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Factor #1 – Management's emphasis on achieving short-term versus long-term profits

'Thinking about' series

On-line lab data analyzed by Factor along with other references

May 5, 2017

Summary of contents

The notion behind measuring this Factor is to explore how a focus on profits impacts innovation within an organization. The proposition is that too heavy an emphasis on the need for short-term profits, such as achieving quarterly result expectations from Wall St., can stultify innovation. Emphasis on the longer-term can lead to inaction. To shed some light on this issue, registrants to the on-line lab are asked to provide their opinion.

CIO's users of the on-line-lab are clear that while they reject the extremes at either end of the spectrum, they lean towards emphasising the importance of making decisions with an eye on the longer term.

'Ideal'	'Reality'	'Delta'
2.2	-0.7	2.9

CIO split out users under 36 years of age from those greater than 36 to ascertain whether there was a significant difference in opinion between the two age groups.

	'Ideal'	'Reality'	'Delta'
Aged under '36'	2.6	-0.6	3.2
'36' and over	2.1	-0.2	2.3

For those under '36 years of age' the average 'Ideal' was 2.6 and the average 'Delta' was 3.2. For those aged 36 and above, the average 'Ideal' was 2.1 and the average 'Delta' was 2.3. The younger group thought the 'Ideal' should be more leaning toward longer-term thinking than the more elderly group. Similarly, the level of dissatisfaction was higher in the 'younger' group.

Unfortunately, the age break does not allow a view of 'millennial' thinking but only a perspective on the split at age 36. Had data from a much younger user group been available, there might have been significant differences from what is becoming known as the 'millennial' group.

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Users register a degree of satisfaction or dissatisfaction by noting the difference between their ‘Ideal’ and the ‘Reality’ of their current situation.

- 25% of users are quite satisfied with their management’s approach – based on a ‘Delta’[1] of less than one.
- 54% indicate a degree of discontent with their management’s approach., based on a ‘Delta’ of 3 or more.

Over one-half of registrants have the opinion that management is too focussed on short-term profits.

3M[2]

An example drawn from this long-standing highly-innovative company.

For 3M, the long-term support for R&D and continual investment, sometimes despite deteriorating economic conditions, is perhaps the best anecdotal evidence that the company has traditionally taken a longer-term view than many companies and are not driven by an over-emphasis on achieving short-term profits.

During James McNerney’s term as CEO, however, the pendulum swung more toward short-term thinking with the focus on cost reduction and improved financial performance. That was his mandate from the Board; improve financial performance.

Under the leadership of George Buckley, the focus shifted back to the longer term, more consistent with the view of 3M’s management over the last century. Thulin, the current CEO, takes a balanced approach with emphasis on both R&D and investment, which he is increasing, and a continuation of ‘Lean Six Sigma’, a program initiated during McNerney’s term.

‘A Century of Innovation’[3] makes numerous references to 3M’s decisions to sustain R&D at all times and more so to continue and often to augment this support even in difficult economic times. The extensive attention to the organization and reorganization of laboratories seems to never lose sight of their importance to the success of the company; clear evidence of a company that places its emphasis on the longer-term, not the short-term. Quote; “Patient money” and patient people help the big ideas germinate.

GE[4]

GE has had its eye on the longer term since 1889

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[1] ‘Delta’ is the difference between a respondent’s ‘Ideal’ rating and their rating of their own situation – i.e. their ‘Reality’. The larger the gap the greater is the dissatisfaction.
[2] See latest Innovation Management (IM) report by CIO.
[3] A publication which is all about 3M’s focus on innovation but discontinued under McNerney’s term as CEO.
[4] See GE IM (Innovation Management0 report available from the web site

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Edison[5], according to the authors, states that his view was that ‘success is a function of perseverance driven by aligning passions with long-term goals.

Since 1889 GE’s leadership has consistently taken a longer-term view and has not been unduly focused on the need for short-term (quarterly) profit gains.

Under Jack Welch however, with his emphasis on growth through acquisition and the application of ‘the GE way’ to newly-acquired companies, the emphasis shifted to the encouragement of short-term market-demanded profits. Under the new Immelt’s regime, the focus has switched course and currently emphasizes a more balanced view of profits; with less emphasis on the need for quarter-to-quarter betterment.

In the early days of GE, Immelt says that GE was viewed by investors almost solely for the longer term with innovation as the driving factor[6].

GE is described as a growth- and bottom-line focused company but at the same time reference is made to the balance with the creative side of the business[7]. An example relates to decisions taken in the Energy side of the business. Quarterly results drove Welch during his time and there was little room for investments which represented dubious short-term prospects[8]. Shareholder expectations were to be met; no question. Because of the vagueness attached to future profits arising from GE’s entry into the wind business, entry was delayed despite much effort on the part of some executives to make it happen. The attitude was to let others do the money-losing experimentation[9] and to follow in later if the business panned out. This strategy was consistent with Welch’s practice over the 20-year period, namely to make acquisitions but not, so much, seek internal organic growth.

More recently, GE [10] states that it is ‘committed to long-term thinking despite volatility in the current environment’. GE’s most recent focus on energy and infrastructure and its move to divest consumer-oriented products is further evidence of a long-term outlook influencing management and Board decisions.

As if to emphasize the point, Immelt states that ‘we want investors to see GE as a safe long-term investment’. Thinking long-term is not just a message for the company but also the for investors and, one presumes, a clear message to Wall St not to expect emphasis on short-term earnings.

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[5] Innovate Like Edison, p49.
[6] The New GE Way, p. 69.
[7] ibid, p. 49.
[8] ibid, p. 50.
[9] ibid, p. 51.
[10] GE Annual Report 2012

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Other views on this issue
Dell and McKinsey speak out

Just listen to Michael Dell[11] (Charlie Rose interview of December 09, 2013), https://charlierose.com/videos/17484, and part of his explanation

> *And so, taking a much longer-term perspective we can make the investments. We can bring the kinds of solutions. We can invest in innovation without being kind of bound to this 89-day planning cycle that public companies are sort of afflicted by. We're much more focused on the long term and want to make investments*

of what he could do with innovation once short-term pressure is lessened with the company having gone private.

Note the New York Times, May 10, 2012, on the issue of corporations having to report quarterly earnings and the need for Boards and senior management to think longer term. This group is led by Dominic Barton, Global Managing Director of McKinsey & Company.

There is an interview with Lynn Forester de Rothschild and an article by Julia Werdigier: A Call for Corporations to Focus on the Long Term. http://dealbook.nytimes.com/2012/05/14/group-calls-on-companies-to-focus-on-long-term-goals/

The CEO's role is everything!
Advice from Eich

Ritch K. Eich[12] provides a set of recommendations for any organization and, quite rightly, states that the buck stops/starts with the CEO. Consider his set of down-to-earth recommendations.

- **Stop focusing on quarterly results.** There is no good argument for basing your future on Wall Street's short-term expectations. It's not good for consumers, employees or shareholders. If Amazon.com had done that, they would never have survived and thrived the way they have.

- **Eliminate unreasonable expectations at all levels**, starting with the board of directors and shareholders. Expecting organizations to continuously outperform the previous quarter just doesn't make sense.

- **Develop performance plans that not only include realistic goals, but also impact the entire organization.** For example, when Continental Airlines offered employees $65 for

[11] Charlie Rose airs on PBS and Bloomberg TV every weeknight
[12] Truth, Trust + Tenacity by Ritch K. Eich, and summarized in 'Industry Week', November 2, 2016 reports on the relevance of the Wells Fargo Bank scandal, and in contrast, the sustainable growth of J.M Smucker.

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each month it beat its on-time arrival record, the company saw a huge difference in performance. The amount of the bonus was obviously insignificant, but no employee wanted to risk being the weak link, and all the employees could clearly see the impact they could have. The goal was reasonable, so it worked.

- **Reward people for doing their jobs well, not just for exceeding goals.** Be sure bonuses and pay are not structured in such a way that they leave employees feeling defeated before they have even started—that just results in poor attitudes, poor performance or worse.

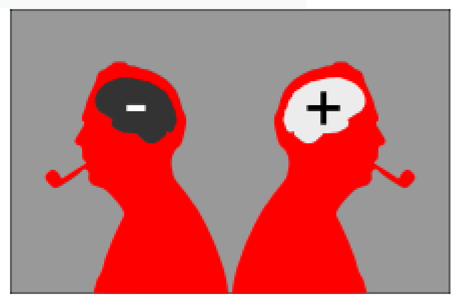
- **Provide resources.** Don't expect employees to support you if you don't support them.

Ritch presents a balanced approach on short-term versus long-term profit decisions. 'Capitalism cannot survive, he states, if we remain focused on short-term profits at the expense of long-term sustainability'; evidently first heard from a prof at CSU-Sacramento.

The link between decision making and the survival of our way of achieving economic growth through capitalism is at risk if more balanced decision making is not encouraged. The CEO is key!

Corporate health

Corporate health is just like Individual health! CFCs. Source; Courtesy of Wikipedia



At the level of the individual, CFC (Consideration for future consequences) has been shown to have implications for health-related behaviours, as those performed to protect health typically involve delayed benefits and immediate costs. Individuals who ignore the future consequences of their behaviour will tend to focus more on short-term needs and the likelihood of these individuals performing a health-related behaviour depends on their evaluation of the inconvenience, loss of pleasure, or psychological costs of the immediate behaviour. Individuals who think ahead to the future consequences of their present behaviours are more inclined to act in ways that are protective of their future health and well-being.

Paraphrasing but using corporate lingo. Varying levels of CFC have been found to be related to smoking and alcohol consumption (*read hubris and greed*), where individuals with higher CFC scores report lower frequencies of such behaviour. High CFC individuals have also been shown to be more cautious about their sexual (*acquisition*) activity, have fewer sexual (lower *turnover of CEOs*) partners, are more likely to use alternate methods (*tighter control of operations, centralization*) of reducing exposure (*reducing transparency*) to HIV (e.g. inquiring about partner's sexual history, delaying or abstaining from sex), and are more likely to seek out (*cost reduction at any cost*) HIV-testing. People high in CFC have also been found to have more regular sleep (*growth, profit and long-term viability*) schedules. Conversely, low CFC has been shown to be associated with higher Body Mass Index (egos)**.**
Check your CFC rating!

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Conclusion

It is no wonder that this question, Factor #1, is the first that issue that needs to be addressed. As most CEOs would know, it is relatively easy to cut costs for a short time but sooner or later such decisions lead to a downturn in creative ideas, morale, and a positive dynamic in any organization. Better to nurture than to starve.

Some pundits refer to the ‘tension’ introduced by the subject of short-term versus long-term decisions. Perhaps ‘tension’, as a topic on Board agendas, would bring about more balanced decisions at Board and senior management levels. In other words, there is a need *for* tension as without tension the more likely outcome would be to focus on short-term easy-to-make decisions.

‘Think longer term’ is a phrase which is increasingly being discussed. Information is also available on the Henry Jackson Initiative for Inclusive Capitalism web site[13].

The issue of short-term versus long-term decision making is omnipresent from the individual and, more broadly, to the rise or fall of capitalism. This issue is one that needs discussion as this decade unfolds.

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[13] The Henry Jackson Society; Democracy Freedom Human Rights. Launched in October 2012 and ‘focused on promoting a more responsible, sustainable and inclusive capitalist system’.