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Creating Organizational Success for Your CEO and Your Shareholders

By Eleanor Bloxham and Blythe McGarvie

Every CEO wants the share price to rise while they are at the helm. Unfortunately, new leaders often don't understand how to embed the financial acuity and discipline needed to vastly improve the probability of their success in driving company value. As part of their oversight duties, it is the responsibility of the board to ensure that the CEO is cognizant of the importance of instilling such acuity.

Fluctuations in the price of a company's stock reflect investors' views of future performance potential. One legacy no CEO wants is a record of poor stock performance during their tenure—or major fluctuations in stock price when they leave. The markets' attribution of poor performance to one corporate officer can be very disheartening. When former CEO Jurgen Schremp left DaimlerChrysler, the share price increased by 10 percent, reflecting market and investor sentiments that he was hurting the business and destroying shareholder value. A plummeting price upon a CEO's departure is also a negative sign, indicating the lack of confidence in the management team and the board more generally.

By contrast, price stability is reflective of an organization that has embedded leadership values and strong talent throughout its ranks. The success of Medtronic in doing this is instructive. The board promotes CEOs from within the company and ensures these leaders have well-honed financial acumen. Recently, Medtronic named Gary Ellis, whom it had groomed over the years for the role, to be its new CFO. Support mechanisms to transition him from treasurer to CFO helped make the change appear seamless to investors.

Director Summary: To create shareholder value and foster organizational success, CEOs must emphasize financial acuity and discipline across all levels of their company. Despite the apparent paradox, fiscal prudence is one of the principal drivers of innovation and wealth creation, particularly in merger and acquisition transactions.

Financial Leadership Is Critical

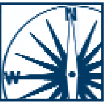
Organizations must develop systems emphasizing the "process of leadership" in order to create sustainable shareholder value. One key aspect of leadership is making effective choices. The insurance giant Marsh & McLennan Cos. discovered this after one of its major revenue streams disappeared following regulatory scrutiny. The new CEO, Michael G. Cherkasky, found the company did not understand the profitability of its 40,000 customers. Needing to act swiftly as the stock price plummeted and revenues deteriorated further, Cherkasky had to make quick decisions about customer profitability that—since no one had regularly analyzed or accumulated the financial data—may or may not have been accurate. Such financial leadership is critical. To create sustainable shareholder value, leaders and followers must develop financial acuity as a discipline respected throughout the company.

How—and where—should the discipline of financial acuity be embedded? To illustrate how embedding financial acuity can make the difference between success and failure, let's take a look at the opportunity many companies face when acquiring a company or major product line.

The first place to begin is in the boardroom. To establish financial acuity and discipline within the organization, corporate boards must assume responsibility in supporting and clarifying management's critical role in enforcing a fiscally prudent culture. Such a culture is crucial when it comes to crucial acquisition decisions.

Acquisition Strategy

Acquisitions can destroy value. According to McKinsey & Co. research, 75 percent of acquisitions fall into this category. Moreover, failed acquisitions result in increased likelihood of



shareholder litigation. Given this backdrop, many boards of directors seek to justify and re-justify purchase prices and evaluate management's ability to handle the risks. Yet properly undertaken acquisitions, those whose risks and benefits have been thoroughly analyzed and addressed both quantitatively and qualitatively, can be a successful strategy for growth. Making a successful acquisition, and subsequently integrating it into the buyer's existing company effectively, requires financial acuity of the highest order.

Management and the board must have more than a thorough understanding of the company's financial picture. They should be able to make reasonably accurate assessments of the future financial picture of their proposed acquisition candidate. This requires looking beneath the surface of reported earnings.

Due Diligence

Making a successful acquisition requires the financial acuity to understand the economics and value creation of the target and calculating the results an acquisition may bring. This financial acuity allows the board to determine reasonable price targets and to gain valuable qualitative information about the acquired firm. A real understanding of the economics of the organization will allow the board to assess not only the true performance, but also the forthrightness and character of the potential management team involved in the acquisition.

Complying with currently accepted practices and regulations is only the beginning of financially savvy management. Leaders must always perceive how actions taken today might be viewed under tomorrow's conditions, or under scrutiny by regulators, the press, and the public. CEOs must consider how actions meet the form of the law or past practices, because their actions will be judged by this measure as well as the substance of the transaction.

With the recent avalanche of frauds and restatements, CEOs and CFOs more actively concentrate on the financial accuracy standards promulgated by generally accepted accounting principles (GAAP). While leaders must adhere to these requirements, these standards are insufficient guides for creating real value. For one thing, rules change over time based on the guidance of the Financial Accounting Standards Board (FASB) and regulators. For example, rules for special purpose entities now follow true economic transfer of risk, not a formulaic calculation. Recent SEC recommendations on off-balance-sheet transactions indicate their and other regulators' interest in setting broader standards for economic analyses. As a leader, it is important to have the financial acuity to understand the true economics of a transaction or a business. Past guidance is no longer adequate.

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Finally, to be successful, acquisitions require management systems based on financial acuity. Making rational choices during integration and implementation is crucial, and leaders must address the inevitable issues that arise from a value—rather than a silo or political—perspective. This requires embedding financial acuity and disciplines throughout the organization, and especially where the front-line integration and implementation decisions will be made. It is this step of deeply embedding these disciplines throughout the organization that serves to limit the swings and volatilities in a company's stock price.

Conclusion

In order to maintain wealth creation and provide for today's customers and their needs, CEOs must be innovative. While it may seem counter-intuitive, appropriate financial disciplines and compensation mechanisms can spur innovation. With the right financial disciplines, creativity is funneled to the sectors with the healthiest prospects for success and value creation. With the right compensation mechanisms, boards can enforce long-term perspectives, which motivate management teams to invest and innovate. As the future unfolds, it is clear those companies that succeed in creating lasting economic value are those that have leaders who excel at instilling financial acuity throughout their organizations. Boards should ensure these important disciplines become a focus of CEO orientation, succession planning, strategic discussions, and compensation design. ■

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