The AMBACHTSHEER Letter
Sustainable Pension Design • Effective Pension Management

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UNDERSTANDING CORPORATE LONGEVITY:

WHAT SECRET SAUCE DO FIRMS OVER 100 YEARS OLD HAVE IN COMMON?

"The longevity practices of Century Club companies described in this book result from 10 years of research. Based on our findings, we built a theoretical longevity model. We tested the validity of the model through extensive corporate surveys. A number of statistically significant practices of long-lasting companies emerged………"

Vicki TenHaken
From her book "Lessons from Century Club Companies" (2016)

Why Does Understanding Corporate Longevity Matter?

Regular readers of this publication know we have been on a multi-year quest to restate the pension investment paradigm so it becomes more operationally useful. For example, terms like 'Pension Fund Capitalism' and 'Ownership Investing' have graced a number of *Letter* titles over the course of the last few years. This quest was originally triggered by Peter Drucker's 1976 book "The Unseen Revolution", where he visualized workers eventually becoming owners of the means of production through their pension funds. With the passage of time, our *Letters* have increasingly focused on the 'operationally useful' constraint that has plagued traditional investment theory. How can concepts like pension fund capitalism and ownership investing facilitate making good investment decisions in practice?

To that end, we have been singing the praises of Bart Madden's '**Pragmatic Theory of the Firm**'.[i] Why? Because it offers an operationally useful description of the four key drivers firms use to create value for their stakeholders, and hence drive investment returns. This framing naturally leads to another investment attribute we often refer to: long-termism. It is still difficult to improve on John Maynard Keynes's 1936 distinction between 'beauty contest' investors who conduct/participate in short-term stock popularity trading contests, and real investors who live and work in the long-term corporate value-creation world.

In this discovery context, finding Vicki TenHaken's cited book on the lessons we can learn from companies that have survived and prospered for over 100 years was an exciting event.[ii] What has been the secret sauce that has enabled these firms to accomplish this for such a long time? How closely does that secret sauce align with Madden's 'Pragmatic Theory of the Firm'? And finally, how can we use the answers to these questions to become better investors? This *Letter* addresses these three questions.

TenHaken's Corporate Longevity Theory

According to TenHaken, corporate longevity is related to five factors:

1. **Strong corporate mission and culture:** current leaders see themselves as stewards/ custodians of the business and feel an obligation to manage the firm in a way that both honours the past and ensures its survival in the future.

2. **Unique core strengths and change management:** the existence and protection of a particular technical specialty or core competency. Updating and developing this specialty/ core competency is essential to maintaining the firm's longevity.

3. **Close relationships with business partners:** fostering close long-term relationships with both its customers and its suppliers are also crucial to maintaining a firm's longevity. Such close-knit, mutually-supportive relationships heighten a company's ability to weather challenges as well as to learn and adapt over time.

4. **Long-term employee relationships:** employees become loyal supporters of the organization. Institutional memory builds over time and new leaders evolve from within.

5. **Active members of the local community:** the development of both commercial and social relationships in the local communities where the organization has workplaces is as important as developing close relationships with business partners. This is yet another key element in the support of a firm's longevity.

How closely do these five corporate longevity drivers mirror Bart Madden's 'Pragmatic Theory of the Firm'?

Madden's 'Pragmatic Theory of the Firm'

Our August 2024 *Letter* explained that Madden starts with the assertion that Milton Friedman's 'maximizing shareholder value' principle is best positioned as a corporate outcome, and not as a purpose. Instead, a useful theory of the firm treats the firm as a holistic system with four key components:

1. **A motivating vision for the firm:** it has the power to motivate and even inspire employees.

2. **A knowledge-building proficiency:** it provides operating returns at least equal to the firm's cost of capital through continuous gains in efficiency and innovation.

3. **Win-win relationships:** these are fostered with all of the firm's stakeholders, both inside (i.e., employees) and outside the organization (i.e., customers and suppliers).

4. **The design, manufacture, and delivery of goods and services that minimize waste and pollution:** thus the firm invests in the well-being of communities and future generations.

In short, successful firms earn at least their cost of capital over the long-term. This requires explicit integration of a firm's purpose and a culture that emphasizes knowledge-building, innovation, fostering win-win relationships, and maintaining multi-decade resilience and sustainability.

Arguably, element #2 of the Pragmatic Theory (i.e., knowledge-building proficiency) is the most challenging of the four value drivers to design and implement. Madden suggests approaching it through a Knowledge-Building Loop with six tasks:

1. **Foster a Knowledge-Building Culture:** it starts with a humble management team that knows and admits it doesn't have all the answers. Learning cultures know that wisdom and truth do not reside in a single place. They are better able to cope with unpredicted events. Get the culture right and it is easier to implement strategies that adapt to changing environments.

2. **Apply Strategic Thinking:** focus on identifying and understanding the firm's challenges. Focus on the ones with big value-creation upside. Be prepared to build or acquire new skills if necessary.

3. **Flatten Organizational Structure:** command and control structures are problematic. Flatter structures push down decision-making power and increase employee engagement and creativity.
4. **Assess the Efficiency of Existing Businesses:** find out how well current processes and practices are working by 'walking around'. How can we create more value with less waste?
5. **Improve Existing and Future Businesses:** there must be a culture of 'no fear' and a willingness to 'think differently'. The actions of observing, questioning, networking, and experimenting can trigger thinking that leads to new processes, services, products, or even businesses.
6. **Build Context-Specific Performance Measurement Protocols:** performance metrics must be created that are suitable to specific contexts.

This 6-task innovation 'to do' list is not only helpful for investee corporations, but for pension investment organizations themselves as well.

Comparing the TenHaken and Madden Theories: Implications

Comparing the descriptions of the two theories, it is hard not to observe that they mirror each other closely. Thus the conclusions of Madden's deductive approach to setting out the conditions for sustainable corporate value-creation are confirmed by TenHaken's historical approach to understanding the drivers of historical corporate longevity.[iii]

What are the implications of this ex ante/ex post investment theory convergence? Specifically, what should it motivate the people responsible for the management of $trillions of retirement savings to do? At a very high level, it should surely lead to decisions to emphasize long-term value-creation strategies over short-term 'beauty contest' trading gains. A more challenging question is how to effectively implement such a strategy, when short-term beauty context games continue to play day in, day out in the media?

Implementing Long-Term Value-Creation Strategies

A logical place to start is to ask: "what can we learn from the Madden 'Value-Creation' and the TenHaken 'Longevity' Theories? For example:

- How closely is our pension organization's mission and culture aligned with investing to create long-term value rather than short-term trading gains? How do we know? For example, are the Madden/TenHaken theories being actively used to guide our investment programs?[iv] Or is it more important for us to win short-term beauty contests every year?
- If our organization mission and culture are not closely aligned to investing to create value, what changes do we need to make? For example, do we have the scale and mandate to attract and retain the right investment expertise in-house? If not, how do we identify external investment managers that truly 'get' investing to create long-term value?[v]
- Are there opportunities/centres where we can innovate/collaborate with like-minded partners? *Focusing Capital on the Long Term* (*FCLT*), the *International Centre for Pension Management* (*ICPM*), *CEM Benchmarking, and the Long Term Stock Exchange (LTSE)* are four examples of these innovation/collaboration opportunities. They should be supported and used to their full extent.[vi]
- How do we maximize transparency with our own stakeholders and partners so there is clarity about what our organizational goals are, and how we intend to achieve them?[vii]

All of these questions raise important governance issues. They must be addressed, resolved, and supported at the Board level.

Making Pension Fund Capitalism Work for All

Peter Drucker launched the pension revolution almost 50 years ago. In his vision of it, not only would workers become capitalists through their pension funds, but the managers of those funds would also improve the efficiency and effectiveness of capitalism itself. Since the launch of the Canadian Pension Model 30 years ago, we have been making slow but steady progress to turn that vision into reality.

In that context, Bart Madden and Vicki TenHaken have both made important contributions to the cause. They have shown us what the key business success attributes look like. Now it is up to pension fund managers to ensure those success attributes become embedded in the businesses they invest in. Everybody wins.

Keith Ambachtsheer

Endnotes:

i. *For example, see the **August 2024 Letter**"A Pragmatic Theory of Pension Fund Capitalism: Implications for Managing Pension Organizations".*

ii. *Thanks to James Gruber of the FirstLinks newsletter for referencing the 2016 TenHaken book in his column.*

iii. *These findings would likely not come as a surprise to Warren Buffett and his late partner Charlie Munger.*

iv. *See our **September 2024 Letter** titled "Pension Fund Capitalism and Ownership Investing: Are These Lofty Ideas Useful In Practice?" for more on this topic.*

v. *For example, ask what is the average holding period length for portfolio holdings in the portfolios managed by the investment manager?*

vi. *Full disclosure, I cofounded CEM Benchmarking in 1992 and continue to be a co-owner and Board member. I cofounded ICPM in 2004, and was its Executive Director until 2016. I invested in the LTSE when it was launched in 2016. Finally, I have been a supporter of FCLT since its founding by Domenic Barton and Mark Wiseman in 2013.*

vii. *TOP1000Funds and CEM Benchmarking have collaborated to create the Global Pension Transparency Benchmark (GPTB). It ranks the transparency performance of the five largest pension funds in the top 15 pension countries.*

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