Global Investor Survey / April 2016

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Redefining business success in a changing world: Global survey of investor and CEO views

438 *investment professionals interviewed in* ***18*** *countries*

65% *of investment professionals see more threats today*

63% *of investment professionals define business success by more than financial profit*

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Introduction

In this report we share views from over 400 investment professionals[1] on their perspectives on the threats and opportunities facing the companies they follow and where they see areas for improvement in strategy and communication.

This report is a companion to our 19th Annual Global CEO Survey, which included interviews with over 1,400 chief executive officers. Our CEO Survey explores business leaders' views on the challenges and opportunities facing their businesses, the expectations of stakeholders and the evolving purpose of a company. This year we posed many of the same questions to over 400 investment professionals: while CEOs answered our questions in the context of their own businesses, investors and analysts responded in relation to the totality of the companies they invest in or follow. The results discussed here show where the investment community and business leaders agree and where they see things differently.

I'm encouraged to see that CEOs and investment professionals share similar opinions on a number of issues. For example, they both identify the same key markets – particularly the USA and China – as most important for companies' future growth prospects. It's also interesting that both groups see technological advances and demographic shifts as the top two global trends most likely to transform wider stakeholder expectations of business over the next five years.

I'm struck by the differences of opinion our research has revealed. Investment professionals, for example, appear far less concerned about skills shortages and the threat these pose to business growth. CEOs may also be surprised to see how much attention some investment professionals are paying to wider issues related to the environment and society. Investors' and analysts' responses suggest a desire for businesses to operate in more socially responsible ways, rather than putting profit generation above all else.

From my conversations with investment professionals I know they see considerable room for improvement in the way that companies explain the value they create. So I'm not surprised to see this message coming through strongly in this latest research. Investors and analysts use a wide range of metrics when forming opinions on company prospects, and CEOs could do more to focus on this information in the ways that investment professionals highlight.

I am convinced these findings, and the conclusions we draw from them, can enhance companies' engagement with the investment community, help them understand their investment goals and communicate more effectively with them. I want to thank all the business leaders and investment professionals around the world who gave their time to complete our surveys and share their opinions with us. Without their generosity and willingness to speak candidly, our research would be far less robust and our insights unavailable to help move the debate forward.

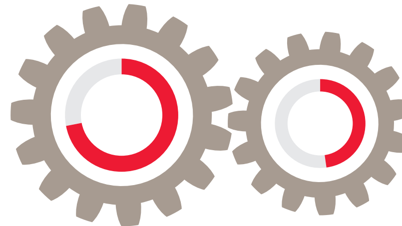
Richard Sexton
Vice Chairman, Global Assurance

1 Our sample includes buy-side investors and analysts, sell-side analysts, and governance experts. Participants included equity and fixed income specialists.

Executive summary

***77%** of CEOs and investors see technological advances as a top-three trend affecting businesses over next 5 years*

***72%** of CEOs see availability of key skills as a threat to business growth compared to **48%** of investment professionals*



% very confident about company revenue growth prospects over next 12 months

CEOs **35%**

Investors **13%**

What impact do providers of capital have on strategy?

CEOs

41%

% answering high or very high

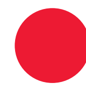
What impact should they have?

Investment professionals

62%

Barriers to responding to stakeholder expectations:

Conflict between stakeholder interests and financial performance expectations



33% CEOs

54% Investment professionals

Misaligned performance incentives

17% CEOs

49% Investment professionals

Our surveys of CEOs and investment professionals have explored attitudes towards growth prospects, threats and opportunities, stakeholder expectations and the purpose of a company. The results, highlighted in this report, offer insights to help strengthen engagement between companies and their investors.

We've found many areas of agreement. For example, both CEOs and investment professionals are under no illusions about the challenges that businesses face when it comes to technology. Both know that tomorrow's innovation could spell the beginning of the end for today's global giant. CEOs and investment professionals also share major concerns about the threat posed by geopolitical uncertainty.

But we've also found that CEOs and investment professionals don't always see the world the same way. These differences of viewpoint spotlight the areas where CEOs might want to look again at their strategic priorities and how they communicate these to investors and analysts. For example, investment professionals appear more pessimistic than CEOs about global economic growth prospects and company revenue growth potential. If CEOs' greater optimism is justified, why aren't they getting the message across more clearly?

There may be some bigger surprises, particularly over the strength of the investment community's interest in drivers of long-term business performance beyond those covered in traditional financial statements. Issues of trust, company purpose and values are on some investment professionals' radar. For some investment professionals, metrics related to environmental impacts now appear fundamental to their assessment of a company's future value-creation potential, as well as their assessment of risks. Investment professionals want CEOs to 'walk the walk', not just 'talk the talk', when it comes to running long-term sustainable businesses. Although CEOs may see a case for a long-term focus, it seems that many also see barriers to its implementation. For example, many CEOs seem to think that markets will punish companies if they incur additional short-term costs by adopting new practices that take account of wider stakeholder interests, even if they believe they could enhance future performance. Based on our research, we encourage CEOs to think again – they may find a more receptive audience than they think.

So what's going wrong? Why do CEOs and investment professionals sometimes fail to see eye to eye? There could be a number of reasons but one, which we think is really important, relates to the quality of company communications and the extent to which they enable investor and analyst understanding of the business and the challenges and opportunities it faces.

Differences in CEOs' and investment professionals' opinions could be attributed to three causes:

- **A reporting gap –** companies may not be telling investors everything they need to know – in the way they need to know it – in order to form accurate opinions.
- **An understanding gap –** investment professionals have the same facts as CEOs, but draw different conclusions.
- **A perception gap –** investment professionals have the facts, but do not place the same importance on them.

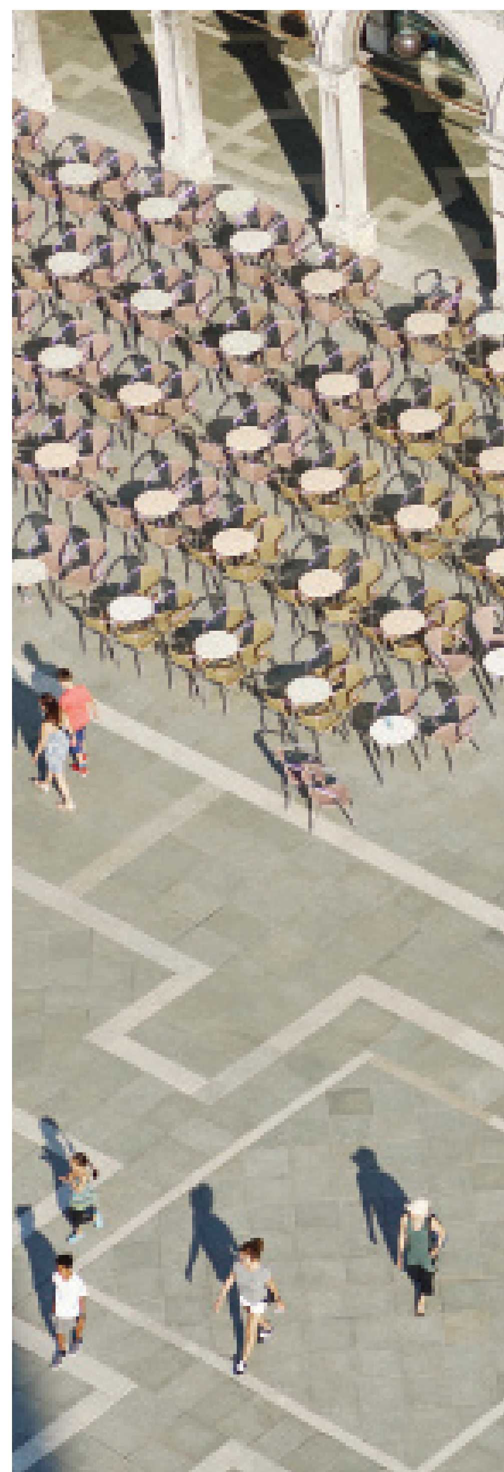
As our previous investor research suggests, investment professionals tend to be naturally sceptical of management 'spin'. This natural scepticism may dampen their expectations for the future. However, our findings suggest that companies could do a better job of explaining why their prospects are good and why their strategy makes sense. It's also important that companies explain how they are addressing current risks and challenges. If corporate communication contains only good news, investment professionals may approach it with caution. But CEOs might have sound reasons for their confidence that are not being communicated clearly to their investors. If they can find a way to do this more effectively, and if their strategies are justified, they may be able to align investors' expectations more closely with their own.

CEOs need to take up the challenge by looking hard at what their companies say and how they say it. Corporate reporting has come a long way in recent years, but there's still plenty of opportunity to make it better.

It's also important for CEOs to talk to stakeholders about what they expect from the companies they run. One message coming through is that many investment professionals see the purpose of a company as extending beyond generating shareholder value. It's also about creating value for customers and society. So companies should consider measuring and communicating the impact they have and the value they create in terms of both hard and soft drivers of success. Investment professionals also want more measurement of innovation and more communication of business strategy. And that business strategy is increasingly expected to take account of social, environmental and economic impacts. In fact, both CEOs and investment professionals think the definition of business success is changing, no longer being limited to solely financial profit.

So while CEOs may need to focus on enhancing their company reporting, investment professionals may need to be more vocal in asking for the information they require, in the form they value. If they want data on a broader range of value drivers and if they want this data clearly linked to business strategies and risks, they need to make this clear. If they value particular key performance indicators, they must say so. If they want CEOs to give a long-term perspective in their annual reports, then they must call for it through ongoing engagement.

Building effective communication is a two-sided activity. Investment professionals have a vital role to play in questioning and challenging the information they are given. CEOs need to take up the challenge by looking hard at what their companies say and how they say it. Corporate reporting has come a long way in recent years, but there's still plenty of opportunity to make it better. It's probably unrealistic to expect CEOs, investors and analysts always to share the same priorities or interpret information in the same way, but meaningful engagement could help to increase mutual understanding.



Growth expectations

Building successful businesses – and choosing which businesses to invest in – continue to be challenging activities for today's CEOs and investment professionals. The fragility of major growth-driving economies such as China, plunging commodity prices, ongoing questions about bank resilience and the stability of political structures (such as the Eurozone) are all unsettling factors that seem to be affecting investment professionals' and CEOs' expectations of the future.

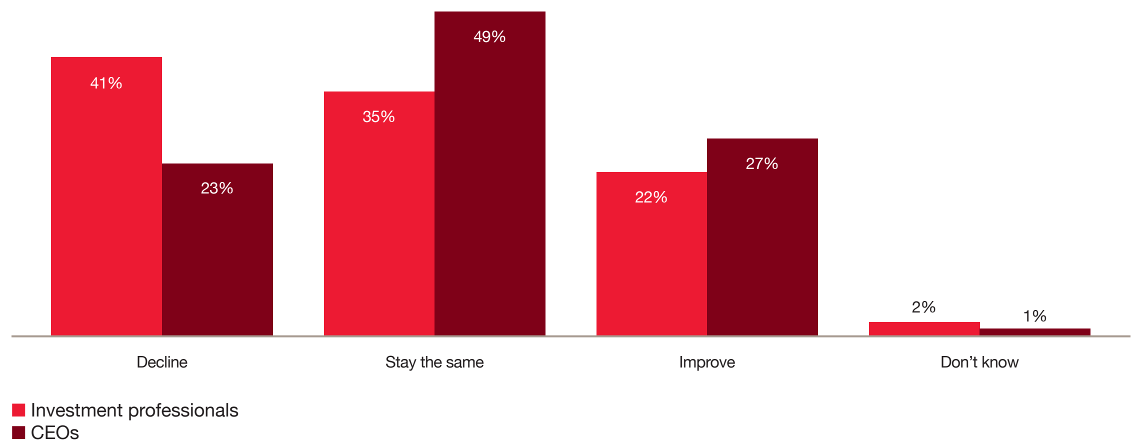
Investment professionals appear to be more pessimistic than CEOs, being almost twice as likely to believe that global economic growth will decline over the next 12 months (figure 1).

41%

of investment professionals surveyed believe that global economic growth will decline over the next 12 months

Figure 1

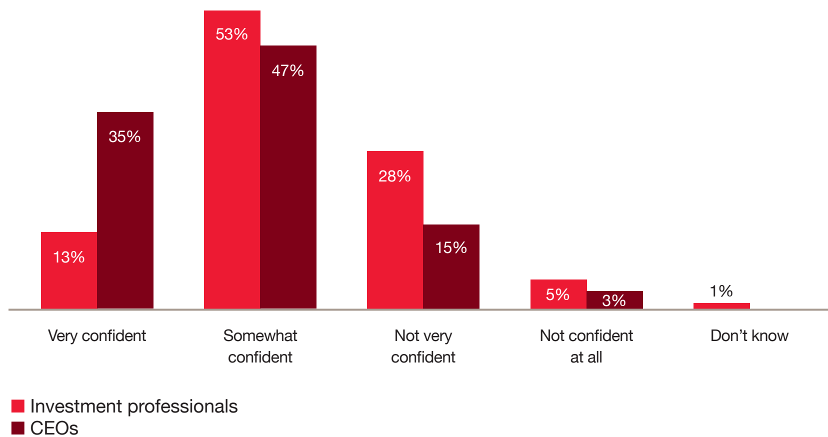
Q: Do you believe global economic growth will improve, stay the same, or decline over the next 12 months?



Investment professionals
CEOs

Figure 2

Q: How confident are you about the prospects for company revenue growth over the next 12 months?

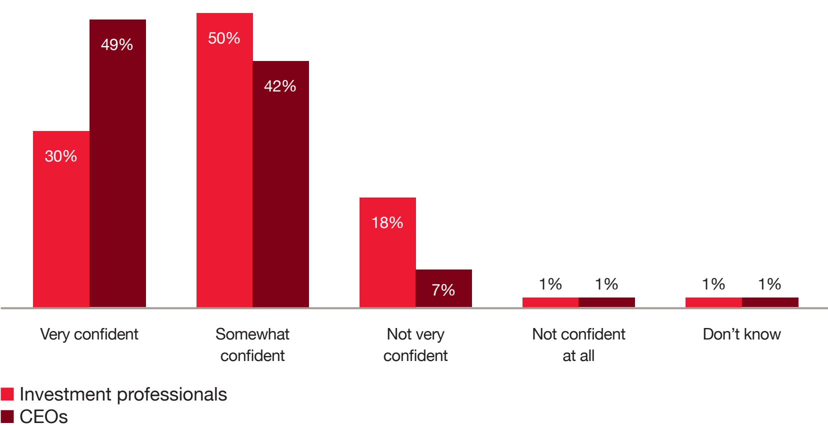


Turning the spotlight on prospects for companies' revenue growth, we asked investment professionals (in the context of the companies they invest in or follow) and CEOs (in the context of their own companies) for their views looking ahead both 12 months and three years. CEOs are far more likely than investment professionals to be 'very confident' about revenue growth prospects over both these short- and medium-term periods, but particularly over the next 12 months figure 2, (although CEOs are slightly less confident about short-term business growth than they were last year).

The fact that investment professionals and CEOs both appear more likely to be 'very confident' about revenue prospects over the three-year horizon (figure 3) suggests that, while times are a bit volatile today, they expect them to become more stable. In addition, some buy-side respondents (such as portfolio managers and their analysts) told us that, by choosing to invest in the companies they've invested in, they would expect to feel reasonably optimistic about their prospects for the future.

Figure 3

Q: How confident are you about the prospects for company revenue growth over the next 3 years?



We think about growth in the next three years by focusing on the USA, Germany, and China. [These are] not necessarily the fastest-growing, but the most stable. The emerging markets as a group will continue to be the places where you should expect to see faster growth in the long run. They have the greatest potential for growth to bring incomes up and to develop as far as infrastructure goes.

USA buy-side analyst

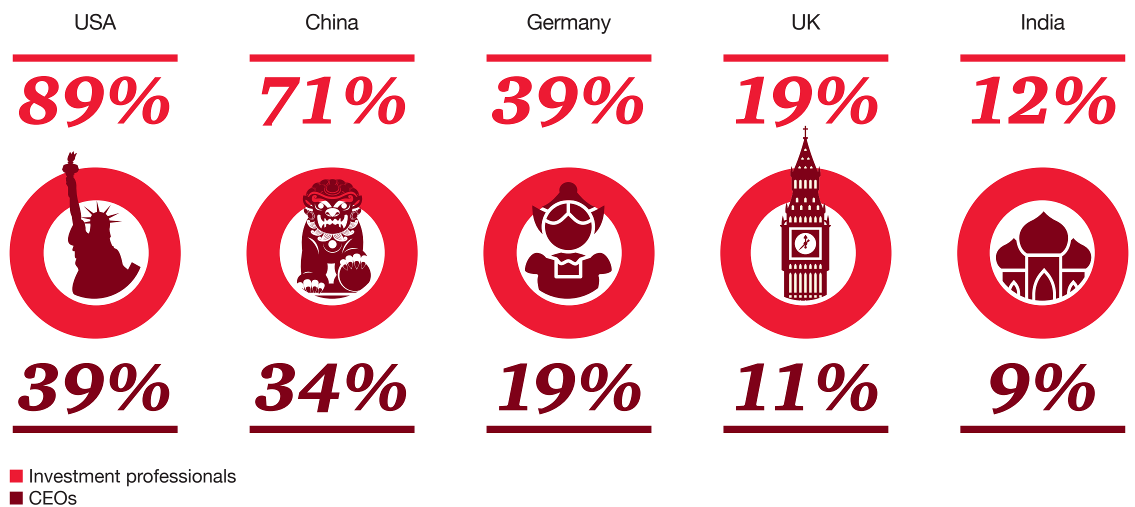
China is the 10,000 pound gorilla. They're shifting from being an investment-led economy (go build bridges, cities), to being a consumer-driven economy. Fighting corruption and increasing wages are going to be great for the long term for China. China scares people now but there's unprecedented government intervention. China is going to be a powerhouse.

USA investment strategist

Figure 4

Q: Which three countries do you think are most important to the overall growth prospects of companies over the next 12 months?

% of respondents naming this country in their top 3



	USA	China	Germany	UK	India
Investment professionals	89%	71%	39%	19%	12%
CEOs	39%	34%	19%	11%	9%

■ Investment professionals
■ CEOs

Are companies developing a comprehensive shareholder engagement strategy, through which they communicate more effectively with investors and analysts, discussing how well their business model is positioned to take advantage of opportunities to drive future growth?

Key markets

We asked investment professionals to name the three countries they consider most important to the overall growth prospects of the companies they invest in or follow (figure 4). Our CEO Survey asked CEOs to name the three countries, excluding the country in which the CEO is based, that they consider most important for their organisation's overall growth prospects over the next 12 months.

The USA and China emerge as the dominant economies for investment professionals. Germany (in some cases used as a proxy for Western Europe or the Eurozone) and the UK, followed by India, complete the top five rankings. Investment professionals tend to have large portfolios and cover businesses in many geographies, so it's understandable that they have selected the major economies – those that are the biggest drivers of growth globally. Our CEO Survey ranked the same countries in the same order, but with far less emphasis on the USA and China.

Threats and opportunities

Investment professionals and CEOs agree that there are more threats to a company's growth than three years ago (figure 5). But when asked about the extent of growth opportunities today (figure 6), investment professionals are much less positive than CEOs. Just over a third of investment professionals surveyed agree or strongly agree that there are more growth opportunities for the companies they invest in or follow than there were three years ago, whereas 60% of CEOs see more such opportunities for their own companies. While it is possible that investment professionals and CEOs simply see different risks and opportunities, this striking result suggests that there is an opportunity for some companies to enhance their communication of forward-looking information, clearly setting out the growth opportunities and explaining how those opportunities will be seized.

Figure 5

Q: There are more threats to the growth of companies today than there were 3 years ago

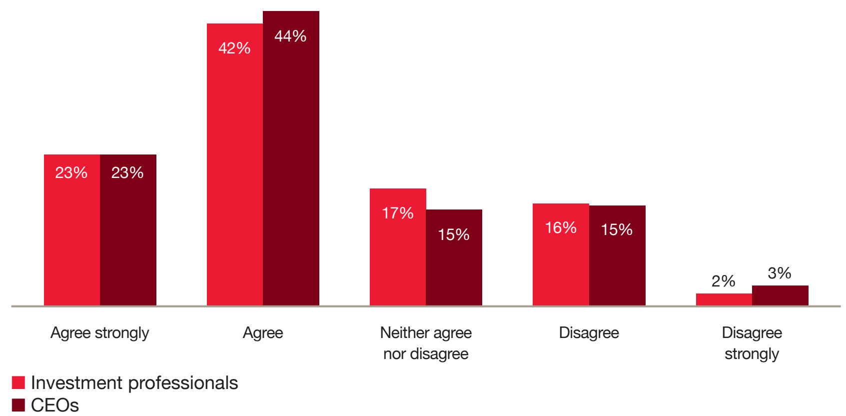
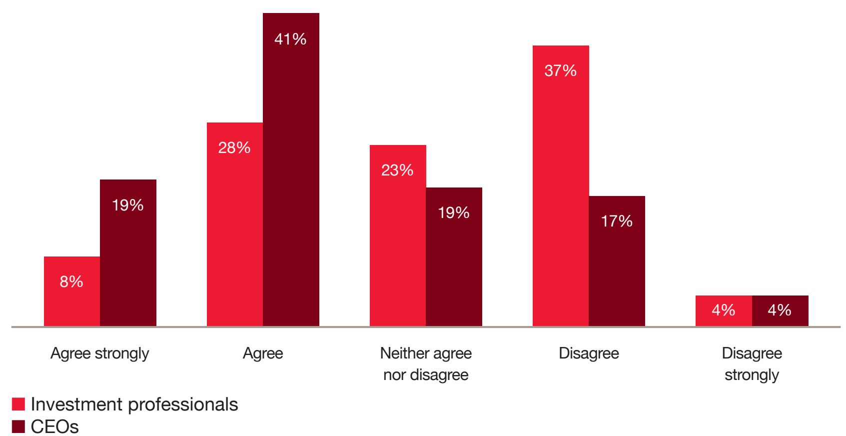


Figure 6

Q: There are more growth opportunities for companies today than there were 3 years ago



I think competition is much more intense than it was three years ago. Companies need to take growth opportunities where they can, while protecting market share.

UK buy-side head of equities

Three years ago, we had fewer bigger threats to consider. Today we have a broader variety of threats to consider.

USA buy-side senior investment officer

I see a lot of threats, but that isn't always a bad thing. Threats create the need to be innovative.

UK buy-side head of equities

Coping with uncertainty

I am very concerned about geopolitical uncertainty. It adds a layer of volatility; there is no way to plan for it or analyse it and you cannot insulate your portfolios from something you can't analyse.

USA equity investor

There are not as many tools available now for governments to respond to a crisis. With the low interest rates globally, it is more of a risk if companies are not able to respond quickly and effectively.

Italian sell-side analyst

For investment professionals, geopolitical uncertainty is the biggest economic, policy, social or environmental threat that they perceive to companies' growth prospects (figure 7), and it ranks second for CEOs (behind over-regulation). Buy-side investment professionals are particularly concerned about geopolitical uncertainty.

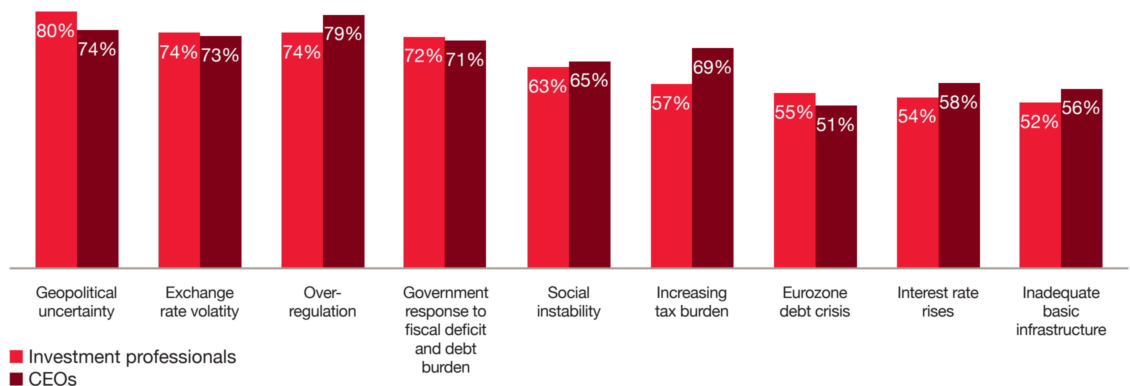
84%

of buy-side investment professionals are particularly concerned about geopolitical uncertainty

Figure 7

Q: How concerned are you about potential economic, policy, social and environmental threats to company growth prospects?

% answering either somewhat concerned or extremely concerned



However, sell-side respondents are more concerned about interest rate rises than buy-side respondents or CEOs.

Shifting global economic power is also a top-three trend that investment professionals and CEOs both believe is most likely to transform wider stakeholder expectations of business over the next five years (figure 9). Some investment professionals volunteered additional trends, with three key geopolitical (and global economic) themes emerging:

- the impact of interest rates or government policy, with references made to the low interest environment and resulting search for yield, as well as the impact of central bank monetary or government fiscal policy;
- the global debt burden and its implications for both governments and consumers; and
- changes in the geopolitical landscape, including an increase in social unrest.

Concerns about uncertainty are also evident in the fact that exchange rate volatility is investment professionals' second-ranked economic, policy, social or environmental threat – and this is also a top-three concern for CEOs (figure 7). The issue is seen as a particular threat by equity investment professionals surveyed.

67%

of CEOs say a stable tax system is more important than low rates of tax

71%

of CEOs agree that their business's approach to tax and tax transparency affects its reputation

Need for certainty on tax

We know from our ongoing conversations with investment professionals that they tend to be more interested in the long-term stability and sustainability of the tax rate incurred by companies, rather than in reducing that tax rate at all costs. This is aligned to the 67% of CEOs who say a stable tax system is more important than low rates of tax.

Overall, however, CEOs are more concerned than investment professionals about the threat of an increasing tax burden (figure 7). There has been increasing publicity about the amount of tax that companies pay. This presents a challenge for CEOs, who need to balance public, NGO and increasingly government calls to pay their fair share of tax, while perhaps assuming that investment professionals want taxes paid to be as low as possible. CEOs appear aware of the reputational risks associated with their tax policies and payments. The vast majority of CEOs say tax is a business cost that needs to be managed efficiently and around half of company boards are actively involved in determining the business's tax strategy. International initiatives, such as the project to tackle base erosion and profit shifting, are also serving to keep the threat of rising tax costs front-of-mind for CEOs.

The total tax contribution made by companies is substantial, but investment professionals may associate tax costs purely with corporation tax, viewing other taxes as part of operational expenses.

Differing CEO and investment professional opinions on the severity of the tax threat may indicate that CEOs are looking at the issue from a more comprehensive viewpoint. Rather than just focusing on corporation tax, CEOs may also be taking account of sales, employment and other forms of business-related taxes, many of which have been on an upward curve. The total tax contribution made by companies is substantial, but investment professionals may associate tax costs purely with corporation tax, viewing other taxes (such as employment and property-related taxes) as part of operational expenses.

In some parts of the world, concerns about the tax burden between investment professionals and CEOs vary drastically. For example, CEOs in North America and Asia-Pacific are more likely to be concerned about this threat than investment professionals in those regions. Investor and CEO respondents in Africa, Latin America and Europe are more closely aligned.

Are companies explaining their total tax contribution clearly so that investment professionals have a better understanding of the real tax impact on the business?

The technology and talent challenge

The pace of technological change and the disruption it has created are great opportunities for some players, but have had devastating consequences for others.

USA equity investor

Technological change is a split story in terms of risk. There will be winners and there will be losers. The real issue for companies is how they respond and keep pace with the changes that are happening.

UK equity portfolio manager

Figure 8

Q: How concerned are you about potential business threats to company growth prospects?

% answering either somewhat concerned or extremely concerned

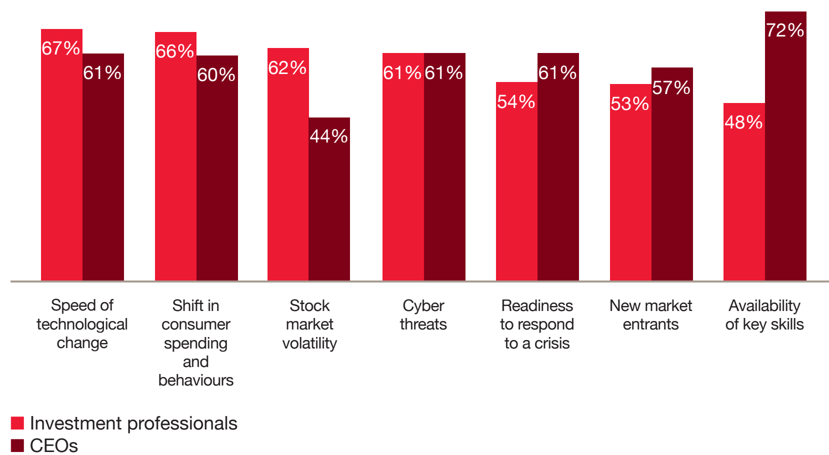
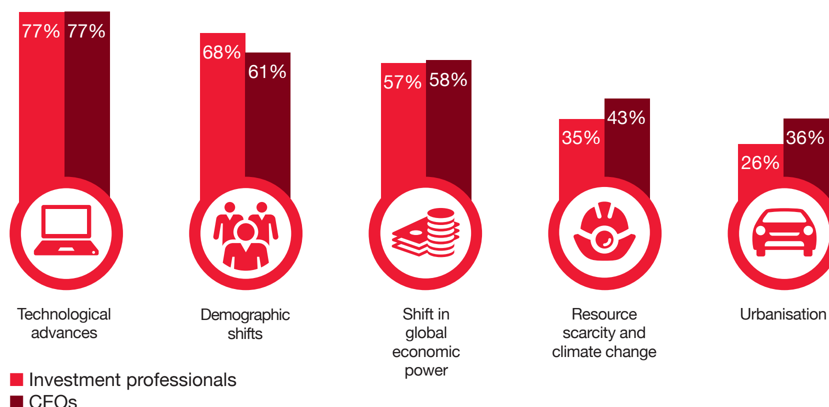


Figure 9

Q: Please rank the top three global trends which you believe will be most likely to transform wider stakeholder expectations of businesses within your sector over the next five years



The technology and talent challenge

The speed of technological change is seen as a major business threat to company growth prospects by both investment professionals and CEOs (figure 8). Investment professionals are aware that rapidly changing technology creates opportunities for fast-moving businesses, but also increases the risk that some companies' products or services will become redundant. Investment professionals and CEOs also see technological advances as playing a major role in transforming wider stakeholder expectations of businesses over the next five years, ahead of demographic shifts.

Mobile connectivity and social media have become fundamental ways to get information and buy goods and services.[i] As highlighted in our CEO Survey, the 'Uberisation' of a growing number of sectors – enabling easy access to goods and services through mobile apps – is also changing customer perceptions of value. These technologies also give more people greater access to more information about companies, what they do and the impact they have.

Technology is critical, because advances can diminish the impact of all those other factors.

UK buy-side head of equities

I think of cyber risk in two ways. The worst-case scenario is where you have a big company breach or hack that hits a particular firm, and companies are getting hit all day every day. But then it is also an opportunity for people in the cybersecurity business to provide resiliency tools. From a growth standpoint, protecting against this type of incursion is causing companies to devote a lot of resources.

USA equity investor

The impact that technology can have is also reflected in both groups' relatively high levels of concern about cyber threats to business (figure 8). This concern is particularly high among buy-side investment professionals. Given that cyber breaches can have broad business implications, cyber security is no longer seen as the problem solely of Chief Information Officers and their teams. For many companies, it has become a key risk that is overseen by the board of directors or audit committee. Awareness of the cyber threat is also high among the investment community, not least because of the regularity with which cyber attacks and breaches are now reported by the global media. Investment professionals are highly concerned about cyber threats and are increasingly asking companies about the risk management processes they have put in place to counter cyber attacks and minimise downside risks of a breach.

The talent priority

Technology may be increasingly important for sustainable business performance, but it cannot exist in a vacuum. It takes talent to develop that technology and maximise its positive impact. Given the range of challenges, risks and opportunities that companies face, finding and accessing the right talent is essential for most organisations.

CEOs and investment professionals agree that a skilled, educated and adaptable workforce should be the top priority for business (figure 10). CEOs place greater emphasis than investment professionals on developing workforce skills but, nevertheless, access to talent clearly is an issue of high interest to the investment community.

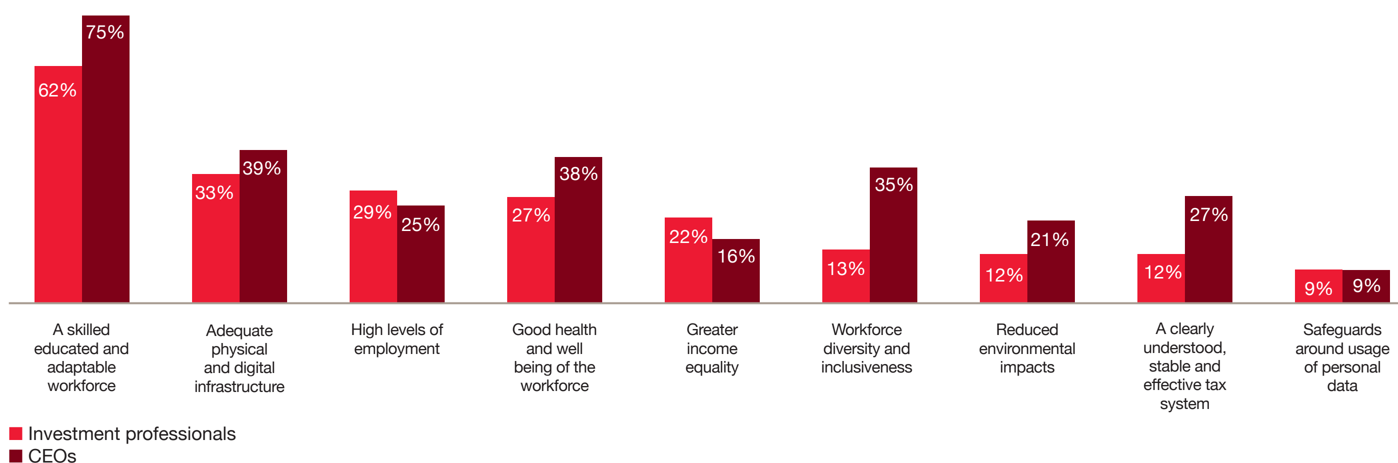
CEOs' greater emphasis on developing workforce skills reflects the fact that they are much more likely to be worried about availability of key skills as a threat to business growth than investment professionals. This direction of focus is consistent across geographies. CEOs are also significantly more likely than investment professionals to see a lack of the right capabilities as a barrier to change when responding to wider stakeholder expectations, although the percentages for both groups are relatively small.

Demographic changes over the next 20 years are really critical, coupled with technology. The long-run drivers of growth are the number of people working and how productive they can be.

Swiss fund manager

Figure 10

Q: Which three of the following outcomes do you think should be priorities for business to help deliver?



31%

of CEOs see a lack of the right capabilities as a barrier to change when responding to wider stakeholder expectations

Investment professionals may have less visibility over the internal skills threat than CEOs. As a result, investment professionals may think companies have this issue more under control than they actually do. Companies may want to disclose the risks they face around the availability of skills more comprehensively including the scale of the corporate challenge in developing and maintaining an adequate talent pipeline. Some companies may be highlighting the issue, perhaps in relation to their activity in sponsoring university courses or training programmes.

Do companies have adequate insight into how technology is changing their sector – and how it could transform it in future?

Are companies managing investor expectations appropriately in the way they communicate their talent management activities?

Are companies communicating their technology strategy appropriately?

Addressing greater expectations

Company purpose

How do investment professionals describe the purpose of a company?

The purpose of a company is to produce products that the market demands, in a socially and environmentally acceptable fashion, while generating returns for its stakeholders including owners and employees.

USA ratings analyst

A company exists to generate cash flow for its owners. This simple objective is the most appropriate one for society because to do so requires generating value for customers, employees, the community and other stakeholders.

Danish private equity investor

The purpose of a company is to create wealth for investors in a sustainable way.

UK fund manager

Figure 11

Q: The purpose of a company is to create value for...

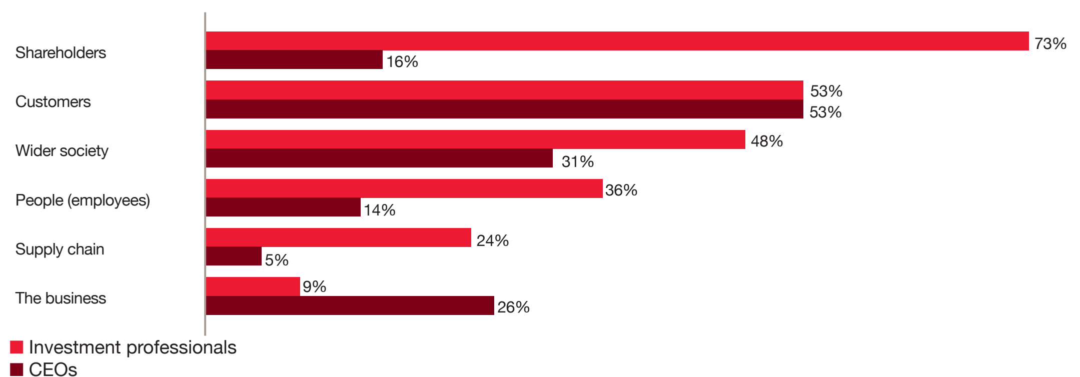
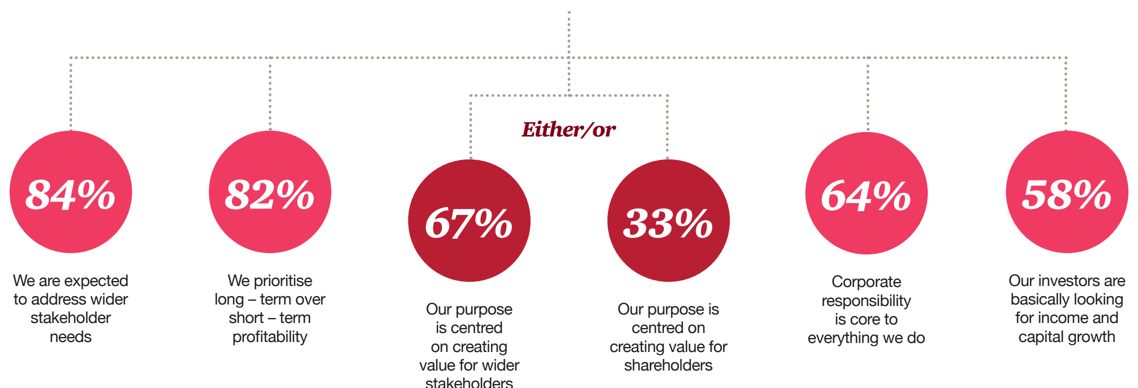


Figure 12

% of CEOs who agreed with the following statements



Investment professionals say the purpose of a company is...

to make money.

to create shareholder value.

to provide profits for investors and jobs for employees.

to make a reasonable return for shareholders and to survive business cycles.

to fill a gap in customers' needs/to deliver a product or service to a customer.

19th Annual Global CEO Survey / January 2016

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Redefining business success in a changing world
CEO Survey

1,409 *CEOs interviewed in 83 countries*

66% *of CEOs see more threats today*

76% *of CEOs define business success by more than financial profit*

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What the CEOs said...

Purpose is something you carry in your heart, not something an ad agency makes up. So we pulled the company's purpose out of our people's hearts and manifested it in seven words: Real food that matters for life's moments. We validated those words with consumers and our employees. Consumers told us stories about how our brands really matter to them. That's led to an umbrella over all of our brands, that purpose can encompass and motivate our people around why what we do every day matters.

Denise Morrison
President and Chief Executive Officer, Campbell Soup Company, USA

... our purpose is to be an effective, responsible champion of low-carbon electricity.

Jean-Bernard Lévy
CEO and Chairman, EDF, France

You know, very recently we reviewed the company's purpose, and we made a slight change. It used to be 'Building the Future'. Now it's 'Building a Better Future'. CEMEX is a company that embraced sustainability a long time ago – and we believe that sustainability is creating a new economy, a different type of economy, reshaping certain economic activities. And we're saying that the first companies to understand and embrace this will be the companies that will be on top of the trend and doing better business than others.

Fernando Gonzalez Olivieri
CEO, CEMEX, Mexico

Is the prime purpose of a company to make money for its shareholders? Or is it to achieve more complex outcomes that take account of the needs and expectations of a wider group of stakeholders? Is it, in a sense, to make money while doing the right thing? Based on our surveys of CEOs and investment professionals, this latter view is becoming the dominant belief.

We asked investment professionals and CEOs to describe company purpose in their own words. We then analysed those responses (figure 11) to see whether respondents focused on meeting the needs of shareholders or whether they referred to one or more other stakeholder groups. Not surprisingly, when investment professionals define purpose, the majority see it in terms of creating value for shareholders. But many also see a wider purpose of a company. Profit is important, but not necessarily sufficient. Explicit links are made between the potential to generate value for companies' owners, while also creating value for customers, employees, the community and other stakeholders. In this context, their views are aligned with those of CEOs, a large majority of whom agree with the proposed statement that they are expected to address wider stakeholder needs. Investment professionals also often talk about company purpose with a long-term perspective, highlighting the importance of companies finding a way to demonstrate both short-term profitability and their ability to create long-term, sustainable value.

When CEOs talk about company purpose, the words they use also reveal a holistic perspective. While they are most likely to highlight creating value for customers, creating value for wider society comes second in terms of frequency, just ahead of creating value for the business. When explaining their company's purpose, CEOs often refer to people, society, stakeholders and sustainable activity. Some might suspect CEOs of recognising the public relations value in expressing corporate purpose from a broader perspective that frames advantages for the wider community. When asked whether or not they agree with various statements (figure 12), CEOs are twice as likely to see their purpose as centred on creating value for wider stakeholders (even if their focus may be customers) than to see it as centred on creating value for shareholders. Our analysis of CEOs' own definitions of company purpose also shows that they are twice as likely to refer to creating value for wider society as they are to talk about creating value for shareholders.

A company is there to provide a good or service to its customers while providing a financial return for its stakeholders.

UK buy-side head of global equities

I would like to think [the purpose] is to give something to people but unfortunately companies only care about money.

Fixed income analyst

It is possible that some respondents in both groups may be mixing up 'ways' and 'means'. For example, they may emphasise the need to create value for customers because a consequence of doing so is that the company generates value for shareholders. But, in effect, the goal of generating value remains the core purpose of the company.

Even if this is the case, the implications for CEOs are the same: future business success depends on creating long-term, sustainable value for shareholders while also satisfying the expectations of wider stakeholders.

Stakeholder impact on strategy

When it comes to responding to stakeholders, it's clear that customers and clients are CEOs' top priority: 90% of survey respondents indicate they have a high or very high impact on their business strategy (figure 13). This reflects CEOs' widely held view that the purpose of the company is to create value for customers. Government and regulators, as well as industry competitors, are also seen by CEOs as influencing business strategy.

In our survey of investment professionals we posed a slightly different question, asking what impact respondents thought a range of stakeholder groups *should* have on companies' strategies. Comparing the responses from both surveys provides insights into the similarities and differences between CEOs' 'real world' experiences and investment professionals' 'ideal world' scenarios.

Starting with the similarities, a large majority of investment professionals think customers and clients should have an impact on business strategy, just as CEOs say they do. Investment professionals and CEOs are also closely aligned in terms of the impact industry competitors and peers should and do have respectively, and seem to have similar views on the impact of local communities.

Customers and clients need to be critical to a company's strategy; they are the reason a company is in business in the first place.

German buy-side head of fixed income research

Good companies tend to have a strong and positive local community presence, but that shouldn't impede global strategies, like where to deploy capex or make an acquisition.

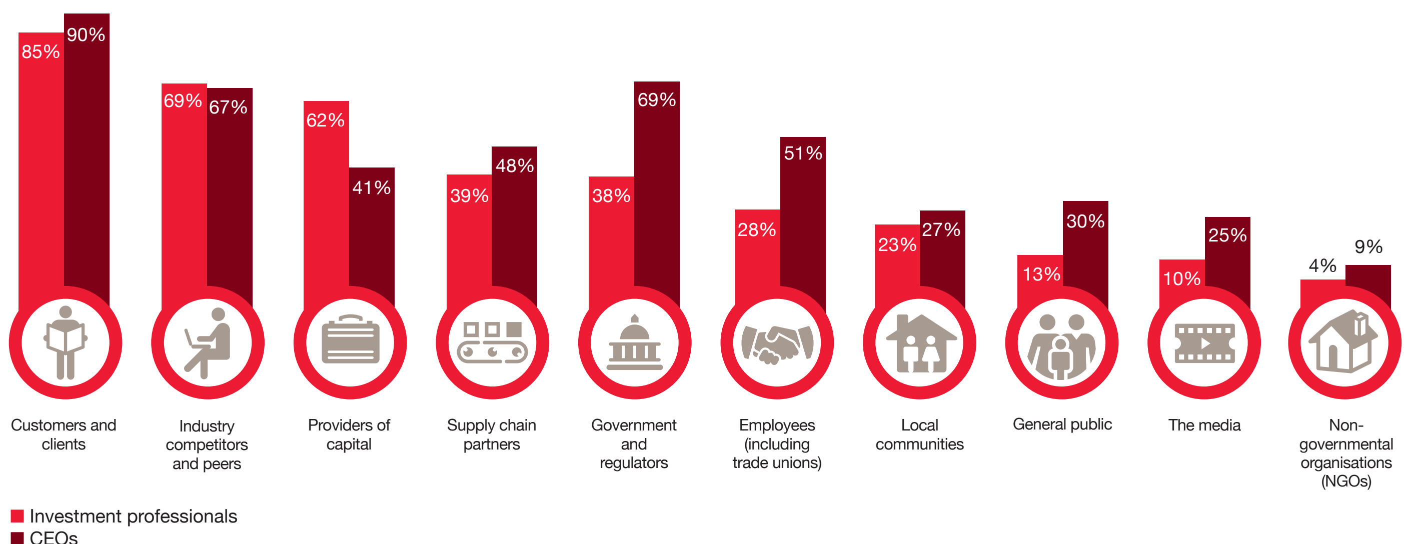
UK sell-side analyst

In general, however, investment professionals think many stakeholder groups should have less impact on strategy than CEOs say they do have in practice.

The major exception – where investment professionals clearly think that stakeholders should have more impact than CEOs say they actually do have – arises in relation to providers of capital, where there is a 'reality/ expectation' gap of 21 percentage points. Investment professionals clearly believe that providers of capital should have a say in how their investee companies spend the money they have invested. This accords with the agency theory of management, and the status quo in which investors have rights (such as voting rights) to protect their interests. As Berkshire Hathaway Chairman Warren Buffett wrote in his February 2016 letter to shareholders, "Some CEOs forget that it is shareholders for whom they should be

Figure 13

Q: What impact do (for CEOs) or should (for investment professionals) these stakeholders have on a company's strategy?



The above chart shows the number of CEO respondents who said each group *has* a high or very high impact on their company's strategy compared to the number of investment professional who said each group *should have* a high or very high impact on the strategy of the companies they invest in or follow.

working…”[ii] Similarly, Dominic Barton, McKinsey & Company’s Global Managing Director, and Mark Wiseman, President and CEO of the Canada Pension Plan Investment Board, welcome the fact that “a small but growing number of leading asset owners and asset managers have begun to act much more like private owners and managers who just happen to be operating in a public market. To create value, they engage with a company’s executives – and stay engaged over time.”[iii]

The finding may also be evidence of ineffective engagement by companies with their investors: companies may not be seeking out the views of investors as actively as those investors would like, or investors may feel that companies are not acting on the views they express in the way that they would like.

The biggest area of difference between CEOs and investment professionals relates to the impact of governments and regulators. The percentage of CEOs saying that government and regulators affect business strategy is far larger than the percentage of investment professionals who think they should. Investment professionals are concerned about over-regulation, albeit they are slightly less concerned than CEOs. It seems that investment professionals would like government and regulators to have less impact on business strategy than they do. There are some geographical variations, however. Investment professionals in Africa and the Asia-Pacific region are more likely to think governments and regulators should have an impact on company strategy than do investment professionals in Europe and North America. Similarly, fixed income respondents are more concerned than equity investors about government and regulators, and sell-side respondents are more concerned than those on the buy side.

Capital providers should have a very high impact on strategy, in particular equity providers. Voting rights are very important.

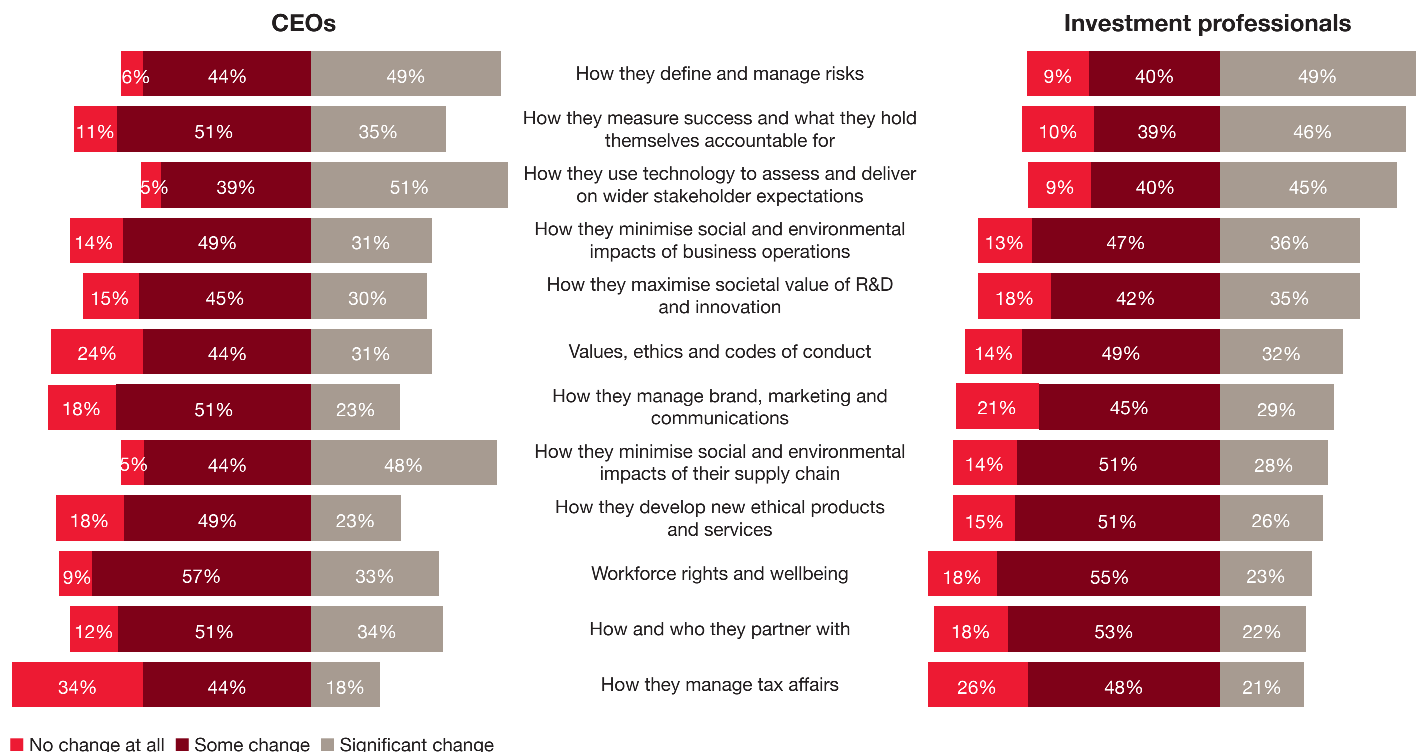
Hong Kong equity investor

74%

of investment professionals see over-regulation as a business threat to growth prospects

Figure 14

Q: To what extent are you (for CEOs) making changes or do you think that companies should be making changes (for investment professionals) in the following areas in response to changing stakeholder expectations?



NB: The charts do not add up to 100% as the remaining respondents answered ‘don’t know’.

Addressing greater expectations

I think stakeholder groups are inconsistent, which makes it hard for companies to find the right balance. The important thing is for management and boards to have a profound vision of where they are going and to communicate that well.

Netherlands governance professional

I think older companies underestimate the value of social media and disruptive technology.

German buy-side head of research

I wouldn't expect companies to focus their R&D efforts on what is best for society. They need to focus on what is best for their business.

UK buy-side equity analyst

Companies can reduce environmental impacts, but for meaningful change to occur, government has to be involved.

USA head of governance

In our CEO Survey we asked participants about the extent to which they were making changes in some areas in response to changing stakeholder expectations. We also asked investment professionals about the extent to which they thought the companies they invested in *should* be making such changes (figure 14). The results give us insights into whether companies are making the changes that investment professionals would like them to be making. We found a close alignment in relation to the way that companies define and manage risks – around half of investment professionals think that companies should be making significant change in this area, and the same proportion of CEOs say they *are* making significant change. There is also close alignment between investment professionals' and CEOs' views in a number of other areas, such as the way companies use technology to assess and deliver on wider stakeholder expectations. This finding is consistent with the fact that, as identified earlier, investment professionals and CEOs both see technological advances as a dominant global trend transforming stakeholder expectations of businesses.

Some interesting differences also come through. Nearly half of investment professionals want significant change in the way that companies measure success and what they hold themselves accountable for, but only about one-third of CEOs think they are making significant change in this area. This theme is considered further in the later section on 'Measuring and communicating success'.

About half of companies say they are making some change to the way they manage brand, marketing and communications, whereas only around a quarter of investment professionals think that companies should be doing so. CEOs' focus on this area reflects the challenge companies now face in controlling the way they are perceived externally. In the past, public perceptions could be shaped by the information companies chose to release. Now, masses of data, analysis and opinion circulate rapidly through social media sites, requiring companies to work harder on their brand and communications activity in order to make sure their point of view is heard and customers and wider stakeholders don't just rely on what they read in the press.

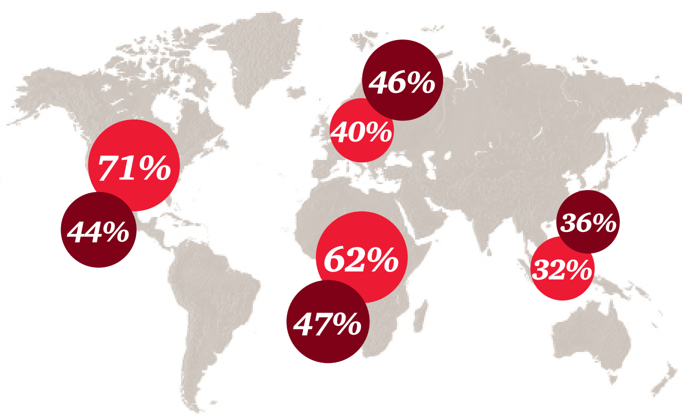
Another reason for CEOs' heightened focus may be that, in some sectors, brand has become closely associated with reputation – in fact, CEOs may perceive them as essentially one and the same. Brand and marketing activity is therefore seen as a vital aspect of reputational risk management.

It is striking, however, that investment professionals prioritise three areas above brand, marketing and communications when identifying the need for some change. These are:

- how companies minimise social and environmental impacts of business operations;
- how they maximise societal value of R&D and innovation; and
- their values, ethics and codes of conduct.

However, in terms of the significant change companies actually are making, CEOs rank them much lower. This is further evidence of the investment community's growing interest in responsible businesses – in companies that are well run in a broader sense, as defined by outcomes that extend beyond pure financial terms. This isn't necessarily for philanthropic reasons, but reflects the growing acceptance among regulators as well as investment professionals that long-term value creation depends on sustainable business practices. For example, the US Department of Labor has acknowledged that "environmental, social and governance factors may have a direct relationship to the economic and financial value of an investment".[iv] Similarly, the UK Law Commission's guidance on pension trustees' duties when setting an investment strategy states that trustees are required to balance returns against risk, including risks to the long-term sustainability of a company's performance. It states: "These [risks] may arise from a wide range of factors, including poor governance or environmental degradation, or the risks to a company's reputation arising from the way it treats its customers, suppliers or employees."[v]

Further food for thought on this theme comes from the differing views that investment professionals and CEOs have of the barriers companies encounter when responding to wider stakeholder expectations (figure 15). The barrier



African and North American investment professionals are most worried about unclear or inconsistent standards or regulations

- 71% and 62% respectively, compared to 32% of respondents in Asia-Pacific and 40% in Europe.
- CEOs respectively: 44%, 47%, 36%, 46%.

perceived by the largest proportion of investment professionals is the conflict between stakeholder interests and financial performance expectations. CEOs are far less likely to see this as a barrier. One interpretation is that investment professionals think companies assume they are only interested in profit, when in fact they do have wider considerations. Investment professionals perhaps think that companies hold back from making some changes for the benefit of wider stakeholders due to concerns about the impact on financial performance – the changes would cost too much. This is a problem identified in 2011 by McKinsey's Dominic Barton, who observed that "although a large majority of executives believe that social initiatives create value in the long term, they don't act on this belief, out of fear that financial markets might frown".[vi]

Investment professionals may also be responding to the current debate on short-termism and the growing opinion that quarterly reporting and the need to meet targets affects investment decisions for the longer term. As highlighted in the Harvard Business Review, "If the vast majority of most firms' value depends on results more than three years from now, but management is preoccupied with what's reportable three months from now, then capitalism has a problem."[vii] Indeed, the CFA Society of the UK has argued that concerns about pressure to meet short-term earnings targets are misplaced. Although it acknowledges that meeting short-term earnings targets is an important way for corporate management to maintain investor trust, the Society thinks "investors understand that companies should seek to maximise value over an appropriate term, not necessarily the short-term". The drivers of value, it says, do not depend on time periods and "should be practised consistently across short, medium and long timeframes". It thinks the debate on 'termism' (i.e., focusing on long-term investment horizons and criticising short-term horizons) is missing the real point: "The key issue is value generation and how that can best be achieved ... rather than the time period over which that value is generated". The Society argues that there should be no single definition of a 'most appropriate' time horizon and there is no optimal investment holding period.

Barriers to change

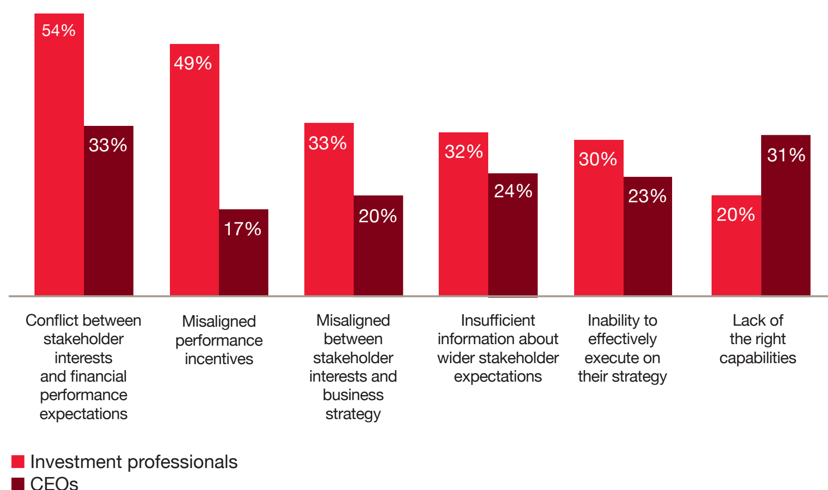
We asked CEOs what barriers their organisation is facing when responding to stakeholder expectations, and investment professionals what barriers they think the companies they invest in or follow have been encountering. Our results show that investment professionals are significantly more likely than CEOs to consider misaligned performance incentives as a barrier to change (figure 15). This highlights another potential area where reporting (in this case, remuneration reporting) could be improved. Companies have more visibility internally into how management is remunerated than investment professionals have from the outside. Equity investors are particularly likely to identify misaligned performance incentives as a barrier, most likely reflecting the agent-principal tension that exists between companies and their shareholders, as well as equity capital providers' desire to have more say on company strategy since they bear the residual risk.

Short-term performance rewards and things like share options are really harmful and not good for encouraging management to make the long-term changes that need to be made.

Swiss fund manager

Figure 15

Q: Which of the following barriers, if any, are companies encountering when responding to wider stakeholder expectations?



42%

of equity investors identify misaligned performance incentives as a barrier to responding to wider stakeholder expectations

From our work with the investment community we know its members tend to be distrustful of remuneration metrics. Companies could do more to link their remuneration policies and key performance indicators (KPIs) to overall strategy and risk management as well as other factors, given the number of investment professionals who think companies need to change the way they measure success and hold themselves accountable (figure 14). Alternatively, if companies believe the link does exist, they could try to enhance disclosure of that linkage for their investors. (Our past research shows that investment professionals want to see more linkage generally in financial reporting.) On a similar theme, investment professionals are far more likely than CEOs to see misalignment between stakeholder interests and business strategy as a barrier to change. However, if CEOs believe these are aligned, they could consider whether their be communications to their investors need to been enhanced. These results support the mounting evidence that investment professionals want companies to act in socially responsible ways – not just talking the talk, but walking the walk.

Too often, management teams run companies for their own benefit. Conflict between their incentives and stakeholder interests is a big barrier.

UK sell-side equity analyst

It is a true change of culture that we need. Management need to focus on making the changes their company needs. There should be no conflict with investor expectations, and management must be sensitive to ethical issues.

Italian sell-side analyst

How are companies maintaining communication channels so that investors can play the role they should in terms of helping to shape business strategy?

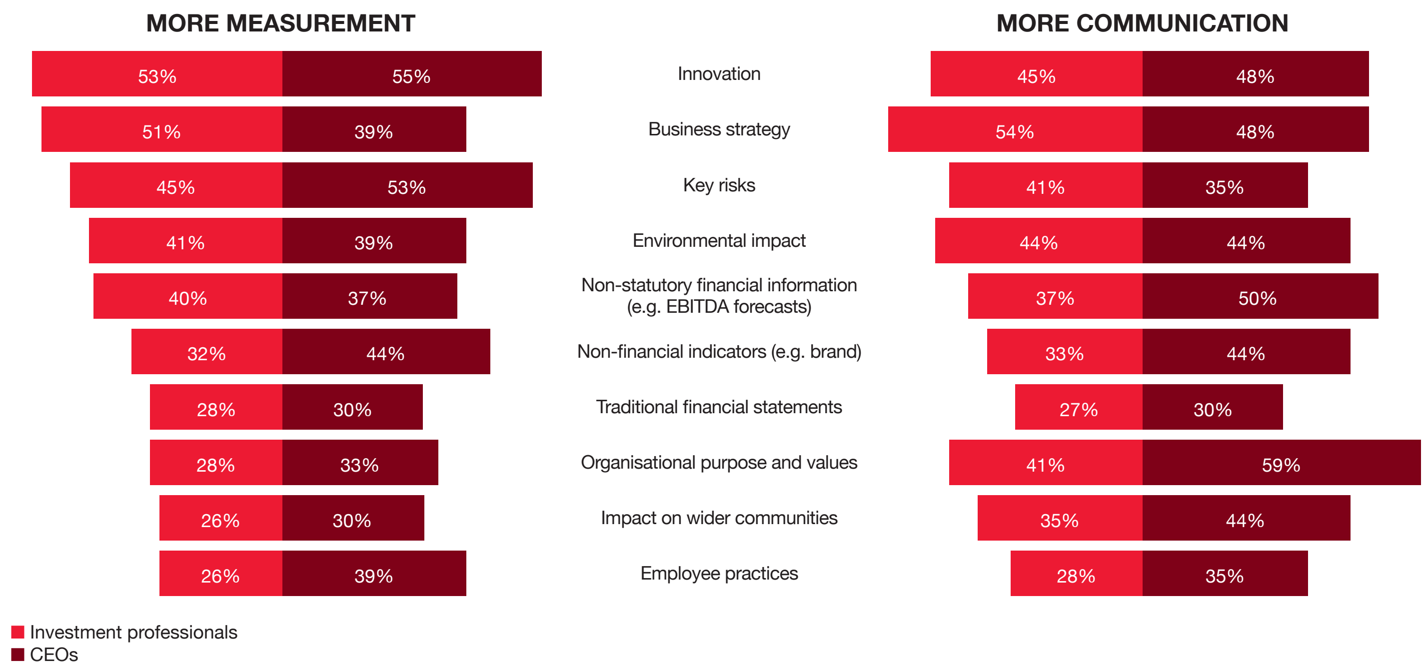
What changes to remuneration policies need to be made to ensure that executive incentives are aligned with shareholder interests?

What information do companies need from their investors to understand better the value they place on environmentally and socially responsible business activity?

Measuring and communicating success

Figure 16

Q: Within the context of wider stakeholders, in which of the following areas do you think companies should be doing more to measure or communicate impact and value?



Measuring and communicating success

Business strategy needs much more detailed measurement over a longer period of time to really show the impact of good or bad decision making.

UK sell-side analyst

Strategy needs to be defined and reported in a much more concrete way. I need to see as much detail as possible: What are the key milestones? What are you doing to reach them?

German buy-side head of research

We need to be able to see a wider set of risks than just the financial risks. Companies should be reporting on risks they are exposed to because of their impact on communities, the environment and other factors.

Italian portfolio manager

I find a lot of senior management teams and boards I talk to don't really know how to articulate their strategy. They can't explain their key risks or their key strengths. I think this is a very real investment risk.

UK buy-side head of equities

Companies report on numerous aspects of their business in terms of impact and value to society. But in which areas do CEOs and investment professionals want more measurement, and in which do they want more communication?

The importance of measurement and communication, particularly around strategies for long-term value creation, was emphasised recently by Larry Fink, Chief Executive of BlackRock, in a letter to CEOs of S&P 500 companies and large European corporations.[viii] Fink wrote:

"Annual shareholder letters and other communications to shareholders are too often backwards-looking and don't do enough to articulate management's vision and plans for the future. This perspective on the future, however, is what investors and all stakeholders truly need, including, for example, how the company is navigating the competitive landscape, how it is innovating, how it is adapting to technological disruption or geopolitical events, where it is investing and how it is developing its talent. As part of this effort, companies should work to develop financial metrics that support a framework for long-term growth. Components of long-term compensation should be linked to these metrics."

Similarly, McKinsey has highlighted the importance of companies communicating long-term metrics to help investors make decisions about long-term value creation:

"Focusing on metrics like 10-year economic value added, R&D efficiency, patent pipelines, multiyear return on capital investments, and energy intensity of production is likely to give investors more useful information than basic GAAP accounting in assessing a company's performance over the long haul."[ix]

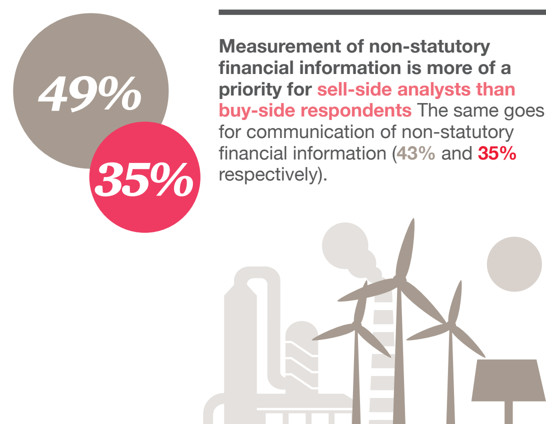
The core message is that companies need to be measuring and communicating impact and value in relation to both hard and soft drivers of success. Companies are therefore encouraged to focus on the quality of their communication with external stakeholders in this respect. PwC's guide to a new business language is a practical way for companies to make the qualitative difference in their internal management and reporting of impact and value creation.

The emphasis on quality is important. Our survey questions asked whether investment professionals want 'more' measurement and communication (figure 16). But we know that what they really value is 'better quality' information that focuses on issues material to individual companies – clear articulations of strategy linked to material key risks, for example. This came out strongly in some of the interviews.

Higher quality communication could also help to address some of the misaligned views highlighted earlier in this report, such as the fact that investment professionals are more likely than CEOs to see conflict between stakeholder interests and financial performance expectations as a barrier when responding to wider stakeholder expectations (figure 15). We noted too that investment professionals (particularly equity investors) are more likely than CEOs to think that companies are unable to execute their strategy effectively. Investment professionals are also more likely than CEOs to think that companies have insufficient information about wider stakeholder expectations (particularly equity investors and sell-side respondents). Companies could look at how they explain their strategy and link their implementation of it to performance outcomes. Companies could also do more to explain the changes they are making for stakeholders and the financial impact of those changes. Companies often present non-financial information separately, rather than linking it to financial performance. In this sense, cause and effect is not apparent.

49% **35%**

Measurement of non-statutory financial information is more of a priority for sell-side analysts than buy-side respondents The same goes for communication of non-statutory financial information (43% and 35% respectively).



Buy-side respondents want more communication on environmental impact than sell-side respondents (48% and 32% respectively).

Missing measures or missing messages?

What do you think companies bring to society which is not currently measured or not fully appreciated?

Innovation and improving the skills of the workforce.

Italian portfolio manager

Society underestimates the innovation that companies bring, particularly when it is not visible – for example, they will appreciate innovation at Apple because they can physically see it and use it. However, lots of companies do a lot of R&D that is not always appreciated.

UK equity fund manager

Shareholder value creation and wealth generation is under-appreciated. Many people in society, especially the press, fail to understand that 'shareholders' are ultimately all of us, the man in the street and his pension savings.

Italian fund manager

Being good sustainable businesses allows them to be sustainable employers. That means they can have a sustainable workforce, bringing sustainable employment and allowing the country to have a sustainable tax base.

South African fund manager

Perhaps society is not fully aware of how our activities help to develop the communities we operate in. Our presence and activity in certain communities lead to significant developments, including better infrastructures, greater services and a more prosperous population. The resulting situation contrasts with the standard of living experienced before we arrived – and this can be seen clearly in certain places, such as Panama.

Manuel Manrique
President and CEO of Sacyr

Investment professionals say companies bring...

on-the-job skills for employees.

taxes, salaries and employee benefits.

products and services that enhance a country's infrastructure and development.

quality of life [in the form of] jobs, high quality food, medicine, transportation, entertainment, etc.

basic working skills, employment, education, improved welfare, [meet] basic needs and general economic prosperity.

rapid change in how people interact, communicate socially and define themselves.

happiness of their customers.

wealth creation.

CEOs say companies bring...

employment, creating jobs in the local communities in which they operate.

prosperity for nations, driving growth and providing funding through taxes.

innovation, from cutting-edge technologies to research in healthcare, transport and environmental sciences.

education and training.

environmental protection, lowering environmental impacts, protecting ecosystems and reducing CO^2 emissions.

safety, security and wellbeing for their employees and communities.

contributions to critical infrastructure.

philanthropic and charitable support.

Redefining success

What is it that defines business success? Based on our feedback from CEOs and investment professionals, success may not always be about maximising profitability. It may also encompass other forms of impact (e.g. environmental or societal). Indeed, if the measure of business success goes beyond the financials and a value (and a cost) is calculated for the societal, environmental and economic impact of a company's activities, businesses can see the total impact they're making and measure success in a far more holistic way. Quantifying and monetising impact means that trade-offs between alternative strategies can be identified and discussed, enabling more informed dialogue with stakeholders and facilitating more optimal decision making.

I think [the definition of business success] will change but I don't think it will be better. The environment should not be the concern of individual companies as that is a challenge for governments. Companies must focus on maximising profit, and the legal frameworks put in place by government should guide their behaviours on these issues.

German fixed income analyst

I expect to see a greater demand for measurement of the benefits to society and the ability of companies to provide useful resources to individuals.

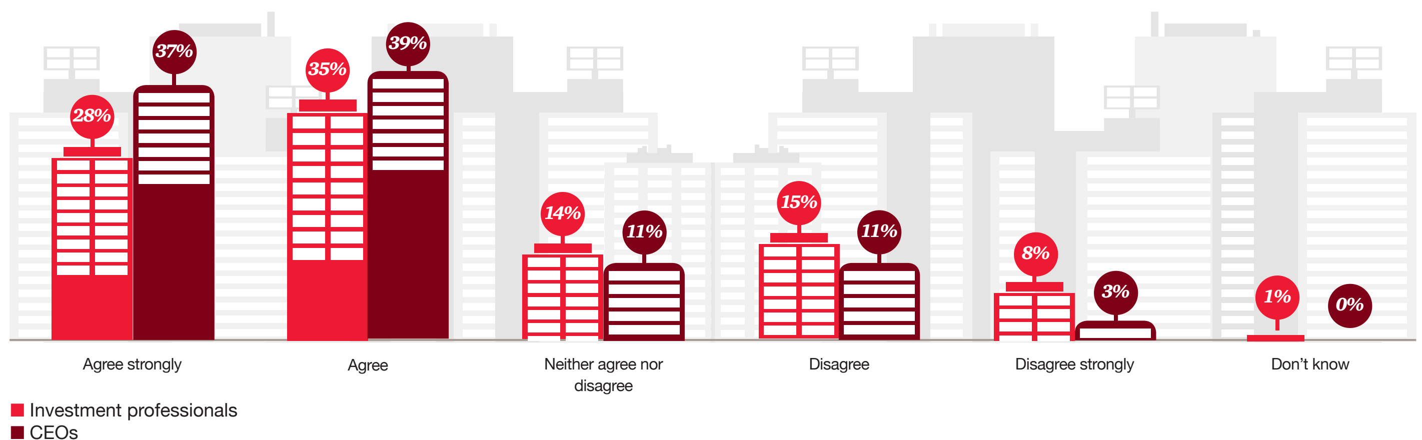
USA equity analyst

When a company goes bankrupt you know they have failed.

Hong Kong equity investor

Figure 17

Q: To what extent do you agree that business success in the 21st century will be redefined by more than financial profit?



Buy-side respondents **(31%)** are more likely to agree strongly than sell-side participants **(21%)** that business success in the 21st century will be redefined by more than financial profit.

Similarly, those on the sell side are more likely to disagree **(21%)** than the buy side **(12%)**.

So we asked CEOs and investment professionals to what extent they think that business success in the 21st century will be defined by more than financial profit (figure 17). Most CEOs and a majority of investment professionals agree or agree strongly with this idea. Our findings are perhaps unsurprising, given the way that 'responsible investment' and the integration of non-traditional financial information into investment decisions have started moving into the mainstream. However, our interviews with investment professionals reveal that, although the majority think that the definition of business success will continue to change, some don't necessarily think that it should. This is an area of increasing change and our work on Total Impact Measurement and Management can offer insights into areas of value creation and costs that offer a significant opportunity to change the way companies do business in these changing times.

In the future, will the ultimate measure of business success still be financial, even if supplemented by a wider set of information necessary to fully understand performance? Or will ultimately the acknowledged measure of business success no longer be financial profit at all?

The context within which companies deliver financial profit will be important to understand. For example, what other important deliverables the company provides will be important (access to healthcare, social). We invest to generate a financial return, but the context in which that return is generated and the corresponding impact on the sustainability of that would be important. The ability to generate a dollar today isn't necessarily as important as the ability to generate dollars in the future.

USA equity investor

Are companies measuring and communicating impact and value in relation to both hard and soft drivers of success in order to meet investment professionals' information needs?

If companies feel their impact on employment and wider society is not fully recognised, how can they report the value they bring more clearly and what additional KPIs could they use?

Conclusion

In theory, CEOs and investment professionals have the same goal: value creation. So why do they see the world differently in some key respects? Why do they have different levels of confidence about companies' future revenue growth prospects? Why do they hold such different views on issues such as the alignment of performance incentives?

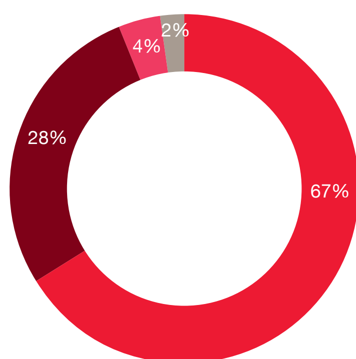
Part of the answer may lie with failures of communication – on both sides. It's not just that companies could be explaining their strategies more clearly, in the context of material risks and with the inclusion of relevant KPIs. Investment professionals may also be failing to express in clear enough terms the value they place on wider issues and profits being generated in socially responsible ways. CEOs need to find out what their investors and other stakeholders want from them, and those stakeholders must tell them. If CEOs don't fully understand the priorities and preferences of the investment community, then not only will their reporting be flawed, but potentially also the strategies they pursue. We therefore encourage both CEOs and investment professionals to commit to more open and ongoing engagement for their mutual benefit.

Research methodology and contacts

We obtained feedback from 438 investment professionals: 286 responses were generated through an online survey running from December 2015 to early February 2016, and 152 through interviews conducted between late September 2015 and January 2016. Respondents included buy-side and sell-side investment professionals with both equity and fixed income interests, as well as ratings agencies. We obtained wide geographical representation, with participating investment professionals located in Europe, North and South America, Asia-Pacific and Africa.

Figure 18

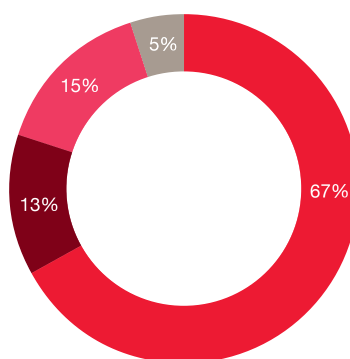
Role



Buy side | Sell side | Ratings agency | Not answered

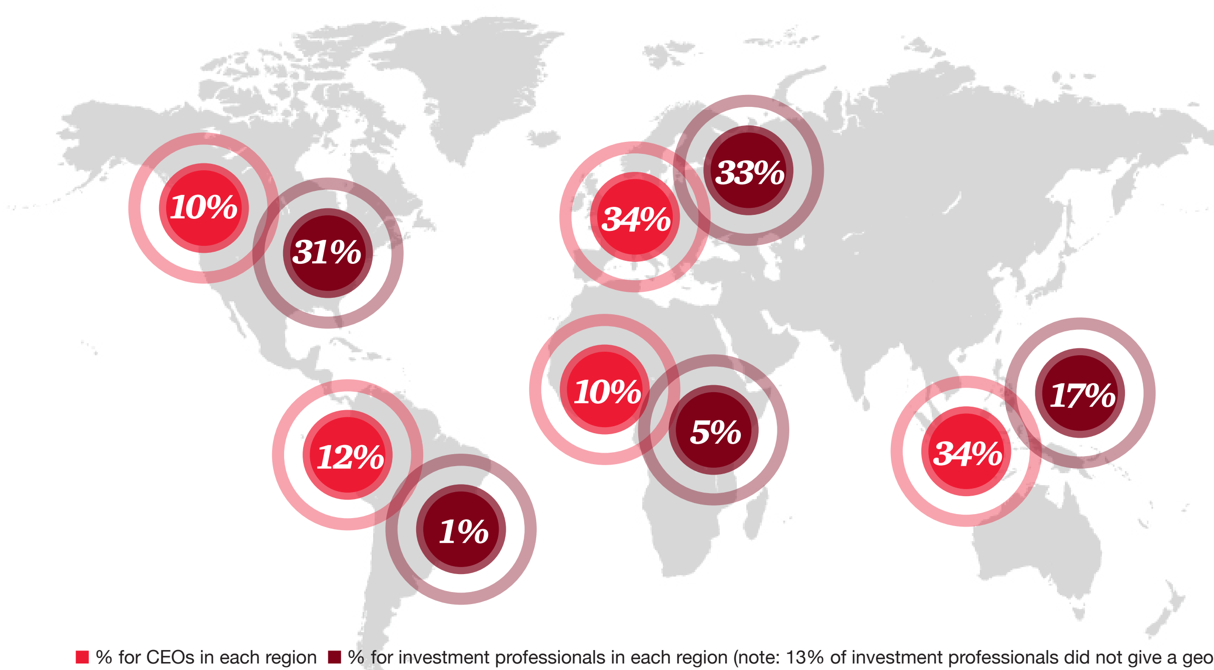
Figure 19

Specialism



Equity | Fixed income | Both | Other

For our 19th Annual CEO Survey, we conducted 1,409 interviews with CEOs in 83 countries. Our sample is selected based on the percentage of the total Gross Domestic Product (GDP) of countries included in the survey, to ensure CEOs' views are fairly represented across all major countries and regions of the world. The interviews were also spread across a wide range of industries. Further details, by region and industry, are available on request. Twenty-six percent of the interviews were conducted by telephone, 60% online and 14% by post. All quantitative interviews were conducted on a confidential basis.



Notes:

- Not all figures add up to 100% due to rounding of percentages and exclusion of 'neither agree nor disagree' and 'don't know' responses.
- The base for figures is 438 investment professionals and 1,409 CEOs unless otherwise stated.
- About 60% of the CEOs we surveyed head private companies, while the investment professionals mainly focus on publicly listed companies (though some invest in private equity). The responses of both groups are still worth comparing. Even private companies may have private equity investors or listed debt investors, or they may plan to list in future. Therefore, the views of these CEOs are also of interest when comparing the outlooks of business leaders with those of members of the investment community.
- Where we have included a geographic breakdown, the analysis is based on the base location of the investment professionals and CEOs surveyed.

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Notes and sources

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