Strategy & Corporate Finance Practice

How new CEOs can manage for the future

The subtle art of delivering short-term wins while setting the stage for long-term success

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In this episode of the *Inside the Strategy Room* podcast, two McKinsey partners help new leaders grapple with the dual imperatives of producing immediate results while establishing the foundation for lasting success. In their conversation with Sean Brown, communications director for strategy and corporate finance, they also share research on the impact of a long-term focus on company performance and CEO fortunes. (This is an edited transcript. For more conversations on the strategy issues that matter, subscribe to the series on Apple Podcasts or Google Play.)

Sean Brown: From McKinsey's Strategy and Corporate Finance Practice, I'm Sean Brown. Welcome to *Inside the Strategy Room*. Today we're talking with two partners about a dilemma that many new CEOs face: should they focus on showing quick results or invest in the company's long-term future, even at the expense of short-term returns? Carolyn Dewar is a senior partner based in San Francisco who co-leads our global CEO and board excellence work. Michael Birshan is a senior partner in our London office who co-leads the Strategy and Corporate Finance Practice across Europe, the Middle East, and Africa, with a special focus on CEO transitions. Welcome, both.

Carolyn, can you kick us off by describing how this research can help new CEOs focus their efforts?

Carolyn Dewar: This is part of broader research on excellence in the CEO role. We have been looking at four stages of the journey: preparing to be a CEO for those still a couple of years out, the transition to being a CEO and the first year or two on the job, mid-tenure CEOs and really critical moments, and finally the folks toward the tail end of their tenure who are preparing successors and thinking about what comes next. As part of that, we wanted to see what matters most in the first few years. How should new CEOs think about this mix of delivering short-term results and setting up their companies for success in the future? We brought together two data sets: one is from McKinsey Global Institute (MGI) on company performance and long-termism, and the other is our database of 600 CEOs throughout their tenures so we can compare what they did and did not do in those early years.

Sean Brown: Why did you decide to study this particular issue?

Michael Birshan: Firstly, if you talk to almost any chief executive of a publicly listed company, they will admit to feeling pressure to deliver short-term performance. That pressure, while always significant, has been increasing, especially with the rise of activist investors. This is true wherever you are in the world. It also translates into duration in the top job: today it's five and a half years, and pretty much on a downward trend. A couple of decades ago it was eight or nine years. People say that a short-term focus has negative consequences, so we wanted to see whether we could identify companies organized with more of a short-term or long-term focus.

Sean Brown: Can you tell us how you went about that?

Michael Birshan: What MGI tried to do was identify a set of markers in financial metrics that point to a more short-term or long-term orientation. For example, the hypothesis is that long-term firms invest more and more consistently than firms focused on the short term, and we can look for that in the ratio of capital expenditure to depreciation. Or you might have the hypothesis that short-term firms will do whatever they can to hit their short-term external targets whereas long-term firms are more willing to miss them if that's in the longer-term interest of the company. You might measure that by looking at the incidence of companies beating earnings-per-share targets by less than two cents or missing them by that amount. We looked at five factors in all, and based on these markers we identified a set of companies we could designate as short-term-oriented and long-term-oriented over a 15-year period.

Sean Brown: And did the research confirm the hypotheses?

Michael Birshan: Yes, absolutely. The long-term-oriented companies outperformed their peers on many metrics (exhibit). R&D spending being 50 percent higher might be expected, but more outcome-related metrics such as revenue and economic profit growth were also higher on average in those companies.

Sean Brown: Once you had evidence that a long-term focus improves performance and creates more value, how did you link that to CEO actions?

Michael Birshan: Our database of S&P 500 chief executives allows us to look at CEOs' entire tenures in a wide variety of industries. We asked: how many of these executives, when they came into a company that may have been run in a short-term-oriented fashion, pivoted it to the long term? And we found that 4 percent of that group did the pivot in their initial years. There are more who pivoted at some point during their tenures and some who inherited a long-term orientation and kept it, but only 25 who pivoted from short to long.

Sean Brown: Were there any commonalities among the CEOs who made the shifts in orientation?

Michael Birshan: We found two things to be true. The chief executives who pivoted were more likely to have been CEOs previously and they almost always had experience in that industry. So, they understood the industry and the challenges it faced, maybe they were on their second at-bat, and they decided to do things in a more thoughtful way going forward.

We measured how many strategic moves these chief executives made early in their tenure—everything from a strategic review to reshuffling more than half the top team to closing a product line, or expanding to a new geography, or doing big M&A. We found that CEOs who pivoted to the long term pulled more levers, as you might expect. They transformed their companies more aggressively in the early years, doing 50 percent more strategic moves than those who did not pivot.

Sean Brown: And are the CEOs who orient their companies toward the future rewarded by investors?

Michael Birshan: I wish the answer were, absolutely, they are massively rewarded in the returns to shareholders. But the reality is, they are not punished but they are also not rewarded. It's a delayed gratification. During their tenure, the pivot to long term doesn't pay off for the individual CEOs. If you track companies beyond that, however, it does pay off for shareholders. That's consistent with MGI research that over the long term, these companies benefit. But those chief executives who made the bold efforts and probably suffered some slings and arrows, they didn't generate the upside in total returns to shareholders; that upside generally accrued to some of their successors.

So, the conclusion from this research is that long-termism does pay for CEOs but more in their legacy than in performance during their tenures. The questions that Carolyn and I have been wrestling with is, how do you strike the balance as CEO between maintaining your credibility and mandate as a leader while setting up your company for future success?

Sean Brown: And what are some of your insights, Carolyn?

Carolyn Dewar: What we have observed and know from our work with CEOs is that starting with a strategic review early and an honest appraisal is important. Having a view on the industry is critical to making bold moves. Whether you have been promoted to CEO from within or come in from outside, you need to know the lay of the land. How do you quickly get a view of the company, its opportunities and stresses, and the external

Exhibit

Long-term companies outperformed their peers on multiple dimensions.

Earnings growth	+36%
Revenue growth	+47%
Market capitalization	+7 billion
R&D spend	+50%
Jobs created	+12,000
Economic-profit growth	+81%

Source: FCLTGlobal; McKinsey Global Institute analysis

> **“The chief executives who pivoted from short-term to long-term focus were more likely to have been CEOs previously and they almost always had earlier experience in that industry.”**
>
> –Michael Birshan

market? It takes real courage and transparency to sit down with your leadership team, hold up the mirror and say, where are we really, and where do we need to go? How do the decisions we make today set up the company for longer-term success?

That first piece informs the second, which is translating the decisions into a few bold moves that set the company on a different trajectory, both in terms of its performance and signaling to the market where you're going. Part of it is creating the mandate within your own organization, but it also involves getting the board and the investor community comfortable with that new focus.

Sean Brown: That's a challenge, especially if it will affect short-term performance, right? Michael, have you come across interesting approaches to this in your work with top executives?

Michael Birshan: The CEOs who navigated this successfully essentially ask themselves, what is the art of the possible as compared to what my tenure might be, and where do I want to end up? It's not always a good idea to shoot out the lights in a very aggressive performance orientation in the first couple of years. If they're in a turnaround situation, that's different, but I have been struck by how mindful some CEOs are of setting the expectation that, you know, over the next year I will deliver this, and that's probably good enough, and then we will get to this, and that will deliver further upside. Let's sequence the impact.

These CEOs also focus on foundational things, taking on some battles right away to position themselves for the long term. In making changes to the management team, for example, they're thinking, if I know certain functions will provide the impact in years four and five, I probably need to start recruiting now so I can bring someone in at the end of year one. It takes year two for them to settle in so they can launch the ambitious agenda in year three that will really begin to bear fruit in year four and hit its stride in year five. So, they need to act now to build that platform for year five, even as they're also pulling the short-term levers to deliver some good news.

Sean Brown: How should the CEO communicate the intention to pivot to the long term to the company's stakeholders, especially the board and investors?

Carolyn Dewar: This idea of communicating and aligning the mandate early is so important. Michael hit on something, which is that excellent CEOs paint a compelling picture of where the company is headed. It's not just for growth's sake; a rallying cry or image can capture the hearts and minds and, frankly, get buy-in from the broader stakeholder groups. I'm thinking of one CEO in the industrial sector who, when he came in, could have said, “Our company is going to be the best in class within our industry vertical.” That had historically been the ambition. But instead he stepped back, did a strategic review, and recalibrated the level of ambition to say, “We want to be in the top quintile of all industrial companies.”

Obviously, that raised the organization's ambition level by shifting the peer set to which they were comparing themselves. Thinking we are the tallest shrub is not that great when we are standing in a forest, right? That changed the measures of success—what that would mean in terms of M&A, the types of customers they would serve, the kind of markets they would be in. But it was a compelling vision that excited people. That story became an anchor point as he went to his board, the Street, and other constituents to say, "You've been thinking about us too small. There is a much bigger, more exciting vision of who we can be, and here is the road map." Of course, he had to rewind the clock and say, "In the next two or three years, here are the markers that will show we are going down the right path." He was shaping the metrics of what he wanted to be assessed against. It's this idea of starting with the end in mind, getting people excited, and then being very clear about what they can look for from you on that journey.

Michael Birshan: To build on that, when you come in as a CEO, you have to understand the board's perception of the previous CEO. Sometimes that CEO is seen as a great hero and you are ostensibly coming in to continue on that path. You might say, "We were all very lucky to have the previous person. There may be a few areas we need to work on, and here is some data on that. Many of our people are nearing retirement so let's look at the talent pipeline, and I have mapped it out here. And there are certain businesses that aren't doing so well."

Then, over the subsequent couple of board meetings, you keep coming back with additional points. "As I get deeper into it, we should also just raise this, and we should raise this." All that can somewhat reposition the view of the previous era. There are CEOs who during their tenures were terrifically celebrated and delivered enormous returns for shareholders but whose legacy now, with the benefit of ten or 20 years' hindsight, is less rosy. Carolyn, you do a lot of work with the McKinsey Organizational Health Index, for example. We can diagnose the real health of a company in a data-driven way. That data-driven start for a CEO can provide them with a mandate to invest for the future.

Sean Brown: Do you have any thoughts on how boards can align incentives so CEOs who make those investments in the future are recognized for that long-term approach?

Michael Birshan: Remuneration committees are experimenting with a variety of things: longer-term claw backs and stock vesting periods. I think there is also a lot we can learn from venture-capital and private-equity firms in the way they align incentives. But most CEOs care about their legacy. They want to be pillars of the community and have their tenure look better over time as they serve on boards, rather than have the company they led in the past fall down just as they are chairing a board somewhere elsewhere. Whom we select has an impact on long-termism, not just more tactical incentives.

Sean Brown: Can you offer any examples of how new CEOs rallied stakeholders around the long term?

Carolyn Dewar: I'm thinking of one CEO's approach to navigating the investor community. They did a strategic review early on to see which investors really mattered and what they were solving for. Then they adopted a stakeholder engagement model based on that segmentation, spending time and developing the investors with a long-term view. So, rather than trying to convince people who would only ever care about the next quarter, this person was deliberate about building the community that cared about the same thing they did.

Michael Birshan: That's a terrific example. Another illustration: a relatively new chief executive said, "A lot of value creation in this company is actually in the long term, but I can't lose sight of the short term." The organization structure had leaders who covered both short-term and long-term initiatives, and he felt that everything was being shortchanged. So, he decided to redesign the structure around horizons. The horizon-one leader was responsible for ensuring continuing performance on the existing business so the company could have a long-term future, but the CEO removed horizon-two and -three responsibilities from him. He then elevated two new people to the executive committee, one who covered horizon two and one who covered horizon three.

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> –Carolyn Dewar

In particular, he made the horizon-three leader, who had been two layers down in the organization, a peer member of the management team. That gave the CEO more time to personally focus on horizon three, because this executive became his direct report. And because he had cleared the horizon-one leader’s plate, he could say, “You don’t need to be distracted and therefore I, as chief executive, don’t need to worry so much about this because I have one of my best people exclusively focused on it.” That’s how he accomplished the pivot.

Sean Brown: What about resources? Should CEOs apply a similar type of horizon approach to allocating those?

Carolyn Dewar: The point on reallocating capital is such a crucial one. How often is the budget really just the same as last year’s, plus or minus a little? You need to take almost a cleansheet view and say, given where we are going, where should we put our money? And do that more frequently than annually so you are placing your money where your mouth is in terms of big bets. For some of these multiyear journeys, you need to be investing appropriately now so that in years three, four and five, it’s bearing fruit.

Michael Birshan: When we looked at the research, companies that perform substantially better or move up the power curve of economic profit are reallocating essentially about half their capital over a ten-year period. You are a very different company at the end than at the start.

Sean Brown: Talent is often tied in with capital. What are some ways leaders can reallocate human capital to priorities that will deliver the biggest long-term returns?

Carolyn Dewar: On this one, the strategy function, the organization, and talent deployment have to come together. When you look strategically at the big moves you are making and where growth will come from, you need to systematically determine the 50 to 100 roles that will matter most. That’s where you get into the notion of agile organization: have a pool of people who can be pivoted onto the highest-priority project, who can form and re-form teams quickly, as opposed to getting stuck in a fixed, hierarchical organizational structure.

Sean Brown: Michael, have you seen some effective ways that CEOs embed this talent mobility within the organization?

Michael Birshan: One thing I have pushed some clients to do is consider the variety of their resources. Do the corporate resources math: where is my capital expenditure? If I’m marketing-oriented, where am I reallocating my marketing dollars? Where am I reallocating my senior or high-potential talent? This also goes for CEO time. The CEO I was referring to earlier pivoted his time from horizon one to horizon three, just as he might pivot the organization. The more we make the conversation about resources more holistic across a variety of resources and the reallocation consistent across the different types, the more powerful the impact. I think that is massively underleveraged in most organizations.

Sean Brown: How can CEOs get the board to pay attention to different performance horizons?

Carolyn Dewar: There is often a lag in the time it takes for markets to reward the efforts CEOs make. That makes engaging the board important. In North America, where the CEO is also often the chair or works closely with the chair, you should think about the composition of the board itself. One of my CEO clients, when she stepped in and saw she would need to strategically pivot the company, realized the board was really the old company's board. So, she worked with her chair to bring talent onto the board who would have the long-term view, the global experience she needed, and experience in the kind of long-term transformation she was aiming for. As directors' terms wound down, she started to cultivate candidates so that as those opportunities came up, she was ready. Over time, they were able to evolve the board, not only to be aligned with the longer-term way of thinking but to have the skills and experience most helpful for her as a chief executive.

CEOs should ask themselves, do you have the board you need to go on this journey, knowing that you can't just swap everyone out? Even bringing two or three new voices onto the board can pivot the orientation. And working closely with the board chair is critical, because he or she can guide the conversations with the board, both between and within the meetings, and shift the markers of success.

Sean Brown: Very interesting. Where will you take this research next?

Carolyn Dewar: As I mentioned, this is part of our broader research on the four stages of the CEO journey, so we're continuing to follow that journey. For CEOs who have made bold moves in the first year or two, what does the next S-curve look like? What are the triggers that let midtenure CEOs know they are on the right path and balancing the short and long term appropriately? How do you think about activist investors? How do you think about disruptions in your market? We are doing deep dives into some of those moments. Also, we are backing up all the way to before you are CEO and looking at the capabilities and experiences you want to be gathering.

Michael Birshan: One additional element related to long-termism that we are going deeper into are purposeful companies and environmental, social, and governance topics. I spend a fair amount of time with CFOs, who 18 months ago would say, "Don't talk to me about that." Now, they are saying, "Hang on, my investors are hitting me very hard on this question." We want to link this to value creation and see how CEOs can approach it with a degree of rigor.

Sean Brown: Carolyn, Michael, thank you.

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