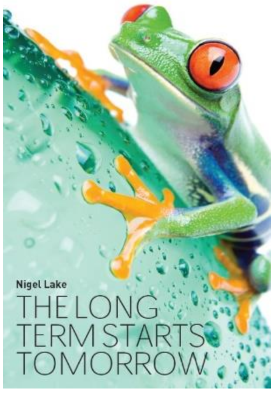
The Long Term Starts Tomorrow



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Part 1: The Problem

Corporate, financial and government decision-making has become increasingly short-term. This is not simply the result of reporting seasons, remuneration schemes or political cycles. It's also a computational direct result of the methodologies used to make decisions, which ignore longer term risk and opportunity. The negative effects of these choices emerge surprisingly rapidly – and they impact everyone in society.

Themes

- ☐ **Incumbency:** Does the tortoise still win the race? Is trusting the status quo – the 'devil you know' – still the best way to make decisions? Why are so many of the most valuable companies relatively young these days?
- ☐ **Timescales:** Whose lives should be taken into account when making decisions in business or government? Should we give any thought to future (unborn) generations? How far into the future should we look, and why?
- ☐ **Action:** How can you persuade people to think longer term? More importantly, how can each of us help to catalyse action? What are the barriers to the changes we'd like to see, and how can we overcome them?

For Reflection

- ☐ What decisions have you seen made that were driven by short-term thinking and which turned out badly? What prevented the person concerned from taking a longer term view? How could you persuade them to act differently next time around?

Key Points

The 1980s and 1990s saw huge advances in the professionalisation of business management, in the form of management consulting specialists (McKinsey, Bain, BCG etc) and also through much more rigorous financial analysis by investment bankers (Goldman Sachs, Morgan Stanley etc in the USA, as well as eg Barings in Europe). Despite this, entire industries have been disrupted by individual start-ups, such as Amazon (retail), Google (advertising/media), Apple (cellphones), Tesla (motor vehicles, batteries) and Netflix (on-demand video). The incumbents were some of the richest, most powerful and best connected businesses, but they were elbowed aside by flimsy startups powered by little more than pizza and RedBull. As those start-ups created huge value almost of out thin air, incumbents such as Nokia saw 90% of its value evaporate in a small handful of years.

Why? One common theme amongst companies that failed was relentless short-termism – a dogged determination to ignore upcoming industrial shifts enabled by emerging technologies. These shifts were predictable. New technologies did not emerge overnight, but rather developed slowly over many years following Moore's Law style efficiency curves. As one example, the emergence of the iPhone in the late 2000s was anticiapted in the early 1990s within companies such as HP. Nokia developed an equivalent product – *and* an app store – but never launched it.

This short-termism is driven by what I call 'economic rationalism', ie the use of economic and financial analysis tools such as discounted cash flow models and the 'capital asset pricing model'. These methodologies derive from the thinking of Nobel prize-winning economists Modigliani and Miller, as well as earlier work by Irving Fisher and Karl Marx amongst others. One critical weakness is that this analysis converts the value of future financial and economic results into a current equivalent using a 'discount rate' to adjust for both time and risk. As a result, inherent risks are not explicitly considered – they are simply bundled into a one-size-fits-all conversion factor.

The discount rates used are typically at least 7% (government), 10% (companies) and 25% or more (private equity). The practical implication of this is that corporate decision-making rarely looks more than a decade into the future, thus ignoring the opportunity and risk created by technological and other changes. Even in government, very little weight is placed on 'longer term' outcomes – ie the implications for today's youth. The human result of this is that decisions typically only take account of the short-term needs of the current population.

As a result, businesses, governments and investors favour quick fixes over long run efficiency. In business, this is illustrated by the failure of incumbents to capitalise on new technologies. In government, countries such as USA, UK and Australia are 60 years behind Japan in adopting high speed rail. Most individuals have been slow reduce costs by adopting renewable energy and changing other habits.

Endemic short-termism frequently means that companies overlook the implications of their actions for customers, suppliers, the community and the environment. Meanwhile, longer run challenges, such as climate change, have been ignored for decades, creating increased risk for almost everyone.

Ironically, short-term thinking comes unstuck surprisingly quickly. Fossil fuel companies that ignored these shifts have seen their share prices savaged. Investors whose portfolios remained biased to the past have been outperformed by those that looked further ahead. Politicians who favoured media spin over policy substance have quickly fallen from grace (including recent examples in USA, UK and Australia).

Conversely, long-term thinking turns out to have a short payback period. As one example, some of the best returns achieved by pension funds over the last two decades have come from investing in long-term infrastructure assets. And politicians who have enunciated a clear long-term visions – and then focussed relentlessly on delivering it – have been rewarded with increased public support.

The effects of short-termism impact almost every aspect of our society – from the physical and social infrastructure that makes our day to day lives cheaper and easier (transport systems, schools, hospitals and public amenities) to the products that we can buy and the way that companies treatus, to the performance of our retirement plans.

Further Reading

- ☐ **The Entrepreneurial State (Mariana Mazzucato)**: Think that America’s technological success over the last fifty years is a result of free market enterprise, low taxes and private capital? The foundations of the American dream are not quite what you might think.
- ☐ **Grow the Pie (Alex Edmans):** There’s no need for a battle between business profits and benefits for society. With the right mindset, purpose and profit can align to benefit all of society.
- ☐ **Wilding – Returning Nature to Our Farm (Isabella Tree):** This isn’t just about business and government. A systems approach and long-term thinking can transform the viability of agriculture too.
- ☐ **The Deficit Myth (Stephanie Kelton):** Do you still hear people telling you that the government needs to balance its books as if it was a corner store? This book turns conventional economic thinking inside out.
- ☐ **Worth It (Dan Price):** How to cut your salary over 90%, create jobs, increase the value of your company, survive the biggest economic crisis in 100 years and emerge with a huge smile on your face.