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Event Recap: Berkeley Sustainable Business & Investment Forum (Part III)

By Kevin Chiu, J.D. Candidate 2018 | December 22, 2015

On November 10 & 11, 2015 the University of California, Berkeley School of Law and Berkeley Haas School of Business jointly hosted the inaugural Berkeley Sustainable Business & Investment Forum at the University Club on campus. Key players from across all industries and academia attended the two-day event to share perspectives and insight on evolving topics of risk management, capital investment, and sustainable business practices with a focus on long term growth and value creation for all stakeholders.

The event was co-sponsored by PepsiCo, Visa, and PriceWaterhouseCoopers (“PWC”). The forum focused on the advancement of risk management, capital allocation, and sustainable business practices, with an emphasis on long-term value-creation

This is part three of a three-part series dedicated to coverage of the event.

“Long & Short Termism”

Caroline Flammer, Assistant Professor at Ivey Business School, James Hawley, Professor at St. Mary’s College, Verity Chegar, VP at BlackRock, Brian Rice, Portfolio Manager at California State Teachers’ Retirement System (“CalSTRS”), Diarmuid O’ Connell, VP for Business Development at Tesla Motors

Long-Term Orientation & Firm Value

Organizations constantly wrestle with their strategic objectives—specifically whether priorities should be placed on short-term or long-term considerations. Professor Flammer presented research suggesting that organizations should focus on “long-term orientation” in order to maximize their value. In a joint research paper with Professor Pratima Bansal of the Ivey Business School, Professor Flammer posits through empirical findings that the adoption of proposals that impact long-term business issues can lead to an increase in firm value and operating performance.

Professor Flammer and Professor Bansal’s paper explores the strategic dynamics that have occurred after the financial crisis, specifically the shift away from emphasizing short term profitability and the realignment of shareholder value as a strategy. The paper examines shareholder proposals advocating the use of long-term executive compensation proposals and applies the analysis of these proposals and their outcomes under a regression discontinuity design (“RDD”), an economic research model designed to observe impacts of variable treatments in a non-experimental setting, i.e. actual businesses in a real-world, non-controlled environment.

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Professor Flammer's findings suggest that the passage of long-term proposals leads to a significant increase in firm value. Moreover, the passage of proposals that orient a company for long-term growth revealed consistent operating performance increases across a number of key financial metrics, specifically return on assets, net profit margin, and sales growth. Interestingly, the research indicated that short term operating performance decreased after the passage of such proposals, suggesting that this type of longer-term orientation make take time to materialize into gains for an organization. Professor Flammer noted that financial context may play an important consideration in the variability of impact from long-term orientation, observing that companies that are financially constrained may not be in a position to execute on long-term orientation strategies.

Implications for Asset Management, Public Investment Funds, and Industry Strategy

Following Professor Flammer's presentation, a panel consisting of representatives of different stakeholders providing commentary and critique of the findings in the paper. For investment management firms such as BlackRock, the relevance of fiduciary duty plays an important role in determining the long-term strategies of the entire portfolio. Given that over two-thirds of their funds are passive long-term investments, the role of long-term orientation merits additional analysis into the specific shareholder proposals as the research only focused on the proposals on long-term executive compensation. Executive compensation should be left to the determination of compensation committees where management can assess the long-term and short-term needs of the organization. As a tradeoff, companies should foster standards of transparency and open communication to defray the need for shareholder proposals on issues of compensation.

Public investment funds such as CalSTRS are primarily long-term oriented and focus on sustainability and viability in order to ensure a stable enterprise that can pay out pension plans for over 900,000 public school teachers in California. A sustainable asset management strategy evaluates both the long-term and short-term considerations of investments, but ultimately turns on the long-term considerations in order to create a pool of sustainable funds for all stakeholders.

For companies such as Tesla, the implications of this research reinforce strategies that stress corporate resilience to myopic shareholder pressures. It was noted that Tesla is in a unique position being an immature company in a mature, capital intensive industry that is defined by a rigid set of reporting and operational practices. Consequently, the company's mission of sustainable transportation is often at odds with industry players who are not only clinging on to the established ways of doing business, but also combating arguably disruptive market forces that Tesla is bringing to the automotive sector. Tesla's repositioning as a sustainable player across different market offerings suggest that the company's long-term orientation tows a delicate balance between ensuring shareholder profitability and the company's long term vision.