DISCLAIMER: This paper is intended to provide research supporting LTSE principles and policies. It is not intended to provide implementation guidance, and none of the concepts described should be viewed as recommendations, legal advice, or listing requirements of the Long-Term Stock Exchange, Inc. (LTSE).

Building for Generations: Foundations of the LTSE Listing Principles
Working Paper - July 2020
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Introduction

The Long-Term Stock Exchange has a set of differentiated listing standards designed to create lasting value for modern public companies and their like minded investors. These standards require companies listed on the Long-Term Stock Exchange to adopt and publish five policies: Long-Term Stakeholder, Strategy, Board, Compensation, and Investors. The policies have certain individual requirements, and must also be consistent with a series of underlying principles which reflect the underlying philosophy of the Long-Term Stock Exchange.\(^3\)

1. Long-term focused companies should consider a broader group of stakeholders and the critical role they play in one another’s success;
2. Long-term focused companies should measure success in years and decades and prioritize long-term decision-making;
3. Long-term focused companies should align executive compensation and board compensation with long-term performance;
4. Boards of directors of long-term focused companies should be engaged in and have explicit oversight of long-term strategy; and
5. Long-term focused companies should engage with their long-term shareholders.

The principles and policies included in the Long-Term Stock Exchange’s differentiated listing standards were developed through years of discussions with executives, founders, workers, investors, policymakers, regulators, financial markets participants, governance experts, academics, trade organizations, and others with perspectives on our current public markets.\(^4\) In addition, substantial research supports the specific standards included in the long-term policies. This paper sets forth that research on a policy-by-policy basis.\(^5\) Despite the discussion of the evidence by policy, it is critical to note that the policies are deeply interconnected. They are not meant to be stand-alone approaches, but rather part of a broader ecosystem designed to promote sustainability, resilience, long-term value creation, and systemic change.

\(^3\) Long-Term Stock Exchange, “Policies for long-term focused companies,” (October 2019)

\(^4\) We are incredibly grateful to the countless people and organizations who provided their input and perspective. Although the list is far too long to include here, we carefully considered all of the input, and continue to do so every day.

\(^5\) This paper is not intended as a guide to implementation of LTSE policies, but rather to articulate the evidence upon which they are based.
**Long-term Stakeholders**

**Principle:** Long-term focused companies should consider a broader group of stakeholders and the critical role they play in one another’s success.

**Policy:** A policy explaining how the company operates its business to consider all of the stakeholders critical to its long-term success, including:

A. Which stakeholder groups the company considers critical to long-term success;
B. The company’s impact on the environment and its community;
C. The company’s approach to diversity and inclusion;
D. The company’s approach to investing in its employees; and
E. The company’s approach to rewarding its employees and other stakeholders for contributing to the company’s long-term success.

Today’s visionary companies face a different set of expectations from the shareholder primacy model espoused fifty years ago by Milton Friedman. Companies intent on creating long-term value need to manage for stakeholders as well as shareholders. In the past decade alone, a number of industry organizations and experts have put forward frameworks and proposals advocating for “stakeholder capitalism.” The Long-Term Stock Exchange Stakeholder Policy builds upon that work. Since our standards were approved, even those who have been at the heart of shareholder primacy are publicly recognizing this fundamental change. In 2019, the Business Roundtable, an association of executives from major American companies, revised their statement on the “Purpose of the Corporation” to reverse a long-standing adherence to shareholder primacy in favor of “a fundamental commitment to all of our stakeholders.”

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8 See for example, Klaus Schwab, “Capitalism Must Reform to Survive: From Shareholders to Stakeholders,” Foreign Affairs (January 16, 2020); Larry Fink, “Letter to CEOs: A Fundamental Reshaping of Finance” (2020); Steve Denning, “The Dumbest Idea in the World: Maximizing Shareholder Value,” Forbes (November 28, 2011)
9 Business Roundtable, “Statement on the Purpose of a Corporation,” (August 19, 2019). Note that there has been criticism of these efforts questioning whether they represent genuine change, see for example Vijay Govindarajan & Anup Srivastava, “We Are Nowhere Near Stakeholder Capitalism,” Harvard Business Review (January 30, 2020)
200 CEOs signed the revised statement. Similarly, the theme of the 2020 World Economic Forum meeting in Davos was “Stakeholders for a Cohesive and Sustainable World.”

While a multi-stakeholder approach has the potential to lead to a new, more equitable form of capitalism, business leaders and investors are not embracing it solely for this reason. Fundamental changes in the dynamics and expectations of corporations have made stakeholder engagement essential to achieving long-term success. Indeed, being a visionary modern company means embracing obligations to do right by all key stakeholders—including employees, customers, suppliers, communities, and long-term shareholders—and recognizing the opportunity this action provides.

Long-standing management theories on the importance of stakeholders to corporate performance have given rise to a robust academic literature related to stakeholder capitalism. Despite the variety and nuance within this literature, the central theme—that all firms have a number of key stakeholders and should proactively pay attention to them—is pervasive. The benefits of taking a multi-stakeholder approach are demonstrated by broad empirical evidence linking stakeholder-focused behavior to superior financial and operational performance across multiple dimensions. These findings are consistent with many case studies showing how

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10 Ibid.
11 See World Economic Forum - Davos 2020
16 K. J. Martijn Cremers, Scott B. Guernsey, & Simone M. Sepe, “Stakeholder Orientation and Firm Value,” (December 27, 2019); Franklin Allen, Elena Carletti, & Robert Marquez, “Stakeholder governance,


advantage. A stakeholder-oriented approach also is associated with attracting a higher-quality workforce, as well as fostering employee commitment to organizational values and practices, and retaining talented employees. Similarly, it also enables companies to attract and retain customers and build brand loyalty and stronger brand recognition. Some researchers also connect a stakeholder approach to increased innovation.

These findings are consistent with more visible shifts in the attitudes and behavior of consumers, workers, and companies. Increasingly, customers are taking into account a company’s impact on society, the environment, and their community when they make purchasing decisions. Brands can be severely damaged by actions that consumers view as unacceptable. Worker expectations have changed as well, and surveys show workers are


looking for more from their jobs than a paycheck. Worker activism is now a regular feature of the business environment and a number of recent examples show workers are willing to protest more than their own treatment - they are also looking at the ethics of the work that companies are asking them to do. Many companies are taking aggressive steps to better align operations with the perspectives of their stakeholders, and some high profile businesses are putting positive community impact and sustainability at the heart of their brand identities.

Under LTSE’s stakeholder policy, companies must identify all of the stakeholder groups the company considers critical to long-term success. In addition, the policy itself identifies a core group of stakeholders and issues, discussed individually below, that visionary companies must consider. While this is not a comprehensive list of stakeholders for any particular company (e.g. customers are clearly a core stakeholder, but the standard does not explicitly identify them), strong evidence supports the inclusion of each of the specifics indicated.

**Environment**

Companies focused on the next quarter may not see the environment as relevant to their success. But for those companies that think of success over decades and generations, consideration of their environmental impact is both necessary to manage risk and reputation, and a potential source of opportunity and competitive advantage.

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28 See MetLife, “Employees To Employers: We Want You To Share Our Values And Make The World A Better Place” (November 29, 2017) (survey reporting 89 percent of employees saying they are willing to trade some of their salary to work at a company that shares their values. Note that this is even more relevant for Millennials, who said they were willing to take an average salary cut of 34 percent to work for a company that shares their views).


31 Long-Term Stock Exchange, “Policies for long-term focused companies,” (October 2019)
Multiple reports and studies demonstrate a strong business case for action on environmental issues like sustainability and carbon reduction. One study found “high sustainability” companies significantly outperform their counterparts over the long-term, both in terms of stock market and accounting performance. Similarly, studies show financial benefits of reduced carbon emissions. Environmental actions can also result in significant cost savings, and many major businesses and private equity firms are championing sustainability as a way to reduce energy costs. One study found improved environmental performance and risk management led to reductions in firms’ costs of capital. A lower cost of capital for firms with robust environmental policies and practices is consistent with the rapid growth of investment flowing to ESG related funds and companies with strong environmental performance.

The growing financial, reputational, and existential risks to companies from environmental

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33 Robert G. Eccles, Ioannis Ioannou, & George Serafeim,”The Impact of Corporate Sustainability on Organizational Processes and Performance,” Management Science 60 (11): 2835–57 (2014). (This study also found these firms were also more likely to have established processes for stakeholder engagement, to be more long-term oriented, and to exhibit higher measurement and disclosure of nonfinancial information)


35 Rebecca M. Henderson, Sophus Reinert, & Mariana Oseguera, “Climate Change in 2020: Implications for Business,” Harvard Business School Background Note 320-087 (2020) (noting how many companies have profited by focusing on renewable energy); Robert G. Eccles, George Serafeim, & Tiffany A. Clay, “KKR: Leveraging Sustainability,” Harvard Business School Case 112-032, September 2011 (Revised March 2012) (KKR claims to have saved $1.2 billion in energy costs and now requires firms it purchases to undergo energy and water audits)


37 See US SIF, “Report on US Sustainable, Responsible and Impact Investing Trends - 2018” (October 31, 2018) (detailing the growth of sustainable and impact investing in the United States, estimating investors now consider environmental, social and governance (ESG) factors across $12 trillion of professionally managed assets, a 38 percent increase since 2016)
factors are requiring businesses to become more proactive and responsive on these issues as well.  

Customers are making buying decisions based on companies’ environmental performance and companies are changing their behavior in response. Indeed, changing public sentiment towards environmental concerns, particularly carbon emission, has led many companies to take unilateral action as a method of legal and regulatory risk management. The vast majority of large companies now report on environmental performance, although that is often done without the context of a stated policy and goals regarding environmental impact.

The exogenous threat of severe weather and climate change on business operations, workers, and supply chains is greater than ever. For example, 2010-2019 is estimated to have been the costliest decade on record in terms of economic damage due to natural disasters - a fact underscored in the US by recent hurricanes, floods, and wildfires. Executives recognize this risk. Still, US reporting requirements on environmental risk are not as well-developed as those


39 IBM Study, “Purpose and Provenance Drive Bigger Profits for Consumer Goods in 2020,” (January 10, 2020) (survey of more than 3,500 respondents finding 40 percent of consumers say they would stop buying from a company whose products have a negative environmental impact).


42 According to a 2018 study by the Investor Responsibility Research Center Institute (IRRCI) and the Sustainable Investment Institute (Si2), 92% of S&P 500 companies included disclosure on sustainability on their websites, but only 395 companies (78%) issued reports (see Jon Lukomnik, et al., “State of Sustainability and Integrated Reporting 2018,” Investor Responsibility Research Center Institute (IRRCI), 2018). Another report found 86 percent of S&P 500 companies published sustainability reports in 2018. (see, Governance & Accountability Institute, Inc. “FLASH REPORT: 86% of S&P 500 Index® Companies Publish Sustainability Reports in 2018”, May 16, 2019). Among large global companies, it is estimated 93 percent of G250 companies issue corporate responsibility reports, (see KPMG, “The Road Ahead The KPMG Survey of Corporate Responsibility Reporting 2017,” October 24, 2017).


45 See Deloitte Insights, “The Fourth Industrial Revolution: At the Intersection of Readiness and Responsibility,” (January 2020) and related infographic (finding 89 percent of the 2,000 executives surveyed felt that climate change would negatively impact their company in some way)
in many other parts of the world. Indeed, the SEC has also been engaged in these issues.

**Community**

Company policy toward, and engagement with, their communities (defined hyper-locally, more globally, or beyond geography) is also critical to performance. Companies with greater engagement are more likely to avoid conflict with community stakeholders, a finding aligned with the importance of community in terms of workforce, customer base, and government interaction. Similar to the findings related to corporate environmental policy, research finds a lower cost of capital for companies with enhanced levels of community engagement. Conversely, companies with weak community engagement can become entangled in expensive conflict with reputational consequences. These findings are particularly salient for companies given the potential of social media to amplify negative or embarrassing stories. Indeed, the profound effects community activism can have on business (including protests and boycotts) can be seen in episodes such as the stalled construction of the Keystone XL Pipeline and Amazon’s decision to scrap plans for a second headquarters in New York City.

**Diversity and inclusion**

Companies that want to succeed over the long-term increasingly rely upon the quality of their talent to outperform. Across multiple dimensions including gender, race and ethnicity, age, and

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46 See generally, Task Force on Climate-related Financial Disclosures (TCFD) (this framework is being adopted by many nations).  
47 See e.g., “Recommendation of the SEC Investor Advisory Committee Relating to ESG Disclosure,” (May 21, 2020); “Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure,” (May 14, 2020). For a brief summary of SEC action see Jones Day, “SEC Again Urged to Regulate ESG Disclosures - The SEC’s Investor Advisory Committee joins the call for SEC rulemaking on ESG disclosure in light of the “global convergence of investor interest” in these matters, although the Commission seems unlikely to consider additional requirements at this time,” (June 19, 2020).  
cultural perspective, research demonstrates the benefits of diversity to company performance. Studies find a positive correlation between diversity and team performance and decision-making. Importantly, diverse teams are found to be more innovative and creative. These findings on the benefits of diversity also extend to executive teams and boards. In terms of race, both younger and older workers benefit from diversity.

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of workers, survey data suggests workers are attracted to diverse workplaces (at least in the US). This means firms with diverse workforces will have competitive advantage in recruitment.

Beyond team effectiveness, research also suggests diversity is linked to better financial performance. An analysis of venture capital investments found diversity significantly improves financial performance on measures such as profitable investments at the individual portfolio-company level and overall fund returns. Another study finds investing in companies with diverse teams yields superior returns. This link between diversity and financial performance is consistent with macro-economic findings showing a positive relationship between diversity and the value of goods and services produced in the United States. These findings suggest a diverse workforce can signal competent management for investors.

In addition to the mounting evidence of the business case for diversity, changing public sentiment and social movements, including “Black Lives Matter” and #MeToo, are making diversity and inclusion a growing imperative for success.

**Investing in employees**

Since talent is an increasingly important differentiator, firms that want to do well over time invest in their employees. Economic theory and research documents how worker education and training, known as human capital, can enhance productivity and provide significant financial benefits. Many studies demonstrate a strong positive correlation between human resource diversity on corporate boards: Do women contribute unique skills?,” American Economic Review, volume 106, p. 267 - 271.

57 See e.g., PwC “Winning the fight for female talent: How to gain the diversity edge through inclusive recruitment," (March 2017) (survey finding that 61 percent of women look at the gender diversity of the employer’s leadership team when deciding where to work); Randstad, Randstad Workmonitor Mobility Index, Q3 2019, (October 2019) (81% of Americans indicate they like working with people from other cultures); Glassdoor, “What Job Seekers Really Think About Your Diversity and Inclusion Stats,” (November 17, 2014) (survey of 1,000 respondents finding 67 percent of job seekers overall look at workforce diversity when evaluating an offer); Pew Research Center, “Americans See Advantages and Challenges in Country's Growing Racial and Ethnic Diversity," (May 2019) (survey of 6,637 US adults finding three-quarters of Americans say it is very (49 percent) or somewhat (26 percent) important for companies and organizations to promote racial and ethnic diversity in their workplace).


63 See Gary S. Becker, Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education, University of Chicago Press (1964) (seminal publication on human capital); Nguyen Ngoc Thang, Truong Quang, and Dirk Buyens, “The Relationship Between Training and Firm Performance: A
initiatives and financial outcomes including total shareholder return, return on assets, return on earnings, return on investment, and return on capital employed. These findings extend to investments in worker training and professional development. One study argues that on-the-job training may be just as important as formal education in determining productivity, after considering specific skills, new technologies and continuous learning. While the data on worker training investments for US firms is limited, multiple studies using European data reveal these investments increase productivity of workers at a rate far surpassing the corresponding increase in wages.

Firms have long understood this link, however, changing economic dynamics put increasing value on “intangible assets,” including intellectual property and human capital. Estimates suggest intangible assets now make up more than 80 percent of the market value of the S&P 500, compared to less than 20 percent forty years ago. The growing importance of workers to firm value has increased calls for reworking reporting and disclosure of human capital management. Major investors and investor organizations are prioritizing human capital and company culture engagement priorities. Frameworks such as the Embankment Project for Inclusive Capital (EPIC), the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and International Standards Organization (ISO) all identify human

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65 Angela Hanks, et al., “Workers or Waste? How Companies Disclose—or Do Not Disclose—Human Capital Investments and What to Do About It,” Center for American Progress Report (June 2016)
69 See Jamie Smith & Stephen Klemash, “How and why human capital disclosures are evolving,” EY (October 29, 2019); Angela Hanks, et al., “Workers or Waste? How Companies Disclose—or Do Not Disclose—Human Capital Investments and What to Do About It,” Center for American Progress Report (June 2016)
capital investment as a key value driver for companies.\textsuperscript{71} Despite the materiality of human capital to company value, spending on worker training shows up in a firm’s financial statement under selling, general, and administrative expenses (SG&A), and therefore is often considered overhead in reporting.\textsuperscript{72} The SEC is currently considering a proposed rule change regarding disclosure of human capital management.\textsuperscript{73}

Modern companies view spending on human capital as investing in their futures. By sharing their approach to human capital with their investors, workers, and others as part of their stakeholder policy, they can show their commitment to this critical ongoing investment.

\textit{Rewarding employees and other stakeholders}

Given the importance of employees and stakeholders to performance, long-term companies are at the forefront of implementing established and novel ways to reward these groups. The increased concern about sharing success is driven in part by increasing economic inequality in our society and questions about the role of business in addressing this trend.\textsuperscript{74}

It is estimated that nearly half of workers participate in some form of “shared capitalism,” including employee stock ownership, broad-based stock options, profit-sharing bonuses, and paid group incentive schemes (gain sharing).\textsuperscript{75} Research shows a strong positive association

\textsuperscript{71} See Coalition for Inclusive Capitalism & EY, \textit{“Embankment Project for Inclusive Capitalism (EPIC) Report,”} (2018) (developed a framework identifying company activities related to long-term value, in which talent was identified as a key. EPIC proposed metrics and narrative disclosures to help guide related company reporting); \textit{SASB Materiality Map} (one of SASB’s five groups of standards related to firm performance is human capital); \textit{GRI Standards} (covering human capital topics such as recruitment and retention, labor and management relations, health and safety, training and education, diversity and pay equity); \textit{ISO 30414:2018 Human resource management — Guidelines for internal and external human capital} (providing guidelines and metrics for human capital reporting, including diversity, organizational cultural, health and safety, recruitment and turnover, skills and capabilities).

\textsuperscript{72} For proposed rule change see \textit{Exchange Act Release No. 86614, “Modernization of Regulation S-K Items 101, 103, and 105,”} (August 8, 2019). In July 2017, the SEC received a rulemaking petition from the \textit{Human Capital Management Coalition}, a cooperative effort currently involving 28 institutional investors representing more than $4 trillion in assets, to require registrants to disclose information about their human capital management policies, practices and performance. After review, the SEC Investor Advisory Committee submitted a \textit{recommendation on Human Capital Management Disclosure} (March 28, 2019).

\textsuperscript{73} For proposed rule change see \textit{Exchange Act Release No. 86614, “Modernization of Regulation S-K Items 101, 103, and 105,”} (August 8, 2019). In July 2017, the SEC received a rulemaking petition from the \textit{Human Capital Management Coalition}, a cooperative effort currently involving 28 institutional investors representing more than $4 trillion in assets, to require registrants to disclose information about their human capital management policies, practices and performance. After review, the SEC Investor Advisory Committee submitted a \textit{recommendation on Human Capital Management Disclosure} (March 28, 2019).


between shared capitalism programs and corporate performance.\textsuperscript{76} These types of programs are linked with higher worker productivity, greater loyalty, reduced turnover, and greater willingness to work hard.\textsuperscript{77} Shared capitalism programs also are linked with increased innovation and greater worker willingness to engage in innovative activity.\textsuperscript{78} Firms with shared capitalism programs also appear to be more resilient, with studies showing these firms are more likely to survive major economic shocks like recessions.\textsuperscript{79}

The benefits of shared capitalism extend beyond corporate performance with improvements to worker well-being, including higher compensation, benefits, and wealth, as well as greater participation in decision making, increased job security.\textsuperscript{80} Shared capitalism has been found to


increase employee satisfaction, trust, and positive relations with employers. \textsuperscript{81} While worker satisfaction may be an end in its own right, the benefits to overall corporate performance are non-trivial and studies have connected employee satisfaction with share performance. \textsuperscript{82}

While much of the research surrounding shared capitalism programs is focused on full- and part-time employees, these findings could also extend logically to key stakeholders, especially workers classified as independent contractors. During their IPOs, some companies choose to offer non-employee workers bonuses, along with special access to purchase shares. \textsuperscript{83} Ultimately, sharing success helps foster increased employee and stakeholder satisfaction, which leads to stronger company performance and better relationships between firms and their stakeholders. \textsuperscript{84}

Summary for stakeholder section

Stakeholder oriented companies are built for long-term success. These stakeholders care far more about investing in the future of the company—including investing in human capital and innovation—than in cutting corners or engaging in financial gymnastics to meet quarterly targets. They will support boards and executives in making the hard choices that are right for future growth, even if they are harder in the short-term. Those same stakeholders provide a counterbalance to short-term activism while reinforcing accountability for results.

Another important factor to note is that many of the stakeholder requirements in this policy are relevant to traditional Environmental, Social and Governance (ESG) metrics and to requirements for Public Benefit Corporations and B-corps. \textsuperscript{85} While the policy is not designed specifically for these purposes, it does purposefully align with them. Thus, companies disclosing pursuant to the policy requirements may be better positioned in terms of their ESG


\textsuperscript{82} Alex Edmans, “Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices” (January 20, 2010). Journal of Financial Economics 101(3), 621-640 (a widely cited study examining the relationship between employee satisfaction and long-run stock returns, which found a value-weighted portfolio of the “100 Best Companies to Work For in America" earned significantly better returns over a 25 year period).

\textsuperscript{83} Both Uber and Lyft provided bonuses to drivers (classified as non-employees) based on the number of trips they completed and access to purchase shares at the offering price.


\textsuperscript{85} See for Benefit Corporation https://benefitcorp.net/; B-corp, https://bcorporation.net/
performance. This may also help to unlock the growing pool of funding targeting companies that meet certain requirements. Of course, the details of a particular company’s policies and the way in which implements and measures results will be highly relevant.

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86 See US SIF, “Report on US Sustainable, Responsible and Impact Investing Trends - 2018” (October 31, 2018) (detailing the growth of sustainable and impact investing in the United States, estimating investors now consider environmental, social and governance (ESG) factors across $12 trillion of professionally managed assets, a 38 percent increase since 2016)
Long-term Strategy

**Principle:** Long-term focused companies should measure success in years and decades and prioritize long-term decision-making.

**Policy:** A policy explaining how the company prioritizes long-term strategic decision-making and long-term success, including discussion of:

A. What time horizon the company considers long-term;
B. How this time horizon relates to the company’s strategic plans;
C. How the company aligns success metrics with its long-term time horizon; and
D. How the company implements long-term prioritization throughout the organization.

Calls for companies to put greater focus on long-term strategy are nearly ubiquitous.\(^87\) Analysis and survey data indicate most investors are more interested in long-term strategy than short-term guidance, which is consistent with the popular narrative espoused by prominent investors.\(^88\) A substantial body of research details the negative effects of focusing too heavily on short-term plans and performance. Studies examining earnings calls found companies where senior management placed greater emphasis on short term earnings experienced greater share price volatility, higher costs of capital, and lower returns on equity.\(^89\) Multiple studies demonstrate negative effects associated with issuing quarterly earnings guidance, including higher stock volatility and reduced investment in R&D relative to their peers.\(^90\) Some findings suggest positive benefits associated with eliminating quarterly earnings guidance, including


more long-term investors, more weight placed on long-term earnings in valuation, and lower sensitivity to short-term analyst forecasts relative to firms that did not end quarterly earnings guidance. Building on this research, industry organizations and investor groups have argued for the elimination of short-term earnings guidance, and the SEC has raised it as well. These arguments are echoed by industry leaders such as Warren Buffet, Jamie Dimon, and Larry Fink, among others. The core argument is that short-term plans and communications can lead to myopic behavior that distorts investment and encourages earnings management. Instead, these actors have urged companies to “take a long-term strategic view” and disclose specific and measurable long-term goals consistent with that view.

The Long-term Strategy Policy is designed to help move the narrative of a company’s success from a quarterly cadence to a long-term focus with appropriate accountability metrics that are not quarterly EPS.

Many organizations, market participants, and industry experts have championed the concept of greater company focus and disclosure of long-term strategy. The research supporting this approach is growing. Studies examining market movements resulting from overall strategy presentations find investors value information on strategy as demonstrated by positive boosts to

95 “Common Sense Principles 2.0”
share price. Recent studies also have found preliminary positive economic impacts related specifically to long-term strategic plans.

However, the business case for developing and sharing long-term strategy extends beyond boosting share price, and these strategies can help solidify commitments among companies, investors, and stakeholders. A recent study found that executives wanted to present their long-term strategies for three primary reasons: (1) frustration at the earnings call and wanting to enhance disclosures on the themes that drive business value over the long-term (2) extending the work of existing initiatives, including reporting on sustainability initiatives (3) desire to demonstrate leadership on a key issue for investors and stakeholders. Research demonstrates that deepening the dialogue and communication around long-term strategy can attract longer-term investors. Others have argued companies with strong long-term strategies are more likely to attract and retain professional talent.

Various groups have put forward frameworks and best practices for how to shape and share long-term strategies. Importantly, sharing a long-term strategy does not equate to divulging all details of a company’s long-term strategy or competitively sensitive information. Rather, it is an approach to sharing appropriate information to provide meaningful accountability and shared understanding with investors and other key stakeholders to enable a narrative for success that minimizes the primacy of quarterly EPS as a success metric.

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97 See Richard Whittington, Basak Yakis-Douglas, & Kwangwon Ahn, “Cheap talk? Strategy presentations as a form of chief executive officer impression management,” Strategic Management Journal, Volume 37, Issue 12, December 2016, Pages 2413-2424 (finding company strategy presentations were associated with a same day average stock value rise of 2 percent, which translated into a $1.1 billion gain in market value); Brian Bushee, Michael J. Jung Gregory S. Miller “Conference Presentations and the Disclosure Milieu,” Journal of Accounting Research, Volume 49, Issue 5, December 2011, Pages 1163-1192 (finding positive average abnormal stock return and share turnover signals following company presentations at conferences).


103 LTSE listing principles do not require disclosure of any competitively sensitive information.
Long-term Compensation

**Principle:** Long-term focused companies should align executive and board compensation with long-term performance metrics.

**Policy:** A policy explaining the company’s alignment of executive compensation and board compensation with the company’s long-term success and long-term success metrics.

Compensation creates incentives for executives and board directors to pursue long-term value creation. Companies recognize that executive compensation is critical to their ability to keep and retain the talent they need to succeed. For long-term investors, alignment of executive compensation with long term goals is a top priority. In recent decades, two trends have driven escalating executive compensation figures. First, boards have sought to meet or exceed compensation of “peer” companies, consistently driving executive compensation higher. Second, companies have largely sought to align incentives through equity-based compensation, which now accounts for roughly two thirds of executive compensation. As a result, CEO compensation has skyrocketed in the last several decades, growing an estimated 940 percent since 1978.

This has subjected executive compensation to heightened scrutiny, with concomitant increases in regulatory requirements. While reporting requirements have increased, this has not necessarily led to more effective transparency, due to the complexity of the disclosures.

Choosing how best to maximize managerial time horizons and incentivize long-term behavior is a primary responsibility of boards and compensation and committees and should be tailored to meet the individual circumstances and needs of each company.

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107 Lawrence Mishel and Julia Wolfe, “CEO compensation has grown 940% since 1978: Typical worker compensation has risen only 12% during that time” Economic Policy Institute (August 14, 2019); also see Lucian A. Bebchuk & Jesse M. Fried, Pay Without Performance, (Cambridge: Harvard University Press, 2004)

108 See e.g., Wachtell, Lipton, Rosen & Katz, Compensation Committee Guide, Chapter I, (Feb. 2020)
Current practice for executive compensation focuses on three years, however there is growing support among investors to lengthen performance and vesting periods. For instance, the Council of Institutional Investors (CII) “Principles for Executive Compensation” considers “the long-term” to be at least five years. Others have also recommended extending performance and vesting periods.

Research overwhelmingly supports the comparative benefits of lengthening executive time horizons and the negative effects of shorter-term incentives. Shorter CEO time horizons are associated with greater levels of financial engineering and reduced investment, including R&D spending. Conversely, longer executive time horizons are associated with better long-term financial performance and increased investment in R&D. Longer executive time horizons have been linked with greater levels of innovation, with one study finding one additional year in horizon is associated with 8 percent more patent citations. Increased executive time horizons have also been correlated with hiring more inventors, setting longer-term incentives for researchers, and increasing firms' investments in long-term innovative strategies and stakeholder relationships.

Given the central importance of executive compensation to companies, compensation for board directors is often overlooked. However, directors are important in setting long-term strategy and ensuring management actions are consistent with creating long-term value. Indeed, investors

111 Alex Edmans, Vivian W. Fang, & Katharina A. Lewellen, “Equity Vesting and Investment,” The Review of Financial Studies, Volume 30, Issue 7, July 2017, Pages 2229–2271 (finding vesting equity induces CEOs to reduce investments in long-term projects and to take actions that increase short-term stock price); Alex Edmans, Vivian W. Fang, & Allen Huang, “The Long-Term Consequences of Short-Term Incentives” (March 13, 2020), European Corporate Governance Institute (ECGI) - Finance Working Paper No. 527/2017 (showing that short-term stock price concerns connected to compensation induce CEOs to take value-reducing actions); Patricia M. Dechow & Richard G. Sloan, “Executive Incentives and the Horizon Problem,” Journal of Accounting and Economics, 14 (1991) 51 (findings suggest CEOs spend less on R&D during their final years in office, but these reductions are mitigated through CEO stock ownership); Daniel B. Bergstresser & Thomas Philippon, “CEO Incentives and Earnings Management,” Journal of Financial Economics, Forthcoming; HBS Finance Working Paper No. 640585 (providing evidence that the use of discretionary accruals to manipulate reported earnings is more pronounced at firms where the CEO’s potential total compensation is more closely tied to the value of stock and option holdings)
cite board remuneration as an often-overlooked but critical component of aligning incentives. Careful consideration must be given to designing incentives that encourage a long-term orientation for the board as well.\footnote{From LTSE interviews with institutional investors.}

At a fundamental level, executive and board compensation approaches are designed to attract and retain talent and align incentives. But the specifics of how to structure compensation to effectively meet these goals continues to evolve.

The other four policies have direct ties to long-term compensation. Performance metrics can be aligned with the long-term strategy and related metrics. The time horizons identified in the long-term strategy policy help guide compensation timeframes. The long-term board policy closely aligns with board compensation.

\footnote{See FCLTGlobal, “\textit{The Long-Term Habits of Highly Successful Boards},” (March 2019)}
Long-term Board

** Principle:** Boards of directors of long-term focused companies should be engaged in and have explicit oversight of long-term strategy.

** Policy:** A policy explaining the engagement of the company’s board of directors in the company’s long-term focus, including discussion of whether the board and/or which board committee(s), if any, have explicit oversight of and responsibility for long-term strategy and success metrics.

Boards of directors are critical leaders in creating long-term value. The board’s role in shaping strategy, determining executive compensation, upholding their fiduciary duty to investors, and leading on stakeholder issues, means boards are required to make decisions on all four of the other principles for long-term success.

Surveys find board directors are concerned about short-term pressures, while executives often perceive their boards as a source of short-term pressure. Reports on board activity indicate directors spend the majority of their time on backwards looking tasks including quarterly reports, audit reviews, budgets, and compliance. These monitoring tasks comprise important fiduciary duties focused on holding managers accountable (i.e., solving the inherent “principal-agent” problem of corporate governance). Yet, in addition to monitoring, boards serve as advisors and thought partners. Companies look to boards for their knowledge and expertise, particularly with regard to setting corporate strategy (arguably the most fundamental board task). Surveys show boards spend roughly a third of their time on strategy and that board directors believe this is the area where they are most effective.

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121 Renée Adams, “The Dual Role of Corporate Boards as Advisors and Monitors of Management: Theory and Evidence,” AFA 2002 Atlanta Meetings

122 Martin Hirt, Frithjof Lund, & Nina Spielmann, “A time for boards to act,” Mckinsey & Company (March 26, 2018)

The “dual role” of boards as both monitors and advisors, makes them key arbiters of a company's time horizon.\textsuperscript{124} If a board chooses to prioritize a long-term orientation (in terms of both monitoring and advising), this will likely affect the behavior of company managers and employees. Many commentators and market participants argue for boards taking a long-term orientation.\textsuperscript{125} One study notes the positive correlation between board outlook and performance.\textsuperscript{126} Analysis also indicates the average tenure of board members exceeds that of CEOs, providing needed stability to align business priorities with long-term success.\textsuperscript{127}

Many characteristics can be used to describe long-term oriented boards. Research shows increased diversity, stakeholder orientation, and focus on strategy are among board characteristics positively correlated with firm performance.\textsuperscript{128}

By making the responsibility for long-term strategy and metrics an explicit responsibility of the Board or a designated committee, the LTSE principle seeks to ensure active board engagement in and oversight of these critical points, as well as ensuring they receive adequate focus at the highest levels.

\textsuperscript{124} Renée Adams, “\textit{The Dual Role of Corporate Boards as Advisors and Monitors of Management: Theory and Evidence},” AFA 2002 Atlanta Meetings
\textsuperscript{125} Christian Casal & Christian Caspar, “\textit{Building a forward-looking board},” McKinsey Quarterly (February 1, 2014); Dominic Barton & Mark Wiseman, “\textit{Where Boards Fall Short},” Harvard Business Review (January-February 2015 Issue); CFA Institute, “\textit{Visionary Board Leadership: Stewardship for the Long Term},” (June, 2012).
\textsuperscript{126} Shawn Cooper, et al., “\textit{Tone at the Top: The Board’s Impact on Long-term Value},” Russell Reynolds Associates & FCLTGlobal (April 2020); also see FCLTGlobal, “\textit{Long Term Habits of Highly Successful Boards},” (March 2019).
\textsuperscript{127} FCLTGlobal, “\textit{The Long-Term Habits of Highly Successful Boards},” (March 2019) Other characteristics include: diversity in gender, race, experience/perspective, age, and adaption of duties beyond the traditional financial oversight.
\textsuperscript{128} FCLTGlobal, “\textit{Long-term Habits of a Highly Effective Corporate Board},” (March 2019).
**Long-term Shareholders**

**Principle:** Long-term focused companies should engage with their long-term shareholders.

**Policy:** A policy explaining how the company engages with long-term investors.

Long-term shareholders are focused on returns measured over multiple years and even decades. One of the primary purposes of the long-term listing standards overall is to align long-term investors and modern companies. When companies have a strong long-term investor base that believes in their mission and strategy, they are better positioned to find ongoing support as they remain steadfast in achieving those goals. Making the right short-term choices to lead to long-term growth can be difficult in today’s public markets. Having an investor base whose time horizons align with the company’s and who have transparency, through the long-term listing standards, into the company’s long-term strategy and metrics, its approach to stakeholders and compensation, and the engagement of its board, will help to ensure ongoing alignment.

Evidence not only demonstrates significant benefits of long-term investors, but also suggests companies can be effective in attracting long-term investors. The long-term listing standards were developed in consultation with long-term institutional investors to ensure that LTSE-listed companies follow principles and provide information that such shareholders are seeking. Institutional investors, including pension funds, insurance companies, and sovereign wealth funds, have longer holding time horizons than most other investor classes. Research has found that companies with more institutional investors are less likely to degrade real economic activities to meet short-term earnings targets. They are more likely to invest in both long-lived

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131 Evidence suggests investors appear to prefer companies that provide the type of information that complements their investment style. Brian Bushee, “Identifying and Attracting the “right” Investors: Evidence on the Behavior of Institutional Investors,” Journal of Applied Corporate Finance, Volume 16, Issue 4, Fall 2004, pp 28-35; Francois Brochet, Maria Loumioti, & George Serafeim, “Speaking of the Short-Term: Disclosure Horizon and Managerial Myopia,” Review of Accounting Studies, Volume 20, Issue 3, pp 1122–1163 (2015) (finding that companies that were able to signal they were more long-term aligned attracted more long-term investors).
real assets and in R&D, which can also lead to greater levels of innovation. They are also better-positioned to thwart short-term focused activism.

135 Philippe Aghion, John Van Reenen, & Luigi Zingales, “Innovation and Institutional Ownership,” American Economic Review 2013, 103(1): 277–304 (finding that higher levels of institutional ownership—mostly dedicated investors, with transient institutional ownership of only 8 percent—not only had a positive effect on R&D levels, but also led to greater R&D productivity)
136 FCLTGlobal, “Making the Call: The Role of Long-term Institutional Investors in Activism,” (June 25, 2020)
Conclusion

The Long-Term Principles and Policies are designed to align long-term investors and visionary companies to better enable sustainable value creation. While research and extensive input from participants support each individual policy and principle, they are meant to work together and are designed to reinforce each other as part of a holistic ecosystem. That is why they were incorporated as listing standards on the Long-Term Stock Exchange.

LTSE spent years developing its principles and policies, based on extensive research, as well as engagement with a wide range of relevant stakeholders. We continue to track emerging research and engage with key stakeholders from throughout the company and financial markets ecosystems. We are committed to learning and adapting to achieve the goal of better positioning companies to create long-term value. As a result, this paper will continue to be updated. We welcome input and comments at jeff@ltse.com.