Commentary

Investment Stewardship's approach to engagement on long-term strategy, purpose, and culture

BlackRock Investment Stewardship is focused on engaging companies to encourage the adoption of business practices that support long-term value creation on which our clients depend to meet their financial goals. In his annual letter to CEOs, Larry Fink, BlackRock's Chairman and CEO, has for several years described our expectations of companies in relation to long-term strategy:

> *We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation. Additionally, because boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their boards have reviewed those plans. BlackRock's corporate governance team, in their engagement with companies, will be looking for this framework and board review.* [1]

These detailed plans not only give shareholders a clear sense of the direction in which management intends to take the company but also provide milestones against which performance can be assessed. Further, these plans offer better context for certain key business decisions such as capital expenditures, e.g. investments in manufacturing plants, workforce training or research and development, proposed acquisitions or divestments, and plans to return capital to shareholders.

While a long-term strategic framework may remain relatively consistent over time, it is likely that detailed implementation plans will change in light of evolving circumstances. It is helpful to shareholders to have an explanation of how management has altered implementation and why. A good understanding ensures investor support for management even when events have resulted in the company missing projected targets and having to deviate or modify implementation plans.

We expect boards to be fully engaged with management on the development and implementation of the company's long-term strategy. The board certainly has an oversight role and a responsibility to hold management to account for delivering the agreed strategic goals.

Why long-term strategy, purpose, and culture are investment issues

The investment case for companies to articulate a strategy is established, although debate continues around the definition of "long-term." We consistently hear in our engagements with companies that "long-term" is a mindset, not a number of years. It is also both industry- and company-specific. Every industry has its own cycle, and each company is unique. An oil and gas company, for example, is likely to have a different time horizon when compared to a youth apparel company. As a result, we ask companies to succinctly explain their long-term strategic goals, the milestones that demonstrate progress, and any obstacles anticipated or incurred.

Most corporate leaders claim to take a long-term approach. Yet a recent study[2] stated that 87% of executives and directors feel most pressured to demonstrate strong financial performance within two years or less. The same study shows that companies that have a long-term mindset experience superior financial performance with lower volatility, create more jobs, and invest more in their businesses. We believe that companies that clearly and credibly set out a long-term strategy will be better able to focus on creating value because long-term shareholders can act as a buffer to short-term pressures on management.

A successful strategy is founded on a clearly articulated purpose, e.g., what a company does every day to create value for its stakeholders. As Larry Fink wrote in his 2018 letter to CEOs, "without a sense of purpose, no company, either public or private, can achieve its full potential." A purpose-driven approach to corporate strategy represents an evolution from traditional practices that relied substantially — if not entirely — on conventional financial metrics. We believe that a strong sense of purpose builds business confidence[3], aligns employees with management's strategy, creates loyal customers[4], and informs other stakeholders.

The prevalent beliefs and behaviors within a company are organic but can be shaped by the board and executive leadership through their own example, as well as through principles, policies, and rewarded practices. The quote widely attributed to management expert Peter Drucker – "culture eats strategy for breakfast" – captures the idea that a strategy incompatible with a company's culture will fail. Culture is woven into engagements on strategy because how a company operates clearly has a strong influence on what it achieves.

Suggestions of places to communicate strategy, purpose, and culture statements are:

- In a chairman's letter to shareholders and annual report
- At the company's investor day
- On the company's corporate website
- Through the company's public filings such as its Form10-K or proxy statement

BlackRock's engagement on strategy, purpose, and culture

When engaging on strategy, purpose, and culture, we seek to understand a company's strategic framework, the board's process for strategic review, and how strategy evolves over time in response to changing economic, regulatory, and societal conditions. Where relevant, we inquire about the board's role in helping management assess the company's purpose, which can inform corporate strategy and its link to long-term value creation.

Strategy, purpose, and culture are more nuanced than many aspects of governance. Some companies publish clear and insightful explanations of their long-term strategy, purpose, and culture; we would like that to be the norm. Moreover, strategy, purpose, and culture are important value drivers and shareholders need to understand them to assess a company's performance and opportunities.

The topics we might cover in a discussion about strategy, purpose, and culture include:

- How the company's strategic framework has evolved and what drove the evolution (e.g., changing customer needs, resources/input constraints, industry dynamics, and global mega trends)
- How the company defines "long-term" and why that time frame is most appropriate
- How the board contributes to strategy, purpose, and culture and oversees management's implementation of the agreed plans and policies; how it assures itself that the stated long-term strategy feeds into practices related to budgeting and financing, capital expenditure, and risk management
- The strategic milestones against which shareholders should assess performance
- Employee involvement, if any, in shaping strategy, purpose, and culture; the feedback mechanisms available; and the incentives provided to ensure implementation
- How the board and management assess the compatibility of the company's culture, purpose, and strategy and, where absent, how it was remedied
- How the short-term dynamics in the business feed into the long-term strategy
- The short-term pressures on the company, their source, how management deals with them, and how the board provides support to management to maintain a long-term focus

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1. Text of Larry Fink's 2016 Corporate Governance Letter to CEOs .
2. McKinsey Global Institute, Measuring the Economic Impact of Short-termism, February 2017.
3. Nearly 70% of respondents to the Edelman Trust Barometer 2018 Global Study said that building trust (or confidence) should be the top priority for company CEOs and was more important (by ranking) than producing high quality products or services.
4. Deloitte, Culture of Purpose – building business confidence; driving growth, 2014 core beliefs and culture survey.