

Will there be a 'next' if corporate governance is focused on the 'now'?

EY Long-Term Value and Corporate
Governance Survey

March 2021

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Foreword

The COVID-19 pandemic has shown that corporations can be a key part of the solution to global and societal challenges. As leaders look to reframe their future beyond the pandemic, they need to define how their company will create sustainable value for their employees, investors, customers and society.

Reflecting this need, the International Business Council (IBC) of the World Economic Forum (WEF) – in collaboration with EY and others – published its Measuring Stakeholder Capitalism white paper on sustainable value creation in September 2020. That initiative was a follow-up to the IBC's 2017 initiative to align company corporate values and strategies with the UN Sustainable Development Goals. On 26 January 2021, 61 global business leaders committed to the core Stakeholder Capitalism Metrics released by the IBC.

This sort of collaboration will be key to accelerating the long-term value agenda. As a firm, we encourage a coming together of governments, regulators, local authorities, corporations, investors and financial institutions to set objectives, develop opportunities, and address economic and social challenges. To inform the long-term value conversation, we launched a European-wide research program among board members, CEOs and other business leaders, to achieve a number of goals:

- ▶ Explore leaders' views and experience of long-term value and the role that an organization's corporate governance plays in sustained value creation
- ▶ Understand the adoption of board practices that support long-term value creation among European businesses
- ▶ Examine how corporate governance can enable companies to become more effective in creating value and inclusive growth for the long term, with a focus on initiatives that are within the control of organizations and that they can begin now

The paper begins by examining the main findings and themes from the survey. Then, based on that analysis, we outline what we believe to be the key implications for corporate governance. Our aim is to provide insight and ideas for the dialogue that will be needed across multiple constituencies, from board members to regulators and investors.

We look forward to collaborating with CEOs and boards on this critical topic, and our thanks go to the corporate leaders and professionals who contributed their thinking to this project.



Julie Linn Teigland
EY EMEIA Area Managing Partner



Andrew Hobbs
EY EMEIA Public Policy leader



Executive Summary

The EY Long-Term Value and Corporate Governance Survey draws on insights from a survey of over 100 CEOs, as well as C-suite and board members, from leading European companies to understand their progress and challenges in supporting sustainable, inclusive growth. We supplemented this with in-depth interviews with business leaders, academics and other professionals in this field, including EY's own subject matter professionals. Three key takeaways emerged from this research:

1 The pandemic has reinforced the importance of a stakeholder-focused approach

While the COVID-19 pandemic has been financially challenging for many companies, it has also highlighted the benefit of a strategy that creates value for a broad set of stakeholders. Leaders emphasize that a focus on long-term value has been critical to building trust during the pandemic and believe it will be key to meeting changing expectations for the role of business in society.

59% say that COVID-19's impact on financial performance has challenged their ability to focus on long-term growth.

However, 66% say that it has increased stakeholders' expectations that companies will drive societal impact, environmental sustainability and inclusive growth.

Over two-thirds (69%) say that they have made strong progress in continuously reassessing strategy and structure to improve their ability to drive long-term value.

2 Companies can directly address many of the key challenges to their long-term value strategy

Companies face a number of internal and external challenges to long-term value creation. Top of the list are how to create a strategy that balances near-term and long-term growth, and how to align management incentives to drive change throughout the organization.

One of the major external challenges to generating long-term value is short-term earnings pressure from investors.

Pressure from short-term investors most commonly manifests as increased price volatility when short-term targets are not met.

The number one internal challenge is that executive compensation is often still tied to short-term performance.

3 Corporate governance is critical to the long-term value agenda and needs to evolve

Leaders believe that corporate governance is foundational to a successful long-term value strategy. At the same time, they highlight the need for governance to evolve to support sustainable growth. This paper suggests there are five governance-related areas that boards should focus on: board attributes, including dynamics and values; risk oversight; long-term value remuneration strategy; shareholder and stakeholder engagement; and authentic reporting disclosures that establish accountability for long-term value performance.

The most important attribute of a long-term value-focused board is one "that has enough trust to be honest, debate openly and have healthy disagreements."

69% make consistent use of nonfinancial metrics to set organizational targets for performance and growth

80% say it would be helpful to have globally consistent frameworks and standards for long-term value-focused corporate reporting.

The pandemic has reinforced
the importance of a stakeholder-
focused approach



- ▶ The survey shows that the financial implications of the pandemic have challenged the long-term investment strategy of CEOs and directors. A majority (59%) say that the impact of the COVID-19 pandemic on financial performance has challenged their ability to focus on long-term growth.
- ▶ Over half (60%) say that there are significant differences of opinion within their leadership team on how to balance short-term crisis response with long-term investments.

However, the pandemic has also reinforced the importance of a long-term value approach:

- ▶ **Stakeholders:** it has increased the expectations of stakeholders – including employees and the wider public – that organizations should play a more active role in tackling major societal issues, such as inequality and climate change
- ▶ **Business leaders:** CEOs and boards have questioned and changed the role of their organizations in terms of who they are serving, the contribution they can make to society, and what constitutes value. They have used these uncertain and anxious times to lead with increased purpose – focusing on employee well-being, developing products and services for frontline workers, making financial donations and cutting executive pay.

The survey sends a strong message that the net effect of the pandemic has been to reinforce the importance of an approach that looks to the long term rather than bowing to short-term earnings pressure:

66%

Two-thirds say “The COVID-19 pandemic has increased expectations from stakeholders that our company will drive societal impact, environmental sustainability and inclusive growth.”

78%

Over three-quarters say “A focus on sustainable and inclusive growth has been critical to building trust with our stakeholders in today’s uncertain times.”

79%

The majority of respondents say “Companies that maintain their focus on long-term value will emerge stronger in a post-pandemic world.”

It also reinforces the importance of stakeholder capitalism in rebuilding trust in businesses and their leaders. When we asked respondents to pinpoint the most significant benefits of pursuing initiatives that create long-term value, “improved brand, reputation and trust” emerged on top, selected by 53% as one of the main benefits, followed by “improved customer acquisition and retention” and “attracting new investors or different types of investors.” The importance of long-term value is also reinforced by the clear commitment of key C-suite leaders. In [EY DNA of the CFO survey](#), 82% of finance leaders said that “CFOs are increasingly seen by key stakeholders as the stewards of long-term value.”

A reset to sustainable growth

The European Commission reacted immediately to the COVID-19 outbreak with a focus on upholding its goals for high living standards for its citizens, protection of human rights and the environment, as well as quality of welfare. As it now looks to reset economic development in the long-term future, sustainable growth is a key platform.

The European Green Deal, in particular, has the potential to act as a multiplier of economic growth and includes initiatives that range from decarbonization of the energy system, transport and logistics infrastructure to scaling up investments in the circular economy. Business leaders are also sharpening their focus on sustainability in investment decisions. In the latest [EY Europe Attractiveness Survey 2020](#), almost six in ten (57%) survey respondents indicated a renewed focus on climate change and sustainability within the next three years.

Alongside this, the appetite from investors is also increasing as evidenced by [Larry Fink's 2021 letter to CEOs](#) in which he highlights “companies with a well-articulated long-term strategy, and a clear plan to address the transition to net zero, will distinguish themselves with their stakeholders – with customers, policymakers, employees and shareholders – by inspiring confidence that they can navigate this global transformation.”

Financing that sustainable growth sits at the heart of the European Commission action plan, which was released in 2018 with the following aims:

- ▶ Reorient capital flows toward sustainable investment
- ▶ Mainstream sustainability into risk management
- ▶ Foster transparency and long-termism in financial and economic activity

Key legislative proposals to achieve these aims are:

- ▶ **EU taxonomy** – a classification system aiming to channel investments into sustainable activities. It requires large public interest companies with over 500 employees to align KPIs that encourage transparency in their activities.
- ▶ **Disclosure and reporting** – introducing new requirements of the Non-financial Reporting Directive (NFRD) order to meet the European Green Deal standards. This includes nonfinancial information in the management report, to link financial and nonfinancial information better, and a new EU nonfinancial reporting standards setter.

The Sustainable Finance Disclosure Regulation (SFDR) – requiring financial market participants and financial advisors to make pre-contractual and ongoing disclosures to end investors when they act as agents of those end investors. It aims to create an even playing field for ESG products and distribution channels across Member States and to increase market awareness of sustainability.

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Green deals – including Europe’s and perhaps the US’ – can be very impactful because it’s the kind of investment package that we don’t see so often. It’s maybe not a once-in-a-lifetime opportunity, but it’s something that would only happen every 20 years or so. I think that the EU Green Deal can bring massive investment in the short term, in the next one to three years, whereas initiatives like the Glasgow COP26 are important from a policy perspective and focused on ensuring overall ambitions are heightened.

Alexis Gazzo, EY France Climate Change Leader; Partner, Climate Change and Sustainability Services, EY & Associés

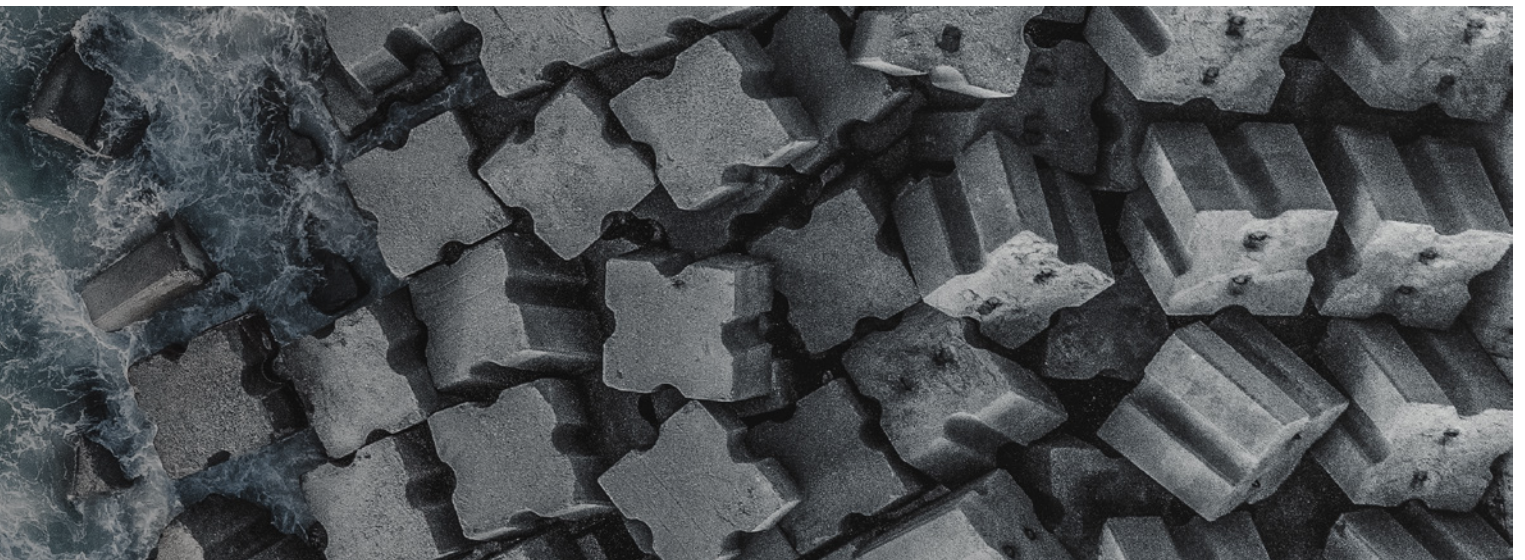
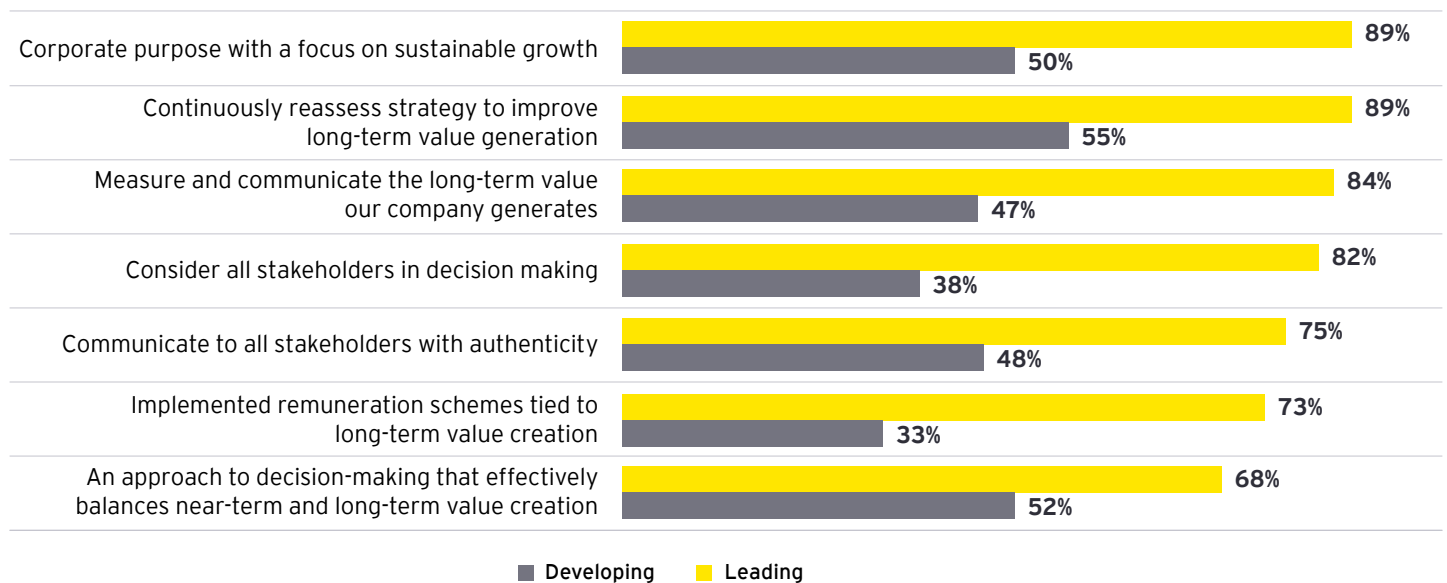
Encouraging progress in turning words into action

Today, boards and CEOs are making encouraging progress in turning their ambition into reality by deploying the approaches needed to drive a long-term, multi-stakeholder orientation. As part of the analysis, we segmented the survey respondents into two groups based on their long-term value maturity: firms that are “leading” (43% of all respondents) and those that are “developing” (57%). The leading organizations are making

significant progress: for example, 89% continuously reassess their company’s strategy and organizational structure to improve the ability to generate long-term value.

While progress made is encouraging, this long-term, multi-stakeholder approach needs to become the new normal for companies, not just a select group of high performers.

Figure 1: Thinking specifically about the progress your board has made in terms of long-term value, to what extent has it put these approaches in place?



View Point

Helena Stjernholm, CEO, Industrivärden



Industrivärden is a long-term asset manager and active owner in listed Nordic companies. Julie Linn Teigland, EY EMEIA Managing Partner, spoke to CEO Helena Stjernholm to understand her perspectives on long-term value, including the role of boards.

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Successful companies that drive long-term value over extended periods of time have a clear long-term vision, strong execution capabilities and can explain why they are doing things, which secures the trust of capital markets.



How has the pandemic affected long-term strategy and how leaders think about balancing long-term value goals while managing short-term pressures?

I think the overall impact is that the pandemic has focused companies on acceleration. Many trends that prevailed before the pandemic have been reinforced over the last year. This is around digitalization, but also an increased focus on sustainability, trends which shape how you think about what your business needs to focus on going forward. This in turn puts pressure on speeding up existing initiatives. At the same time, of course, the pandemic has increased pressure on managing the short term.

When you evaluate your plan, which likely will be very different compared to the pre-pandemic plan, you need a long-term vision to be able to prioritize in an efficient way. If you do not have a clear long-term view, you will have a hard time prioritizing where to dedicate your resources, capital as well as people.

The questions you are asking are 'what projects can we put on hold and which ones do we need to sustain to not lose long-term competitive advantage?' I believe strong companies with a long-term view will be even stronger after these tough times.

What do you see the pressure on leaders and businesses coming from mostly?

Today pressure on leaders and businesses is coming from several different stakeholders, but I do not think it makes sense to rank them. Capital markets and investors, for example, have an increasing awareness of and focus on sustainability, which has much wider implications than it had before. Also, employees of today, particularly younger people, want to work for a company that has a clear purpose and acts in a good

way. Customer behaviour is also changing because of sustainability. If customer behaviour changes in a way where you find yourself not having relevant products and services to sell, this calls into question your whole long-term strategy and business model. Pressure also comes from getting the right talent onboard – especially in some industries which require highly technical skills. To conclude, policies and regulation and incentives can sometimes be helpful to enable the change, but the change needs to come from within the companies.

What do you see as the key role of the board in long-term value?

Given that one of the most important tasks of the board of directors is to find and employ a CEO, then a key responsibility is to find a leader with the right mindset and a view of the future that is shared by the board. Defining the long-term vision and setting the strategic agenda it is also a key role of the board. Especially in times of change like we have today, the board's role is to stay close to the business and ask questions that challenge management while of course also supporting them.

The board's role in long-term value creation is also about creating continuity. The time span of a CEO in a publicly listed company is getting shorter and shorter. If you operate in a heavy industry, like manufacturing, some of your capital investment decisions will not be up and running at full speed until possibly 10 years into the future. In that time, you may have changed CEO once or twice. So, the board has a key role in making sure that you are still striving towards your long-term goals. Successful companies that drive long-term value over extended periods of times have a clear long-term vision, strong execution capabilities and can explain why they are doing things, which secures you the trust of capital markets.

View Point

Chris Hodge, International Corporate Governance Network (ICGN)



Chris Hodge is an advisor to the International Corporate Governance Network and chairs the Global Stewardship Codes Network. Ilaria Lavalle Miller, Associate Director of Regulatory and Public Policy – Ernst & Young LLP United Kingdom, spoke to Mr. Hodge to get his views on the regulatory environment for long-term value and the role of governance.

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One of the biggest impacts on the company’s ability and willingness to be focused on long-term value is the mindset of the board.



What do you think are some of the key attributes of a board that drives a long-term, stakeholder-focused strategy?

When I was involved with corporate governance standards setting, some companies embraced what we were trying to achieve – they would buy into the rationale and use the tools and requirements to improve their governance, with an eye on improving their long-term performance. However, there were others who would see it as merely a compliance exercise. In that sense, one of the biggest impacts on the company's ability and willingness to be focused on long-term value is the mindset of the board.

What are some of the challenges for board members in driving a long-term value orientation?

I'm not sure that all boards have the time today to devote to the sort of issues that determine whether or not the company is able to create long-term value.

There are a number of possible answers, from changing what we expect the board to be doing to revised governance structures. One approach might be to reverse the trend that has seen all sorts of issues escalated to board level. Believing a board meeting eight times a year should be able to deal

with everything that's now expected of them seems unrealistic, so a different governance structure could be preferred. In a revised structure, decisions on aspects that are material to strategic goals and required to achieve long-term value objectives could be taken at the top. And other issues, which are all still important, but potentially distract directors from long-term value, might be better addressed elsewhere in the organization.

What impact can regulatory requirements around reporting have on the behaviors that support long-term value?

Changes to reporting tend to focus on increasing transparency and accountability. I question the value of this where such changes don't end up changing behaviors. Take the example of increasingly prescriptive reporting over the nearly 20 years on executive remuneration – what tangible impact has that had on behavior? That said, there are examples where it has made a difference. For example, reporting on the gender pay gap, which has seen great attention from the media and the public, bringing the debate to the boardroom and accelerating change in the right direction.

Companies can directly address many of the key challenges to their long-term value strategy



While encouraging progress has been made, significant challenges – both external and internal – still stand in the way of driving long-term value and meeting the interests of investors and other stakeholders.

External challenges

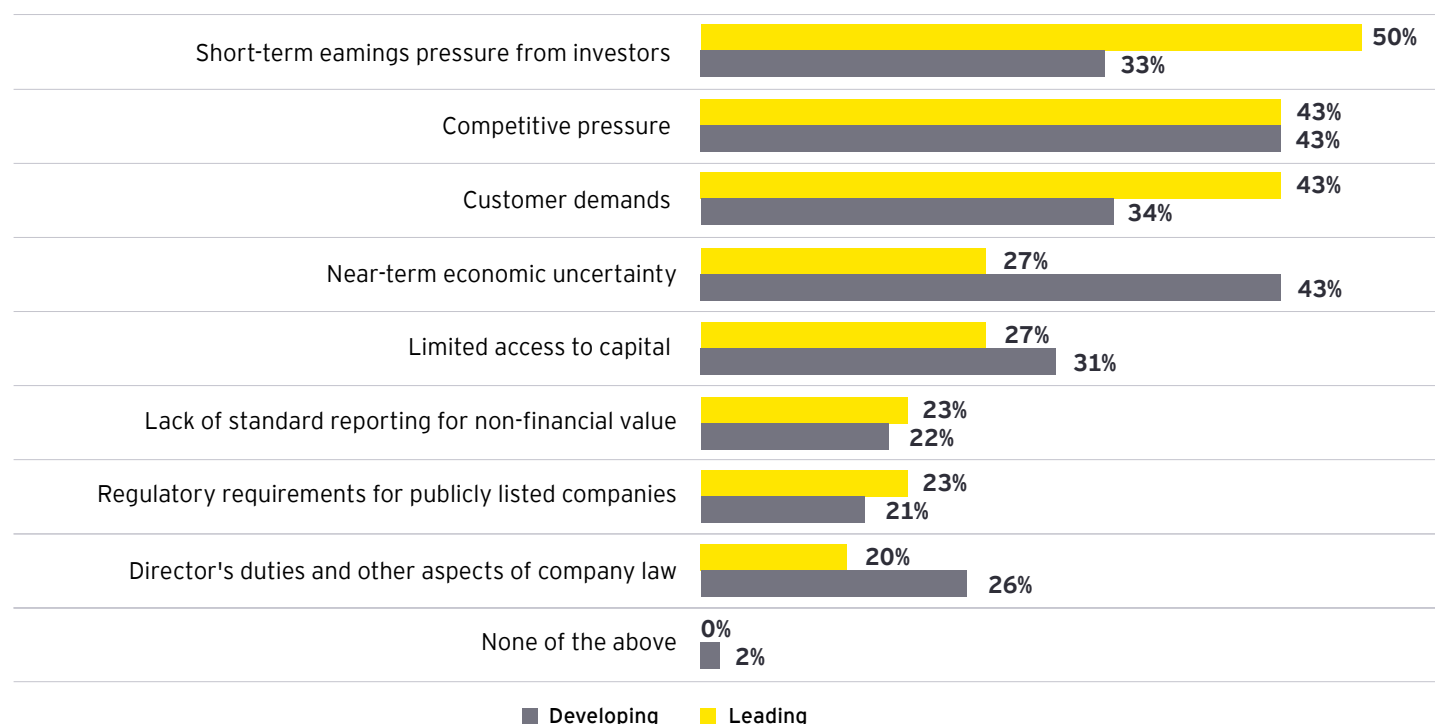
Our analysis finds that “short-term earnings pressure from investors” is the critical external challenge facing the “leaders” in our survey.

While leading companies appear to be making significant progress, we did find that around one in three (32%) have not put in place a consistent approach to decision-making that balances near-term and long-term value creation. This may help explain why the number one external pressure facing this group is the short-term pressure. It suggests that as you focus

on long-term value, the tension and awareness of balancing near-term and long-term growth may increase, not decrease.

Investor pressure on short-term earnings risks causing companies to redirect capital and human resources from long-term strategic initiatives to meet short-term financial goals. All those in the sample who selected “short-term earnings pressure from investors” as a critical challenge were also asked how this short-term pressure manifests itself. The answer is increased price volatility.

Figure 2: Which of the following external factors have the greatest impact on your ability to generate long-term value?



The major challenge of short-term pressure reflects a number of issues: first, the growing importance of institutional investors with a limited length of share ownership, which creates pressure on boards to focus on the short-term market value of the share; second, the continued emphasis on short-term disclosures within listed companies, including quarterly

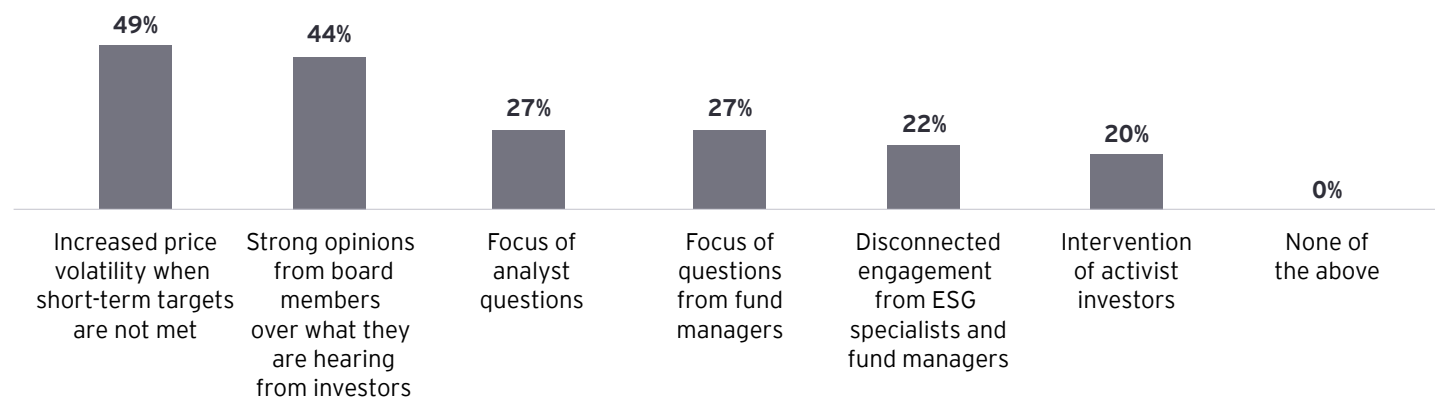
returns and earnings guidance, which can drive a focus on short-term financial performance.

For this reason, it's crucial that boards establish effective engagement with investors – including activists – to build trust, explain purpose, identify common ground and ensure support for long-term value oriented strategic approaches.

This is not a new idea, yet it feels more relevant than ever. Warren Buffet made the point in 1979 in [his letter to Berkshire Hathaway](#) shareholders when he said: “In large part, companies obtain the shareholder constituency that they seek and deserve.

If they focus their thinking and communications on short-term results or short-term stock market consequences they will, in large part, attract shareholders who focus on the same factors.” The opposite should also be true.

Figure 3: Thinking about how investors exert pressure for short-term earnings, what are the most common ways that pressure manifests itself?



Note: Data based on 41 respondents.

Sustainable growth: a spotlight on ESG

The focus on long-term value has emphasized the critical role that ESG programs play in sustainable growth. Based on discussions with EY subject matter professionals, we have identified five themes that are driving the importance of ESG, as well as some key considerations for boards:

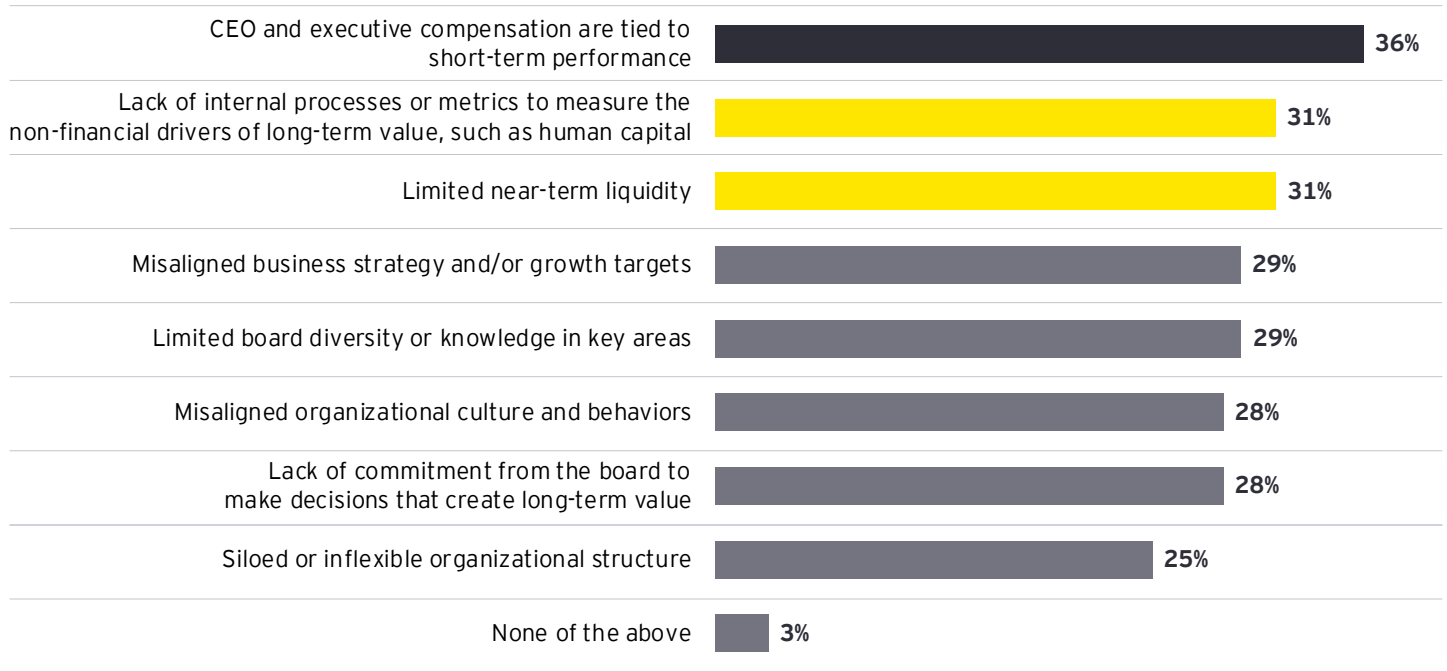
1. Societal, government and consumer scrutiny of companies' ESG performance has intensified, with the pandemic leading to intensifying public attention on the social dimension of ESG in particular.
2. Investor focus on ESG disclosures has also increased during the pandemic, as stakeholders focus on a company's ability to manage long-term risks, including environmental risk. Given that climate change time horizons extend over 30 to 50 years, they are meaningless in conventional risk management terms. This means breaking down these issues to shorter-term steps – and modeling will also be key.
3. Trusted ESG disclosures require robust processes and controls, and independent assurance plays a key role in driving reliability and consistency. The large number of voluntary standards today make comparability and reliability difficult, and the IFRS Foundation is working on a coherent approach. The credibility of ESG disclosures is also critical, with the onus on issuers to demonstrate outcomes.
4. Board directors are increasingly focused on ESG performance, and it is no longer a niche area that is the preserve of the sustainability officer. This is because ESG performance and reporting are important in raising funds, green bonds and credit lines, and attracting the right investors.
5. Board education will be increasingly important to arm members with the knowledge they need to understand the impact of sustainability on areas such as risk and finance. Board composition, and the quality of the nonfinancial information boards use in decision-making, will also be key.

Internal challenges

The greatest portion of respondents chose the following as an internal challenge to long-term value orientation: “CEO and executive compensation are tied to short-term performance.”

Shifting to an approach that supports long-term value creation will require boards and compensation committees to rethink the design of executive compensation plans.

Figure 4: Which of the following internal factors have the greatest impact on your ability to generate long-term value?



View Point

Ilham Kadri, CEO, Solvay Group



Solvay is a Belgian, science-based multinational that was founded in 1863 and which is today focused on three segments: advanced materials, chemicals and solutions. Julie Linn Teigland – EY EMEIA Area Managing Partner – spoke to CEO Ilham Kadri to understand her perspectives on long-term value.

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It's important to keep one eye on the 'microscope' – the short-term performance, and one eye on the 'telescope' – the long-term strategy.”



Can you tell us how long-term value thinking is shaping your strategy for Solvay?

The primary mandate I received from the board when I joined was to unleash the significant potential of this company and today I am here to lead a purpose-driven transformation of Solvay that creates long-term value. Our purpose reflects the thinking of our founder, Ernest Solvay, who said that the company's scientific and technology capabilities have a 'positive role to play for the progress of mankind'. You cannot transform a company in a sustainable way by simply demanding that the presidents of your business units step up EBITDA and cashflow. At least that's not how I see transformation. The way we like to think about it is through the concept of 'cathedral thinking'. Like the construction of great cathedrals, different generations are inspired by the long-term vision and the goal of benefitting future generations. It's a multiple generation process.

That said, there is no long-term value without short-term performance. Finding a balance is key. I like to say that it's important to keep one eye on the 'microscope' – the short-term performance, and one eye on the 'telescope' – the long-term strategy.

What are some of the main changes you are focused on to deliver your long-term value approach?

A key responsibility I have is to identify the new behaviors in my company that will drive long-term value. Our purpose is about sustainable and shared value, including purposeful responsibility, unity but not

uniformity, and passion for performance. That's the new Solvay. So, if you take 'passion for performance', that means encouraging people to not only behave like 'farmers' but also 'hunters' who seek new business, which in turn drives long-term value. We also need to be customer-obsessed – not just intimate, but obsessed. Last but not least, innovation is key to long-term value. Since I joined the company, we have launched three innovation platforms: EV batteries, thermoplastic composite and green hydrogen. This is the long-term value, 'telescope' part of our strategy.

Can you tell us about the role of the board in delivering Solvay's long-term value strategy?

Governance is key and I have been focused on strengthening the relationship with the board through openness and transparency about the issues we face. Like many companies, the crisis has shown areas where we can improve that perhaps we did not see before. We have been very transparent with the board about what we are seeing so that we are aligned on the environment for the company.

The board and executive management work hand-in-hand to find the right balance between both short-term value creation and long-term value creation. For example, resource allocation was decentralized in the past and now it is centralized with me. Business unit presidents have to earn the right to investments and it allows us to be guardians of shareholder value, balance the short and longer term projects, and ensure initiatives don't conflict with our sustainability ambition memorialized through 'Solvay One Planet'.

View Point

Professor Suraj Srinivasan, Harvard Business School



Suraj Srinivasan is a Professor and Chair of the Accounting and Management area at Harvard Business School (HBS) where he teaches in a range of MBA and Executive Education programs. In addition to teaching in leadership programs on strategy execution and risk management, he chairs or co-chairs executive programs for corporate board effectiveness, such as 'Preparing to be Corporate Director' and 'Making Corporate Boards More Effective'. Andrew Hobbs, EY EMEA Public Policy Leader – spoke to Professor Srinivasan to understand his views on corporate governance and long-term value.

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The pandemic has helped companies move faster toward what their purpose really is and who they actually exist for.



How has the pandemic changed how we think about long-term value and stakeholder capitalism?

The pandemic has really focused attention on a multi-stakeholder approach – it has caught the imagination in a way that we have not seen before. After all, the UN Sustainable Development Goals have been around for many years, so it's not new in concept, but the intense focus today has concentrated minds much more clearly on this now than in the past. Previously, we may have talked about a few leading companies who were driving a multi-stakeholder approach, but there was not the broad context that we have today. If you look back over the past 12 months, there is so much more attention on, and questions being asked about, the really big issues, such as the impact of globalization on society.

And what impact has the pandemic had on organizations' abilities to drive long-term value for multiple stakeholders?

The pandemic forced almost every company out there to make hard choices. The multi-stakeholder model is wonderful in concept, but it's more difficult in practice. When you are a purpose-driven, multi-stakeholder company, then making decisions involves making trade-offs. So, for example, that might be employee safety versus customer service. If you're a retail outlet, for example, how do you manage the trade-off between keeping your stores open versus employee safety versus furloughing workers?

What the pandemic has done is push leaders to make these trade-offs in real-time, and I have seen CEOs and senior business leaders struggling with how to do that. Most of them, though, have come out very well. In that sense, the pandemic has helped companies move faster toward what their purpose really is and who they actually exist for. I don't think anyone has gone through the pandemic and said 'we exist only for shareholders and we do everything for the owners alone'. The pandemic has really brought into stark focus that leaders always make decisions for multiple stakeholders. They are starting to do it more purposefully now with a clearer recognition of the trade-offs.

Thinking about how organizations meet their commitments to multiple stakeholders, how will they measure the value they deliver and performance against sustainable goals?

It took us decades, if not hundreds of years, to figure out financial reporting and we still don't have it entirely right, so it's going to take us some time

to work out sustainability reporting. But it's going to be critical because of two factors. First, resource allocation – without a measurement system it's hard to know how to allocate resources. Then, once you allocate resources, how do you tell how well you are performing? You need measurement to figure out where to invest and then how well you are doing when you spend the resources.

While we still have some way to go in measuring externalities such as social outcomes, that is not to say we shouldn't measure anything until we can measure perfectly. We need to take the first step forward and not think about where we're going to be two miles down the road. Take biodiversity, for example, and measuring the number of trees that have been planted. That at least allows us to be informed about the right thing to do, what value we place on that activity, and who is accountable. With measures like that as an initial step, we can then move forward, drawing on initiatives from the likes of the WEF and the SASB (South African Bureau of Standards). The WEF's 'four pillars' provide the overall framework for the disclosures that everyone should produce at a minimum, and then the SASB's work looks at the detailed disclosures that are material for specific industries.

What are some of the key steps that boards can take to ensure corporate governance is aligned on a multi-stakeholder approach?

There needs to be a shared understanding within the board on what the purpose of the organization is and exactly who its stakeholders are. For example, have stakeholders been identified and prioritized? Also, have potential trade-offs between stakeholder groups been identified? Within the best boards, this is not something that is just the sustainability committee's job. Instead, it's the whole board's responsibility, and you have a shared understanding of the commitment that the organization makes toward its stakeholders and what that means in terms of decision-making and trade-offs. If the board is thinking about the strategy of the organization, for example, are commitments to stakeholders part of that strategic discussion? Is investment policy or the compensation of senior management teams assessed in the context of stakeholder commitments? If they are not, then a stakeholder approach is not coherent or aligned with everything else the company is doing. Boards need to be asking these very specific questions.

Corporate governance is critical
to the long-term value agenda
and needs to evolve



Overall, a range of challenges have emerged from this analysis, many of which fall squarely into the corporate governance domain. EY teams identified five governance-related areas that boards could focus on to positive effect, without the need for external assistance or regulation.

To achieve this ambition, governance practices and structures need to be examined end to end to ensure they are aligned

to the achievement of a sustainable strategy. Alignment is critical. If boards struggle to align with management on long-term value goals, progress will be stifled. There also needs to be alignment across the key areas of governance, from how boards manage risk to how they devise remuneration strategies, to drive sustainable and inclusive growth. The five areas are:



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Today’s business models are being challenged by an increasing demand for more sustainable products or services. This shift represents a completely different way of creating value for the future. Companies today need to think about the whole lifecycle of their products, which is requiring them to work both on responsible supply chains and responsible product engineering.

Eric Duvaud, EY France Sustainable Performance & Transformation Leader, EY & Associés

1 Attributes

We asked executives to nominate which board attributes were most critical for making decisions that generate long-term value. Interestingly, the main attribute that emerged was behavioral – for a board to focus on the long term, the ability for directors to speak their mind is seen as critical. The top-ranked attributes are:

First	A board that has enough trust to be honest, debate openly and have healthy disagreement
Joint second	A board that engages and considers the interests of all stakeholders when making decisions
	A board that implements management remuneration schemes linked to long-term value goals
Third	A board that proactively identifies and engages potential investors focused on long-term value

In addition to the above other priority attributes are:

- ▶ **Values:** directors who are committed to long-term value creation, with values that recognize the importance of ESG and of understanding stakeholders, are important in a number of ways. First, boards setting the right tone at

the top and acting as role models for management teams and wider employees is essential to embedding a culture that supports a company’s long-term stakeholder-focused strategy. Second, for external advocacy, demonstrating passion and commitment is needed to court the right shareholders to support the strategy.

- ▶ **Diversity:** healthy disagreement and honest debate also foster diverse opinions. Diverse and inclusive boards – including dimensions such as race, gender, career background and age – bring a full range of perspectives and solutions to big issues, such as climate change or inequality, and can challenge established thinking and biases in a way that homogenous boards will not. Diverse and inclusive boards are also better placed to ensure that different stakeholder impacts have been taken into account in decision-making.

- ▶ **Skills:** companies will need to make sure they have the skills, experience and knowledge to help them deliver on their long-term value strategy over time: for example, on matters such as climate change or ESG metrics. Companies are likely to need to actively refresh and change the skills profile of board members as they reach different stages of the long-term value strategy execution.

Internal and independent external board evaluations should naturally incorporate an assessment of these attributes moving forward.



2 Risk

When we asked executives what would likely deter their board from pursuing an initiative that was expected to improve long-term value but diminish near-term financial performance, the top two factors were:

1 A high degree of uncertainty that the initiative will succeed

2 A risk framework and appetite that is geared toward short-term shareholder return rather than long-term, inclusive growth

However, “lack of committed support and leadership from management” was much less of a concern for executives. This suggests companies have the willingness to pursue initiatives with longer time horizons, but need to improve their risk assessment and management capabilities to better understand long-term risk and the likelihood of success. In other words, it could allow boards to increase their risk appetite because they will have greater confidence about long-term risk-taking and the potential upside of doing so, including being able to explain it to stakeholders.

A critical function of boards has always been to understand and mitigate business risk – but the pandemic has brought that responsibility into sharp focus. Its unprecedented impact has highlighted the interconnectedness of risks and the velocity at which the landscape can change. In this environment, how can boards be sure that long-term risks – such as climate change – are appropriately forecasted and managed effectively across the organization?

Before the COVID-19 crisis, [EY Global board risk survey](#) found that boards were concerned that their organization was not paying enough attention to emerging and existential threats, but they were not equipped to adequately understand, detect and mitigate certain types of risk. Just 40% of boards said enterprise risk management was effective in managing atypical and emerging risks before the COVID-19 crisis. And only 21% of boards said their organization was well prepared to respond to an adverse risk event from a planning, communications, recovery and resilience standpoint.

Now is the time to consider constructive reforms and embed cultural and operational changes to better equip businesses with the tools to respond to fluid and uncertain business environments and introduce safeguards to mitigate future crises.

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When we talk about ESG risk and of course long-term value, we talk about 10-year projections or even longer. So the key questions are: how do we bring this vision into the very short-term, internal capital adequacy processes, internal liquidity adequacy processes, capital KPIs and liquidity KPIs? It’s a transition and it requires time.

Dr. Max Weber, EY Germany FSO Consulting Partner and EY EMEIA Climate Change Risk Pillar Lead

3 Reward

Compensation schemes need a mixture of near- and long-term incentives to reward executives for generating sustainable growth. Coming up with the right mix can be challenging, but boards can consider the following guidance as a starting point to evaluate what is right for their company:

The short game: companies can focus first on short-term compensation plans, such as annual bonuses. This will allow them to get a feel for how the metrics are working and whether hurdle rates are reasonable. If adjustments need to be made, it is relatively easy to do so with short-term plans. Learning can then be applied to the design of long-term plans. If companies focus first on long-term plans, it may be hard to course-correct if things do not work as intended.

The long game: long-term incentive plans should be designed so that they use multiyear measurement periods. In our experience, three-year measurement periods are a common tactic. In some countries, there is an increasing expectation that senior executives hold shares for a minimum period after they leave their firms, with two years being typical. Extending this principle to other countries can encourage executives to focus on the long-term consequences of the decisions they make.

Compensation schemes also need to alight on the right metrics, which can be challenging to both define and assess. Metrics related to ESG goals are an increasing focus. However, not all ESG metrics are relevant for all companies, so companies need to assess their strategy and determine which metrics are most relevant to them. This will vary by industry. Such metrics must be reliable if they are to influence executive remuneration; therefore, robust processes and controls will be required, including board committee oversight.

Finally, there is the question of how much pay to tie to long-term measures. In most companies today, the percentage of executive pay tied to metrics that reflect long-term value is fairly modest. But, if companies are to change executive behavior and drive long-term performance, they need to ensure that a meaningful portion of pay is at stake. Based on their experience, EY remuneration professionals believe that a range of 15%-25% of pay connected to long-term metrics, with clear performance targets, would make a significant difference.

4 Engagement

While stakeholder engagement is not a new topic, many organizations still struggle to bring the stakeholder voice to the boardroom table and really consider their feedback in decision-making. Therefore, it is worth taking another look at the building blocks that are required for effective engagement:

- ▶ As a start point, organizations need to define their key stakeholders. While there will be any number of potential stakeholders for a company, they need to be prioritized, and boards need to be clear on who are the most important.
- ▶ Once stakeholders are identified, the next step is the engagement strategy. This has to take account of two factors. On the one hand, it is about getting the stakeholders onboard to develop loyalty and buy-in. On the other, it is important that boards use the engagement to understand what is important to the stakeholders. In other words, it is about understanding their needs and how they factor into the board's decision-making about what is required for long-term value creation.
- ▶ The engagement strategy should also be pragmatic. It may not be possible for the board to engage evenly with all key stakeholders, from suppliers to communities. Therefore, boards must decide who they engage with directly and who they engage with indirectly through management.
- ▶ Finally, boards need to close the feedback loop. Getting feedback from a key stakeholder does not obligate boards to act in accordance with their viewpoint. However, there should be communication back to the stakeholder on how the feedback was considered, or the quality of the relationship will deteriorate.

There is increasing focus on engagement between independent board members and investors. As a starting point, it would be valuable for this director group to hear more about growing investor expectations regarding long-term value and ESG principles. However, if directors are to engage more directly with investors, it is important that they buy into a long-term value approach and have a deep understanding of the subject. This will be critical to ensuring not only that boards play an effective role but also that a focus on long-term value and ESG principles is achieved across the company.

Driving progress in stakeholder engagement

One way to shift the dial on stakeholder engagement is for the board to define the engagement strategy, then measure and report on it – driving accountability and transparency. This would see companies describing publicly – and at least annually – information such as:

- ▶ Stakeholder outcomes that are necessary for successful strategy execution (key stakeholders): for example, target net promoter scores for customers, level of employee satisfaction, level of investment in employee development, and expected return on capital invested
- ▶ How the company has interacted with the key stakeholders
- ▶ How the board has taken their interests into account
- ▶ How board-specific decisions have been influenced as a result

Such reporting would describe specifically what the board has done during the year and would avoid boilerplate. Through this mechanism, stakeholders should be able to assess how their interests are being considered. They should also be able to exercise their existing levers in holding companies to account: for example, purchasing power of customers or rights that already exist in law, such as health and safety. This approach will also help shareholders specifically to assess the company's future prospects.

5 Authenticity

Long-term value orientation has significant implications for how corporates communicate performance. On the one hand, it is about being authentic and accountable. This means being open to communicating both good and bad news. As a recent [EY survey on corporate reporting](#) examines, this shift to a broader view of value and performance may require changes not only to frameworks and practices but also to mindset and culture. Essentially, organizations need to adopt a new culture and mindset regarding the information they share about themselves – a culture based on authenticity and accountability.

Effective and credible reporting against long-term value metrics – establishing where there has been progress or lack of progress – is also key to accountability. Strong and effective audit committees have a key leadership role to play here. For example:

- ▶ Ensuring the company operates strong and effective controls that support the quality of both financial and nonfinancial information/reporting, including long-term value metrics
- ▶ Overseeing the robustness and reliability of risk information

Reliability and consistency is crucial to boards confidently making decisions and stakeholders using the information to assess the company's future prospects and cash flow.

Reinventing corporate reporting

Of course, being authentic and accountable will not happen if organizations are still heavily dependent on conventional reporting frameworks. Focusing on the long term requires

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Asset managers are definitely embracing ESG with authenticity. They are looking to integrate it across the whole of their business. I think the sentiment of the industry is that they know that in the future they won't be talking about ESG because essentially ESG and long-term value creation will become what they do. Therefore, there will be a big transition from the current status, something which is still niche and has a label, toward actually what will be a description of the sector in the future.

Gill Lofts, EY EMEA Financial Services Sustainable Finance leader, EY Financial Services Wealth & Asset Management Leader, Ernst & Young LLP United Kingdom

organizations to shift from a narrow focus on backward-looking financial reporting to forward-looking insight based on financial and nonfinancial disclosures, including ESG disclosures.

Significant progress has been made in using nonfinancial metrics to measure and communicate performance:

- ▶ 69% make consistent use of nonfinancial metrics to set organizational targets for performance and growth (39% 'often' and 30% 'always')
- ▶ 65% say the same of communicating sustainable performance to investors (40% 'often' and 25% 'always').

Figure 5: How often does your company use nonfinancial value metrics to do the following?



While progress has been made, organizations are seeking greater clarity and rigor in producing nonfinancial disclosures that are credible and comparable. For example, 80% of executives say it would be helpful to have globally consistent frameworks and standards for long-term value-focused corporate reporting. Without it, there is a risk that stakeholders do not get an authentic, credible picture of whether KPIs such as emissions reduction targets have been met.

However, firm guidance on metrics and reporting standards is difficult because businesses are structured and create value differently. That said, leaving it up to individual companies is inefficient in terms of identifying common areas of value, as well as frustrating for stakeholders who struggle to make relevant comparisons. This is an area where policy-makers and advisors can make a meaningful difference. Initiatives such as the Sustainable Value Creation program, led by the IBC of the WEF in conjunction with EY, has developed [a set of core](#)

[metrics for businesses](#) to which 61 top business leaders across industries have committed already. As these gold standards emerge, it will be easier for companies to measure and communicate the total value they create for stakeholders.

This desire for consistent, credible and comparable approaches is reflected in the appetite for policy and regulatory changes that clarify or amplify the pursuit of long-term value:

- ▶ Developing globally consistent frameworks – 80% think that it would be helpful to develop frameworks, standards and guidance for measuring and communicating how long-term value is being created.
- ▶ Putting a stronger focus on multi-horizon risk – 76% think it would be helpful to require companies to disclose any major risks to, and uncertainties regarding, continued viability in the long term, in addition to the short and medium term.

Defining long-term value

Long-term value is how EY teams define the human, financial and societal value that companies generate over time for their stakeholders, including investors, customers, employees and wider society. There are many competing and overlapping terms that try to capture this concept, but we use long-term value to acknowledge and emphasize that companies need to focus on sustainable growth over a long-term horizon. We believe that long-term value includes the following concepts and considerations:

- ▶ **Stakeholder capitalism:** focusing on delivering long-term value to shareholders by understanding and addressing the needs of customers, employees, investors, regulators and other key stakeholders. This is opposed to shareholder primacy, which is commonly understood as a focus on maximizing shareholder returns in the near term. A multi-stakeholder approach can perhaps be seen as a form of “enlightened shareholder value.” By that, we mean that the main reason for being interested in stakeholder outcomes is that it leads to better shareholder returns over time.
- ▶ **Resisting short-term earnings pressure:** this is part and parcel of stakeholder capitalism, as the outcomes desired by key stakeholders will tend to be realized over a longer time horizon than the earnings pressure from some investors.
- ▶ **A purpose-driven approach to strategy:** using a “reason for being” to define an organization long-term strategy and align business with social and environmental goals.
- ▶ **Sustainable growth:** considering the long-term impact of corporate decisions to build a more sustainable future for all. Note that “sustainable” growth means more than environmental considerations. It includes the pursuit of a wider environmental, social and governance (ESG) agenda: environmental issues (such as climate change), social (such as inequality and diversity) and governance (such as ethics and transparency).
- ▶ **Management of multi-horizon risks:** including managing the impact of risks such as climate change on a company’s long-term prospects.
- ▶ **Business and investment decision-making:** making critical decisions about strategic positioning and investments, not just for today’s business but for future growth in a changing environment, creating the flexibility to respond to disruption.

Later in this paper, and as part of the research survey, we examine the progress that companies have made in specific long-term value approaches. These include:

- ▶ Embedding a corporate purpose with a focus on generating sustainable, long-term value for a broad set of stakeholders
- ▶ An approach to strategy formulation and decision-making that effectively balances near-term and long-term value creation
- ▶ Continuously reassessing the company’s strategy and organizational structure to improve the ability to generate long-term value
- ▶ An established approach to measure and communicate the long-term value the company generates
- ▶ Considering the interests of all stakeholders in decision-making, not just shareholders
- ▶ Communicating to all stakeholders with authenticity, including being transparent about the positive and negative impacts of business decisions
- ▶ Implementing remuneration schemes for executives and management tied to long-term value creation

View Point

Markus Duesmann, CEO, Audi



Audi, which is part of the Volkswagen Group, is one of the world's best-known premium automotive brands, renowned for its slogan "Vorsprung durch Technik" (progress through technology). Julie Linn Teigland – EY EMEA Area Managing Partner – spoke to Markus Duesmann, CEO of Audi, to understand his perspectives on driving long-term value.

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You don't want to sacrifice your long-term future because of short-term pressure on results.



You took over as CEO of Audi in early April 2020, when many markets were entering their first major lockdown. Can you tell us how this disruption shaped your approach as a new CEO and the challenges it posed in terms of balancing short-term needs with long-term value?

Because of the COVID-19 outbreak, my first days, and even my whole first year, at Audi turned out to be quite different than I expected. The most important task for me from the very beginning was to make sure that all employees and their families remain healthy – and in the long run that they can rest assured that their jobs are safe in the future.

Talking about the financial aspects, because of the pandemic, we certainly had to look at cash. When I studied at Harvard in my free time, a professor said: ‘There are three things you always have to consider: Don’t run out of cash, don’t run out of cash, and don’t run out of cash’. That’s true, but at the same time, we certainly never lost sight of our long-term focus during the pandemic. While we were focusing on cash, for example, we actually increased our engineering budget. Thanks to our efficiency program, which started in 2018, Audi has a solid financial base that allows us to allocate resources to the top priority issues of transformation.

The big challenge is – and was already before COVID-19 – that in the past the future was more foreseeable, but that’s no longer the case today. It’s much more difficult to define what is long-term value. The speed of change has accelerated and will only get faster in the future. For example, it’s clear that we have to invest in engineering as we confront fast-paced trends like digitalization and electrification. But as the future is uncertain, you have to invest in all the fields that you believe will be relevant, to ensure you don’t miss out on major trends or changes in the industry.

What are some of the challenges facing CEOs when it comes to driving long-term value, and what can help overcome those challenges?

First, we have to be aware of the fact that working on the brand and building trust is key for us. So for

us a key question is: How do we build trust with our customers? The answer is: We have to make mobility sustainable and environmentally friendly so that people can use it with a clear conscience. Therefore, acting sustainably is crucial, especially in our sector. So, trust is crucial, but it builds up very slowly.

Second, CEOs have to find a balance between investments in the long-term and delivering results in the year you are in. Pressure can come from all sides to deliver in the year you are in, but you don’t want to sacrifice your long-term future because of short-term pressure on results. For an organization with a result-driven mindset, of course, long-term return on investment is likely to be less of a motivation than short-term results. This needs to change and it is our responsibility as members of the board to do so. One trigger is definitely the salary scheme. At the moment, the dilemma is that the current year is often the year that salary schemes are evaluated against.

Therefore, at Audi and the wider group, salary schemes have changed from the short-term to the long-term, to incentivize an increased focus toward long-term results. For the performance part of remuneration, for example, at Audi, we measure leaders on their support around diversity issues. Having diverse teams promotes your ability to innovate, which is vital for a long-term focus.

Can you tell us about the role of the board in Audi’s long-term value strategy?

The board plays a critical role in challenging and debating the future strategy and long-term vision. Of course, it’s inevitable that the uncertainties of the pandemic are sparking hard debates. And I welcome authentic debate. Even when we were dealing with the immediate COVID-19 crisis response, we never lost sight of the need to focus on the long-term strategy. I believe our people respect that. So, while looking at cost containment in some areas, we were also investing more in products and long-term projects. After all, we want to live in the future. And the members of the board are the ones that give orientation and set the key cornerstones for future value.

View Point

Professor Rajna Gibson Brandon, University of Geneva



Rajna Gibson Brandon is Professor of Finance at the University of Geneva and Deputy Director Education & External Affairs of its Geneva Finance Research Institute as well as Managing Director of the Geneva Institute for Wealth Management, Switzerland. EY EMEA Public Policy Leader Andrew Hobbs spoke to Professor Gibson Brandon to understand her views on corporate governance and long-term value.

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How boards approach issues like climate challenges or social inequality will depend on how directors prioritize certain values.



The pandemic has brought increasing focus on strategic risk – how can boards be sure that the effects on the company of long-term risks, such as climate change, are appropriately modelled and managed?

Long-term risk factors can be hard to measure when there is no reliable data. Therefore, scenario analysis and complex statistical models will be necessary to allow some level of assessment. However, even these methods may not prove completely accurate.

Climate change is not an issue that will manifest itself on next year's balance sheet or P&L; rather it will show over the next five, ten or even twenty years from now. You can't reduce this down to one single number. Instead we need to think in terms of ranges. This can be quite challenging and complex. It's going to require quantitative forecasting methods, scientific insights into the determinants of climate change and qualitative judgment. The appropriate analysis and "blending" of these factors is what will make the difference.

What are some of the challenges for board members in achieving a long-term value orientation?

One of the questions to consider is the optimal tenure of a board member. We re-elect board members over relatively short periods these days, which is viewed as a good thing. Very long tenures have downside for sure so at one level this is a positive change. But there is a danger that short terms could encourage short termism. If a board member is only elected for two years, it doesn't necessarily give them the incentives

to think about what's going to happen in the company after they leave. Another important consideration is the director's company's knowledge and learning about long-term value as a desired objective to pursue in all its complexities, especially in large, global companies. In order to be effective, challenge decisions and give valuable advice, directors must have the time and opportunity to understand the complexities of a company sustainability objectives, its sector, market positioning and the environment in which it sits. That takes time.

What do you think are some of the key attributes of a board that drives a long-term, stakeholder-focused strategy?

When a board wants to adopt a broader stakeholder perspective and seek to promote resilience, it inevitably goes to your ethics and your values. Part of my research looks at how you reconcile moral values with financial decision-making. This is a very important part of the challenge, because how a board deals with issues like climate change or social inequality will depend on the values of the board and its individual members. This means recognizing the importance of financial value to the viability of the company, but not exclusively prioritizing that factor.

That means choosing the right people, with the right mindset, and right intrinsic motivation. As well as extrinsic motivators – like remuneration – you need corporate leaders also to be intrinsically and morally motivated to address issues such as social inequalities or climate change.

Looking ahead

Business leaders are increasingly realizing that, to be successful, they need to have a multi-stakeholder, long-term value orientation. Sustainable corporate governance is a key enabler for companies to embed a long-term focus – and one that is within their control to change.

Now is the time to reframe the relationships and establish effective multi-stakeholder engagement to implement the key corporate governance elements that are instrumental to delivering real value for all – and for the long term.

About the survey

Between December 2020 and January 2021, 102 business leaders were interviewed to understand their progress and challenges in driving long-term value, and the implications for corporate governance. Over a quarter of respondents (29%) were CEOs, 7% were board members and the remainder (64%) were drawn from across the C-suite. Half of respondents' organizations have revenues in excess of €1 billion a year, with the other half between €100 million and €999 million. Respondents were split across 15 European countries and 13 sectors.

The survey was supplemented by in-depth interviews with the following business leaders, academics and other professionals:

Chris Hodge: Advisor, International Corporate Governance Network (ICGN)

Helena Stjernholm: CEO, Industrivärden

Ilham Kadri: CEO, Solvay Group

Markus Duesmann: CEO, Audi

Professor Rajna Gibson Brandon: Professor of Finance at the University of Geneva and Deputy Director (Education & External Affairs) of its Geneva Finance Research Institute

Professor Suraj Srinivasan: Harvard Business School

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Our thanks also go to the EY subject matter professionals who contributed their insights: Alexis Gazzo, Caroline Johnson, Danielle Grennan, Eric Duvaud, Gill Lofts, Iain Harrison, Ilaria Lavalle Miller, Jan-Menko Grummer, Jens Massmann, Maria Kepa, Martin Reynolds and Dr. Max Weber.

Leading-developing analysis

EY teams conducted an analysis of the long-term value maturity of respondents. Using a technique called "latest class regression," the survey sample were analysed to identify two groups: those that are "leading on long-term value" and those that are still "developing a long-term value focus." Respondents were assessed based on three dimensions of long-term value maturity: the board's adoption of long-term value best practices, the most important attributes of a long-term value-focused board, and the company's use of nonfinancial metrics. The "leading" cohort represents 43% of the sample of 102 respondents.



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