Rapport

It Is Never Easy Being the CEO

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It Is Never Easy Being the CEO

It is never easy being the CEO because that is where the buck stops. The bright lights shine on the few who succeed. It is lights out for the many who fail.

When you come to think about it, there are but three ways to get to the top of the corporate ladder. Birthright is one of them. Merit and default are the other two. Common to all is the fact that very few aspirants ever get to be the CEO as a result of being a successful investor in their own right. Yet the CEO's primary responsibility is to see to it that the enterprise is managed in the best interest of all the shareholders.

Most newly appointed CEOs move into the corner office long on good intentions but short of first-hand experience. Few have any idea just how lonely it can be at the top. Those who cannot hack the silence soon find an excuse to sit in on other people's meetings. Such is often a bad omen for longer-term success.

Rather than continue to be concerned about the minutia, all CEOs must learn a whole lot more about the bigger picture, hoping to position the company in such a way that it will grow and become even more profitable in the years ahead. They must accept as fact that better-focused business interests will lead to better multiples of cash flow and earnings. Helter-skelter diversification inevitably leads to the dungeons of hell for the CEO, senior management and investors alike.

OUTSIDE CONSULTANTS AND CONTACTS PLAY A VITAL ROLE

In order to gain a better understanding of what is going on across the country, every CEO should rejoice in reading the front and editorial pages, and particularly the business sections, of the national newspapers. Those operating overseas should do likewise in the countries where the company has business interests. In a concerted effort to extend their knowledge base, they must also get about and hire the very best consultants that money can buy. Second best will never do!

As such, reading about and talking to the real movers and shakers and investment research analysts must become an integral aspect of a CEO's everyday life. He or she would also be wise to try to gain an in-depth understanding of any significant competitors in the field, including a good grasp of their respective market share, profitability and future plans. Correspondent relationships across borders can prove to be very informative and quite rewarding.

CEOS MUST THINK LIKE INVESTORS

Even if all the foregoing comes to pass, there is very little chance that the majority of CEOs will ultimately have a really profound understanding of the ways and means of the capital markets. As a result, they are prone to being led down the garden path by a bunch of professional fee swatters, seldom by knowledgeable investors.

For example, investment dealers have always liked the idea of buybacks, and have frowned on dividends as being less tax effective. Yet investors have always been drawn to, and been willing to pay up for, companies with an established record of increasing the payout over time. Incidentally, longer-term investors also tend to stay clear of companies that try to finagle the stock price, even by way of stock splits and share consolidations.

To guard against going with the grain of conventional investment banking thought, which is primarily driven by underwriting fees and trading commissions, CEOs are advised to seek out the opinion of creditable capital formation strategists. Furthermore, if proper study has not be done to test a particular business combination scenario, the CEO should not show his hand or proceed until further investigation has been done. Haste is all too often a precursor to failure in the world of investment. Please remember too, short-term thinkers, like short-term traders, seldom live in large houses. Nor do CEOs who “diworsify” their companies!

TWO CASE STUDIES WORTH EXAMINATION

Two rather remarkable and recent transactions are worth citing. They have to do with Shoppers Drug Mart Corp. and Yellow Pages Group Co., formerly wholly owned subsidiaries of Imasco Limited and BCE Inc., respectively. Both of these outfits were acquired by way of a leveraged buyout, masterminded by the firm of Kohlberg Kravis Roberts and Co. Soon afterwards portions were resold back to Canadian investors at a great profit to the real movers and shakers from New York City. I am proud to say that I participated in each of these secondary offerings and have yet to sell a single share or unit as both investments continue to outperform the broader market averages.

In 1999, KKR bought Shoppers Drug Mart Corp. by outbidding a strategic buyer in Jean Coutu Group Inc. At the time it was the very picture of corporate stability. The CEO had been in place for eighteen years, guiding a company hooked on prescription drug sales as its business core. Rather than sit back and live off dividends, KKR chose instead to redirect the franchise. Shifting from pushing prescription drugs to so-called front-of-store sales, such as cosmetics and candy, meant many existing stores had to be rebuilt.

In the midst of all the sawdust of renovation, KKR opted to take the company public (again) in 2001 at $18 per share. Those who bought the potential, not proven, results did very well indeed. So too did the leverage buyout partners who had put up only $5 per share of their own money just two years earlier. Subsequently, two additional secondary offerings were done at $23 per share. At the recent trading price of $26 per share, the company has a market value of $5.4 billion, a far cry from the $2.55 billion paid to Imasco. Is it any wonder that the likes of London Drugs, Jean Coutu and even Loblaws are tending to follow KKR’s lead, given as Shoppers Drug Mart’s earnings are now racing ahead at a 30 percent per annum clip!

Why did the previous owner, the CEO and the directors on the Shoppers Drug Mart

board not see the same sort of potential in the franchise that KKR obviously did? Could it have been because they had not read the national newspapers or leading business magazines; had not fully understood what their North American competitors were up to; had not retained the best outside advice that money could buy? Or had they just grown complacent and fallen asleep at the switch? If such were the case, how come the so-called well-versed institutional investors, those now so piously wrapped up in the corporate governance flag, also failed to see the light and thus did nothing to help Imasco come to its senses? After all, had they not realized that the major department stores – the key players in cosmetics – were steadily falling by the wayside, thereby opening the door for the drug stores to step forward and take advantage of their demise?

The second example I would like to cite has to do with KKR's more recently led $3 billion leverage buyout of Yellow Pages Group. While BCE Inc. still owns 10 percent and the Ontario Teachers Pension Fund has a 30 percent interest, it is really KKR who is turning over the pages these days, so to speak. By way of astute acquisitions, cutting costs, and making the company into a more sales- and client-oriented organization where advertisers are tempted to pay more for catchier advertisements, KKR is striving to bump up revenues and improve the year-over-year payout to investors for many years to come. This is despite paying for an array of top-notch consultants, and after stock options and bonuses were granted to the management team members.

The recent record $1 billion IPO of Yellow Pages Income Fund at $10 per unit would suggest that the outfit is now valued at $4.3 billion. Not bad for an initial investment of $900 million made just over a year ago. Once again you have to ask yourself how it was possible for KKR and its partner to do so well and why in heaven's name did the BCE Inc. corporate hierarchy, the investment bankers, the outside advisors and board of directors not see the same writing on the wall as the leverage buyouters did. I believe the same sort of failings as were cited in the case of KKR's purchase of Shoppers Drug Mart Corp., likely applied.

As I see it, the leverage buyout firms, like KKR, where every single partner's own money and borrowing capacity is on the line every day of the week, tend to do more homework, have a very carefully defined game plan and a well thought-out exit strategy before they ever step up to the plate. Perhaps if CEOs and professional managers of public companies had the same sort of overall plan and commitment, they too would do a much better job when it comes to improving the returns to share and unit holders. It is certainly an idea worth thinking about. No matter what, those CEOs paralyzed by indecision are doomed to fail. Similarly, dawdlers will never win the race!

Unfortunately, many of today's chief executive officers seem to be afraid to make decisions for fear that some unforeseen event might prove them wrong. When combined with the current focus on cost-cutting, a plethora of ill-advised decisions in the past decade during the investment bubble, and increasing corporate scrutiny as a result of ethics scandals, many CEOs appear to be reluctant to try anything new. With confidence in the future somewhat shattered, many are choosing to take the safe way out, rather than striving to change the corporate culture and work processes. They forget that great decisions cause an adrenaline rush, and that is good for business. They should re-examine business strategy, establish new priorities and realistic targets, and communicate that vision and direction to the staff, the investment research analysts and the shareholders alike. It is never easy being the CEO, and those who cannot stand the heat should get out of the corner office!