Dollars & Sense

Assessing corporate cork *by Briar Foster*

In the context of character, the term cork refers to an individual's ability to shake off adversity, much as a submerged cork when released will quickly resurface. Individuals vary in the amount of cork they have, depending upon the situation. Some sports teams, like the Pittsburgh Steelers and the New York Yankees, seem to possess far more cork than their competitors. Broadly based investment markets, like real estate, metals and financial services, invariably show above average resiliency; however, once a publicly traded corporation makes a mess of its business, it takes a lot for investors to forgive a company that wounded them financially.

Corporations fall out of favour for many reasons: accounting fraud, moribund management, new technologies, aggressive competition, dumb investments, and the list goes on. Total disasters like Enron and Nortel suffered from "misleading" financial reports; Eastman Kodak didn't react quickly enough to the change in camera technology; in the 1950s, U.S. Steel seems to have grown so obese that it lost the ability to compete; Yellow Pages suffered when the digital economy all but eliminated the need for phone books; once a world leader in cell phones, Nokia waited too long before shifting production to smartphones; Blackberry possibly took their customer base for granted. In all these cases, why didn't management do something?

Globally, the industrialized economies are going through a long transitional phase from analog to digital that ranks in significance with the transition from stagecoach to buses and smithies to steel mills. Few industries will be left untouched. (Pity the elderly whose tremulous digits make smartphone keyboards unmanageable.) During such a major transition, corporate leadership is more important than ever.

During this transition phase, corporations that have been slow to accept the digital-based trends have done their shareholders a disservice. lnvestors have been wise to avoid them, because they have lagged in the market or worse. While Hudson Bay Company (HBC) was accumulating prime retail real estate with an aggregate worth nearly four times the $11 price of their shares, their retail business was being decimated by the likes of online shopping giant Amazon. Recently, FIBC's stock price has stabilized, but the question remains: How are they going to turn an operating profit on all that prime real estate? It's going to take a lot of hard work, imagination and "cork" to regain the interest of investors.

A slightly different case is that of General Electric, a trillion-dollar conglomerate that at one time manufactured everything from small appliances to turbines and jet engines and had healthcare and eco-management divisions, as well as a finance division ranked by some regulators as too big to fail. Recently, Jeff Imelt resigned his CEO position after 16 years. He is regarded as a very able administrator, but not a dealmaker. Conglomerates without a dealmaker at the helm are really only holding companies. Jeff Imelt is being replaced by John Flannery, who successfully headed GE's Health Science division.

During Imelt's tenure, GE's stock price underperformed the indices. The company was widely thought to be a bloated but a well-run company that badly needed to focus its business in order to grow its profits. Yet selling off GE Finance assets took many years to complete, as did its sale of the small appliance division. Like many manufacturers, GE had moved plants to Mexico instead of modernizing them at home. Employee morale suffered. Eventually, the dividend was cut. To John Flannery's benefit, expectations of a GE recovery are not robust.

This past June, I attended a presentation by Elyse Allen, CEO of GE Canada. The theme of her remarks was how and why all manufacturers, not just GE, must embrace the digital age. Specifically, she cited GE's $238 million modernization of their aerospace plant in Bromont, Quebec. Not only were robots central to the modernization, but GE will be adding 20 percent more personnel to the facility because the modernization will enable them to take on more business. A hopeful sign of a turnaround at GE?

The question remains: How fast can the new CEO get rid of the holding company culture of a trillion-dollar mammoth like General Electric? Some liken the task to turning around an ocean liner in the mid-Atlantic. The cork-less comfort of a holding company culture will not be gotten rid of easily. It will take the efforts of many like Elyse Allen and John Flannery to turn the GE ship around.

Much like individuals, corporations have a particular character. It is produced by the CEO, directors, employees and the nature of the business. Investors need to find ways to assess this character. During this transitional period, it would be especially helpful to know the approximate age of the senior management and directors and what experience they have had in other lines of business. Most of this information is available in the online editions of the annual reports. It can be illuminating to read the chairman's and CEO's presentation to shareholders. Is it forward thinking or merely pats on the back to the management team? Investing in a company without assessing its character is like hiring an assistant without a CV and without checking references. A period of transition creates dangers as well as opportunities.

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