A Lesson in Leadership: Keeping the Barbarians from the Gate

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Given the turbulent political, regulatory and economic environment in which we reside, the corporate landscape is rife with discontent. Companies exist in a world of mergers and acquisitions, takeovers and ownership transfers. Without strong leadership both in the C-suite and at the Board level, the future of many organizations could be called into question. Even corporate titans are no stranger to the influence of overzealous stakeholders … some for the better and some otherwise. Consider the following contrasting examples and how the companies you serve could be impacted if activists penetrate the leadership walls.

The Effects of Activist CEOs

If nothing else, the recent passing of F. Ross Johnson, former CEO of RJR Nabisco, should provide the impetus for Boards and CEOs to take a fresh look at their company’s potential exposure to activist investors. Under Johnson, RJR Nabisco assembled a fleet of aircraft that rivaled that of many small countries. He created and frequently hobnobbed with “Team Nabisco” — a stable of leading athletes across multiple sports with sizeable endorsement contracts. He was also the single force behind moving the company’s headquarters from its long-time Winston-Salem home to Atlanta, largely for reasons of personal and corporate image. Given the spending excesses and an incoherent portfolio of businesses, the stock price languished. When he tried to take the company private in 1988 at what was perceived to be a low price (“He’s stealing the company” was Wall Street’s assessment), the company was put in play, with Kohlberg Kravis Roberts & Co. ultimately winning a bidding war.

In contrast to Johnson stands the tenure of a contemporary, Jack Welch, Chairman and CEO of GE. During Welch’s 20-year tenure, GE provided shareholders a return of 4,000% — the equivalent of four times the return of the Dow and five times the return of the S&P 500. Welch might best be described as an internal activist. He aggressively managed GE’s
portfolio, famously requiring that business units be #1 or #2 in their segment or face being susceptible to disposition. He built synergies around businesses, such as linking manufacturing and financing businesses to fully leverage GE’s credit strength. He built service offerings around industrial manufacturing to “lean-out” business models. He had little patience for managerial missteps, aggressively moving managers among units. Finally, GE routinely “hit its mark,” continually announcing quarterly results just slightly above analysts’ expectation.

More than size alone, Jack Welch’s management (as an internal activist) made GE impervious to activist shareholders. For years under Welch GE was a “Premium Conglomerate” — and one of very few — in which the whole (GE) was worth more than the sum of its parts (the individual business unit valuations).

There are lessons for today’s corporate leaders in Johnson’s tribulations and Welch’s successes. Hostile takeovers and shareholder activism are more common place than in 1988. With low returns on traditional passive investments, there is more capital seeking higher returns through more aggressive alternative investments. Institutional investors, such as pensions and mutual funds, are more willing to hear out and side with activists as a means of increasing their returns on otherwise passive investments. Too often, these activists value short-term returns over long-term health and viability.

**Taking Action in the Today’s Environment**

In this current environment, public company Boards and CEOs can protect their companies by keeping a strong focus on creating shareholder value. One aspect of this focus is maintaining credibility with the investment community. The company’s strategy and source(s) of sustainable, competitive advantage must be clearly articulated and understood by this group. Furthermore, consistent progress in executing the strategy, year-by-year and even quarter-by-quarter, should be demonstrated.

Another important tool is thinking and acting like an activist pre-emptively. Boards and management must take a hard look at “value levers” that may not be effectively addressed, including:

- Maintaining too much low-return cash on the balance sheet that would be better returned to shareholders to reinvest;
- A capital structure providing too little leverage to ratchet up returns to shareholders;
- A portfolio of businesses that do not offer synergies and are worth more broken up;
- Conversely, a business that offers significant scale or scope benefits which would be part of an industry roll-up; and
- Lingering self-inflicted management or operational difficulties.

In this time of increasing activism, Boards and CEOs should follow Welch’s lead. The strategy process should include a review from the lens of a potential activist, challenging to ensure that all appropriate value levers are being pulled. Consideration should be given to having a formal “Devil’s Advocate” in the process, consisting of an internal or external team tasked with building the case for an activist. Once susceptibility is assessed, management and the Board can take appropriate action to ensure the long-term success of the company and keep or repel the barbarians at the gate.

As managing director at Verus Strategic Advisors, Paul Fenaroli leverages 30+ years of senior management, consulting and leadership experience to help businesses address an array of strategic issues and achieve sustainable growth. He pairs analytical insights with the vision and guidance that bring everyone from the C-suite to the frontlines together in support of a common goal. Satisfied clients range in size, industry and sales, but all have experienced the meaningful difference Paul has made in their business.