

# QV UPDATE

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## It's People & Principles Behind the Numbers

A friend of mine recommended reading a book on leadership and decision making. It was not written by a former CEO, nor a former world leader. Rather, it was written by two combat-proven US Navy SEAL officers who honed their skills in some of the most dangerous places in the world. They describe some of the lessons they learned in their book called *Extreme Ownership*. Jocko Willink and Leif Babin (W&B) have used the principles in the book to train new SEAL officers and to consult business leaders through their private sector firm.

Over the years, we have witnessed how the people operating a business can have a dramatic influence on its success. As discussed below, some of the principles in the book have been used by a number of successful Canadian companies.

### Principle: Check the Ego

Many successful individuals have an ego that has driven them to their current position. However, the ability of a leader to admit mistakes and make adjustments is an important characteristic, otherwise there may be severe implications for the business. An executive willing to admit a mistake is an executive we are interested in investing with. As an example, Saputo, a global cheese producer, entered a new geography via an acquisition in 2006. The CEO felt it could be a potential beachhead to expand their business. After seven years, however, the CEO announced the division would be closed. He stated that despite their best efforts, they realized they needed to have stronger brands to compete in this market. In his final statement, the CEO affirmed that this did not mean they would never enter the geography again, but they now understand what has to be done for next time.

### Principle: Decentralized Command

It would be impossible for a leader to manage hundreds of people. W&B believes humans are not capable of managing more than six to ten people. Furthermore, the authors feel junior leaders must be empowered to make decisions on the front line to adjust to the environment, always remaining focused on the mission goal.

Alimentation Couche-Tard, an international convenience store operator, is an example of a company with a decentralized structure. They have determined that the best size for a division is 500-600 stores. Each division is led by one executive. However, this group of stores is further decentralized to include regional managers, and then district managers, who oversee individual store managers. At each level, the leaders are expected to interreact with their direct reports to ensure the vision of Couche-Tard is being executed across the store network. A component of Couche-Tard's vision is to "challenge ourselves every day to think like customers and act like owners." Store managers can make adjustments in their stores, within certain parameters, to meet the needs of their particular market. This important philosophy has been used to expand Couche-Tard's store network from one store in 1980 to over 12,000 stores today.

### Principle: Plan – What is the Desired Outcome?

Leaders must identify the most important objectives for their team. Then, the plan needs to contemplate what resources and activities are required to meet the objectives. Finally, leaders must determine how the plan is going to be communicated throughout the organization. Toromont, which primarily sells and services Caterpillar equipment, states that its purpose is to "increase shareholder value by driving consistent and profitable earnings growth over the long term." They do so by analyzing every facet of the business to ensure that facilities are the right size and inventory is managed appropriately. This plan has been consistently conveyed in our meetings with the company and in its corporate communications. Moreover, the compensation structure is aligned with the objectives, with the bulk of executive bonuses based on return on shareholder equity. Toromont's 5 year return on capital and return on equity record makes it one of the top 20 public companies in Canada.

Our job, as investors, is to identify management teams that are able and committed to executing their plan consistently. As the founder of Four Seasons Hotels, Isadore Sharp, has said, "We are only what we do, not what we say..."