Operating and Investing for the Long-Term:

Best Practices in Communications, Guidance and Incentive Structures to create value for the long-term

November 2008

Introduction

Based on an ongoing collaboration among the organizations listed below, this document summarizes the organizations' shared stance in recommending investor communication strategies and incentive structures that both reflect and encourage management and investment for the long-term.

Those who may take an interest in this document include corporate issuers, analysts, investors and boards. All of these groups are instrumental to promoting a market-wide focus on long term measures of success, which in turn is critical to the creation of long-term value.

Working Group Members

The Aspen Institute Business and Society Program
Business Roundtable Institute for Corporate Ethics
CFA Institute Centre for Financial Market Integrity
Committee for Economic Development (CED)
U.S. Chamber of Commerce Center for Capital Markets Competitiveness

Background

On September 17, 2008, our organizations co-sponsored a symposium on *Best Practices in Earnings Guidance and Communications*, hosted at Bloomberg L.P.'s New York headquarters. For several years these organizations have been leading a call for a greater focus on the long-term among publicly traded companies, long-term oriented investors, and analysts.

A consensus was evident among the symposium's organizers, panelists and attendees about the need for corporations, analysts and investors to better focus on long-term strategic objectives in their decision making, communications, and compensation processes.

In light of the recent turmoil in financial markets and the views expressed during the symposium, we reiterate the importance of the longer-term viewpoint from all market participants. Accordingly, we have synthesized the findings of our own research and the practices espoused at the symposium to generate a set of "best practices for long-term value creation" aimed at corporate issuers, analysts, and investors. Our goal is to engender robust practices that will counterbalance the short-term vicissitudes that characterize today's markets.

Long-Term Strategic Planning

The organizations listed above were brought together by the issue of short-termism—defined as corporate and investment decision making based disproportionately on short-term expectations and metrics.

In the reports of each symposium sponsor, each organization made a number of recommendations aimed at getting companies, investors and analysts thinking more for the long-term, in particular on earnings guidance practices, incentive structures, and in their communications to other market participants.

A focus on the long-term begins with a long-term strategic plan determined by the board and management and periodically updated to reflect changing circumstances. This long-term strategic plan forms the core of a communications strategy that should focus on the long-term as much as it does on a company's current endeavors.

Communications
Companies can draw public attention to their long-term strategic plans by consciously focusing their communications to other market participants on appropriate long-term messages. Also, public companies may step off the short-term treadmill by communicating more of the high-quality performance metrics they themselves use for internal planning.

Company managers can then focus their efforts on educating analysts about the business drivers of both their industry broadly and the company specifically. In particular, this will provide management the opportunity to distinguish between facts material to the investor and what analysts often view negatively as the company's opinion aimed at "spinning" projections. Managers can then direct more of their efforts towards initiatives that drive long-term value, such as hiring, R&D, and other longer-term investment decisions. Investor relations officers can also focus communication efforts on longer-term metrics.

Earnings Guidance
Although there may be certain benefits to providing earnings guidance, the costs and negative consequences of the current focused, quarterly earnings guidance practices are significant. These include (1) unproductive time spent by corporations in preparing such guidance, (2) neglect of long-term business growth in order to meet short-term expectations, (3) distorted managerial incentives to meet quarterly numbers by any means necessary, even some that may be unethical or worse, illegal, (4) a "quarterly results" financial culture characterized by disproportionate reactions among internal and external groups to the downside and upside of earnings surprises, and (5) macro-incentives for companies to avoid earnings guidance pressure altogether by moving to the private markets.

We recognize that there is no "one-size-fits-all" earnings guidance model, and that some companies may feel a greater need to give quarterly earnings guidance than others. However, we recommend that companies focus their communications more on their long-term strategic plans, thereby leading and encouraging investors to do the same. We encourage firms to use their quarterly reporting to redirect analyst focus to the more fundamental information about the sustainability of the business.

Incentive Structures
Corporate incentive schemes should reflect both the long-term upside potential *and* downside risk of management actions and should align management interests with those of shareowners. One way companies can encourage long-term value creation is by basing a *significant portion* of executive compensation on long-term performance measures, even if such terms extend beyond the tenure of the executives themselves.

Similarly, evaluating the performance of analysts and asset managers against a monthly or quarterly benchmark is counterproductive to conditioning them as long-term investors. When asset managers are evaluated and compensated primarily on the basis of such short-term metrics, they may pressure companies into the same short-term thinking or increase volatility by regularly trading in and out of company securities in an effort to capture short-term profit.

Principles and Practices

Drawn from the earlier publications of the Working Group organizations as well as the experiences shared by the symposium speakers and panelists, the following principles and practices are intended to provide a framework for promoting strategic planning, communication, and compensation structures that promote long-term value creation and investment. Long-term can be defined generally, though not necessarily, as three to five years or more.

Long-Term Strategic Planning

- Boards should engage with management in developing and promoting long-term strategic plans, including the development of key performance indicators, and should regularly monitor execution of the plans by management.

- Companies and their boards should communicate the context of the long-term strategic plans to shareowners at least annually. This should be done in a consistent format so that shareowners understand the corporate strategy and performance metrics of the company, and general industry conditions and outlooks.

- Analysts and investors should actively encourage companies to engage in such strategic planning and communications if the company does not already to so.

Communications

- Companies should emphasize communications on the long-term strategic plans, communicate to educate, and communicate based on the strength of facts, not opinions.

- Companies should build more long-term focus into communications. This can be achieved in part by de-emphasizing existing communications mechanisms – including focused, quarterly EPS guidance.

- Companies should establish internal discipline to communicate a unified message about their long-term performance metrics. This should include assigning specific persons with the responsibility of communicating this message at the management (CFO) and board (Chairman) level.

- Companies should report financial results that allow statement users to see the substance – over the form – of corporate operating results. For example, the measurement project, led by the FASB and the IAB "divide" income statements along (1) operating earnings and (2) unrealized profit and loss results, which allows for assessments of quality of income streams.

- Companies should reinforce long-term strategic communication by providing a broad suite of longer-term, forward-looking performance metrics that are developed and customized by the relevant industries, not defined and required by regulators. Such metrics should include environmental, social, and governance (ESG) indicators as such criteria are increasingly contributing to an organization's long-term value proposition.

- Analysts and investors should clearly identify what long-term strategic communications they request companies to provide.

Earnings Guidance

- When possible, companies should discontinue quarterly EPS guidance that disproportionately focuses management and investors on short-term performance. As a first step, companies might issue annual earnings guidance in a range, along with other measures.

- Companies should on a consistent basis and in a consistent format inform investors of the broader financial and non-financial measures that the company uses to track its own performance.

- If a company plans to change any of its guidance practices, such changes should be communicated well in advance (a year or more if possible) to the investment community. A company needs to give a clear business justification for such a move and a clear communication plan to market participants to ensure investors that the company will provide the quality information investors and analysts need to adequately analyze that company.

- Quarterly earnings reports should always focus investors and management on a company's long-term strategic plans, by reiterating and updating these long-term strategic goals and placing the discussion of these long-term plans and goals in a place of prominence.

- Companies can follow the CFA Institute and Business Roundtable Institute Model Earnings release and NIRI's Earnings Release Content [1] for models on how best to construct earnings releases that are of greatest use to investors. These best practice documents can be used to help focus analyst and investor attention on the long-term fundamentals of a business.

- Analysts and investors should clearly identify what long-term, forward-looking metrics they wish companies to provide.

Incentive Structures

- Companies should align incentive compensation structures with long-term strategic plans, metrics, and results measured in years, not quarters.

- Companies should communicate the alignment of such incentive structures to interested parties in a clear, transparent manner.

- Analysts and institutional investors need to ensure that the incentive structures of their analysts and money managers are aligned with the long-term investment goals of their ultimate beneficiaries.

- The analyst and investor communities should communicate the alignment of such incentive structures to interested parties in a clear, transparent manner.

[1] The National Investor Relations Institute (NIRI) suggests the following earning release template (currently in draft form): http://www.niri.org/about/pdfs/EarningsReleasesforComment.pdf

Partner Organizations' Publications

- In 2008, the National Investor Relations Institute (NIRI) and CFA Institute conducted parallel surveys of their members examining the potential causes of short-termism. The surveys aimed to gauge the relationship between short-term thinking among market participants and the following topics: 1) earnings and other guidance, 2) communications practices and preferences and 3) incentives of buy-side and sell-side professionals. The results appear in two reports: NIRI's "Executive Alert: NIRI and CFA Institute Release Results of Joint Study on Guidance" and CFA Institute's "Short-Termism Survey: Practices and Preferences of Investment Professionals".

- In November 2007, the Aspen Institute Corporate Values Strategy Group (CVSG), part of the Aspen Institute Business & Society Program, released *In Focus: Earnings Guidance*, a summary of and references to foundational studies from 2002 to mid-2007 on earnings guidance.

- On June 27, 2007, the Committee for Economic Development (CED) issued a report titled "Built to Last: Focusing Corporations on Long Term Performance" that recommended among other things that companies end quarterly EPS guidance. The report focuses on how "short-termism" hampers corporate performance and economic growth. It calls on boards of directors to put the long-term interests of their corporations at the forefront of their concerns. Recommendations include: supporting a comprehensive strategic plan with long-term objectives, making a significant portion of executive pay dependent on the achievement of long-term performance objectives, including non-financial indicators of value in corporate reporting, and promoting succession planning that grows internal talent.

- On June 17, 2007, Aspen CVSG issued The Aspen Principles on Long-Term Value Creation in concert with the Principles' drafting partners and signers, an unprecedented coalition of leaders from business, institutional investors and labor. The Principles urge companies and investors to operate with a view to the long term and address three equally important factors in sustainable long-term value creation: metrics, communications, and compensation.

- In March 2007, the Business Roundtable Institute for Corporate Ethics and CFA Institute issued "Apples to Apples: A Template for Reported Quarterly Earnings", which calls for companies to issue earnings reports that are easily comprehensible to the average investor. This was a follow-on to work conducted by these partners during the prior two years. In July 2006, these same organizations issued a joint report "Breaking the Short Term Cycle", as a product associated with a symposium on short-termism that recommended all parties reconsider the roles that earnings guidance practices, communications practices, and incentive structures play in engendering a mindset among market participants that is too short-term oriented.

- In March 2007, the independent, bipartisan Commission on the Regulation of U.S. Capital Markets established by the U.S. Chamber of Commerce issued a report that concluded "there is too much focus on short-term performance of U.S. companies….causing adverse incentives to forgo value-added investments in long term projects". The Commission recommended that "all public companies seriously consider the permanent elimination of quarterly guidance on EPS."