough.

Further, what is a "good" or "bad" plan for a specific issue is hard to define—e.g., is announcing a plan to invest $200 million or $500 million in R&D over the next five years better? Is the plan to introduce one type of employee training programme better than another one? As such, we cannot assess whether the actual information on a specific issue presented by the CEO is good or bad. This assessment is up to the analyst to make. We can, however, analyze whether the movements in the capital markets are abnormal or not – i.e., if the presentations contained some new and valuable information that is being reflected in the market.

**We build our event analysis around four key metrics:**

- **Absolute Abnormal Return (ABNRET):** The average absolute abnormal return across the sample of 17 companies. Absolute abnormal return is defined by the difference in cumulative company returns in the event window minus cumulative market returns in the event window.
- **Adjusted Absolute Abnormal Return (Adjusted ABNRET):** Accounts for the companies' past ABNRET by comparing the ABNRET in the event window to the median ABNRET in past event windows. We compute this metric for both 60 and 120 days before the event.
- **Turnover (%):** The percentage of shares traded within the event window compared to the median percentage of shares traded within 60 days before the event. Percentage of shares traded is measured by (Volume/(Shares Outstanding*1000))*100.
- **Analyst Forecast (AFOR):** The difference in number of EPS analyst forecasts revised within the event period compared to the past 60 days.

We compute **ABNRET**, **Adjusted ABNRET** and **Turnover** for four different event windows: [-1,5], [0], [0-3], [0-5]. The first event window takes into account the day before the event and is computed to see whether there is any leakage of information before the event. We then compute market reactions for the same day, same day +3 days, and same day +5 days. For **AFOR** we look at same day +5 days and same day +10 days windows as the revisions of forecasts take a bit longer time.

We check for potential contaminations from news around the dates of the event (specifically earnings calls, new launches, mergers and acquisitions, regulations, and lawsuits). No company has its earnings announcement within the event window, but all companies had an earnings call within 60 or 120 days before the event. Because of this, our control is the median abnormal market movement rather than the average abnormal market movement, as this could skew the results.

When combining the size of the market reaction with the quality of the plan, we compare the market reactions of the five companies with the highest content quality score with the bottom five. This is done in general for the content of the whole long-term plan presentation, as well as by looking at the issue level where the top five and bottom five companies may vary.

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