

**Avondale Perspective:**  
Aligning the Board and Management  
for Value Growth

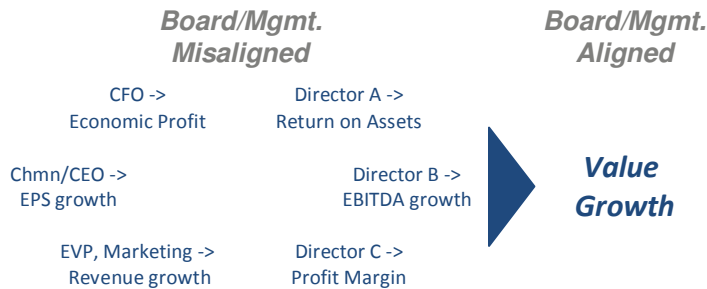
**Re-examining Value:**  
Managing for value in today's  
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**Avondale Connections:**  
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## Avondale Perspective: Aligning the Board and Management for Value Growth

### Do your board and senior management agree on what's really important?

Chances are, your senior management team and board are dedicated to growing shareholder value. It's also likely that each member of management and the board has deeply held convictions regarding the drivers of shareholder value, based on unique professional experiences. Is it volume growth and market share, or productivity and margin improvement? Revenue growth or return on assets? Big, flashy mergers or steady investment in competitive advantage? Quarterly EPS expectations or non-financial strategic milestones? EBITDA growth and P/E multiples or economic profit and discounted cash flow?



These convictions form a lens through which each executive and director evaluates strategy, investment and operating decisions. Their perspectives often conflict with one another, resulting in endless debates, muddled strategies, slow decision making and confusing messages to employees and investors. The CEO and management team waste time reconciling and managing conflicting agendas rather than driving value growth.

Private equity has already figured this out. As the authors of "The Private Equity Edge" point out, "Common goals are critical. Large committees and boards composed of individuals with different (continues on following page)

### Re-examining Value

Once upon a time, corporate objectives were pretty straightforward: Double the stock price every three years (for high-flying tech companies), or every seven years (for commodity manufacturers), or somewhere in between (for everyone else). Keep the same EBITDA multiple, grow margins somewhat, and more or less double revenue. Stock price management – the practice of, for example, manipulating EPS with short-term actions, or share repurchases – was an acceptable proxy for "shareholder value."

This goal-setting approach to growth doesn't work anymore. It has become clear that over finite time periods, the stock price has less to do with management actions than with macroeconomic factors or stock traders' speculations. Setting objectives for absolute stock ... (continues on page 5)

ideologies and multiple goals are slow to act, and they achieve less than those with a common goal. Smaller private equity boards focused on value give their portfolio companies a clear edge.”

Corporate CEOs can achieve the same clarity and singleness of purpose among their board directors and executives, while retaining the advantages of diverse backgrounds and perspectives. The first step is gaining an understanding of the nature and severity of current misalignment, the barriers it is creating, and the areas of common ground on which to grow.

## The Alignment Audit

We have found that a three-step Alignment Audit (diagram below) can be extremely effective in illuminating the nature and sources of misalignment, and in so doing setting the stage for true alignment going forward. We suggest that the audit be performed with the senior management team first, if needed, and then with the board.



### Step 1: Interview

Interview each stakeholder about his or her respective goals and objectives for the company. This should be a relatively unstructured discussion about what each thinks is important to the company and why. How does each member view the company today? What are their expectations for the future? What metrics do they use to measure success? Sample questions are provided to the right, but the specific content of each interview should be guided by the interviewee’s priorities and responses.

Management teams and boards are not immune to dysfunctional group dynamics that prevent the wisdom and insights of individuals from adding to the effectiveness of the group. For this reason, board and management team members should be interviewed individually by a trusted, neutral party. It should be made clear that the sources of interview revelations will remain anonymous and confidential.

#### Questions to ask key stakeholders

- How do you define “success” for the company?
- What three metrics are the most important indicators of success for the company?
- What are the company’s top three priorities?
- Do you think the company is overvalued or undervalued?
- What do you think the company must do to double its value? How long will that take?
- How important is it to meet or beat quarterly earnings expectations?
- Is it more important to grow revenue or margins?
- Does the company have the people, capabilities and assets required to execute its strategy?
- How attractive are the markets we serve? Are our products and services differentiated?
- Should we be buying companies, selling assets, or focusing on internal development?
- What information do you need in order to make better decisions as an executive or director?



## Step 2: Compare and Contrast

Your objective in analyzing the interview notes is to discover the degree of alignment or misalignment along the following dimensions:

- a) How is success or value defined?
- b) What is the company worth today?
- c) What can and should the company be worth?
- d) How long should it take to get there and why?
- e) What are the company’s most important value drivers?
- f) What missing facts and data are needed in order to improve their conclusions?

In addition to identifying the degree of misalignment, you’ll want to know if current differences are *fundamental* (e.g., stock price versus intrinsic value), *semantic* (revenue versus volume growth), *knowledge-* or *experience-*based (marketing versus HR versus finance backgrounds), or *due to missing facts and data*. Understanding the nature and underlying causes of current misalignment will guide your efforts to align your executives and board directors going forward.



## Step 3: Share and Reconcile

Share and discuss the results of the analysis with the board and senior management team. A valuable approach is to ask the group to predict the results before you share your analysis. We have found that more often than not, the members of the group are already aware of alignment issues. The value of this exercise comes as much from providing a safe forum for the self-acknowledgement of these issues by the group as it does from the interviews and analysis itself.

Once the degree and nature of misalignments are confirmed and acknowledged by the group, you can move on to defining a plan to close the gaps. *Fundamental* and *semantic* misalignments require intense, facilitated discussions to reconcile. For example, goals for quick increases in stock price need not conflict with longer-term, sustainable value growth. Other seemingly fundamental disagreements often result from one person’s goal being another person’s driver. Identifying or recreating examples of such misalignments contributing to slowed and conflicted decision-making will help keep everyone motivated to find common ground.

*Knowledge-* or *experience-*based differences can be addressed through a program to level-set your executives’ and directors’ appreciation of key functional drivers of value in your business. This must be much more than a course in “Finance for Non-finance Executives,” and it won’t happen overnight. An effective way to accomplish this is to devote a portion of each board and executive team meeting to a

discussion of one key area of the company and how it affects the company’s objectives.

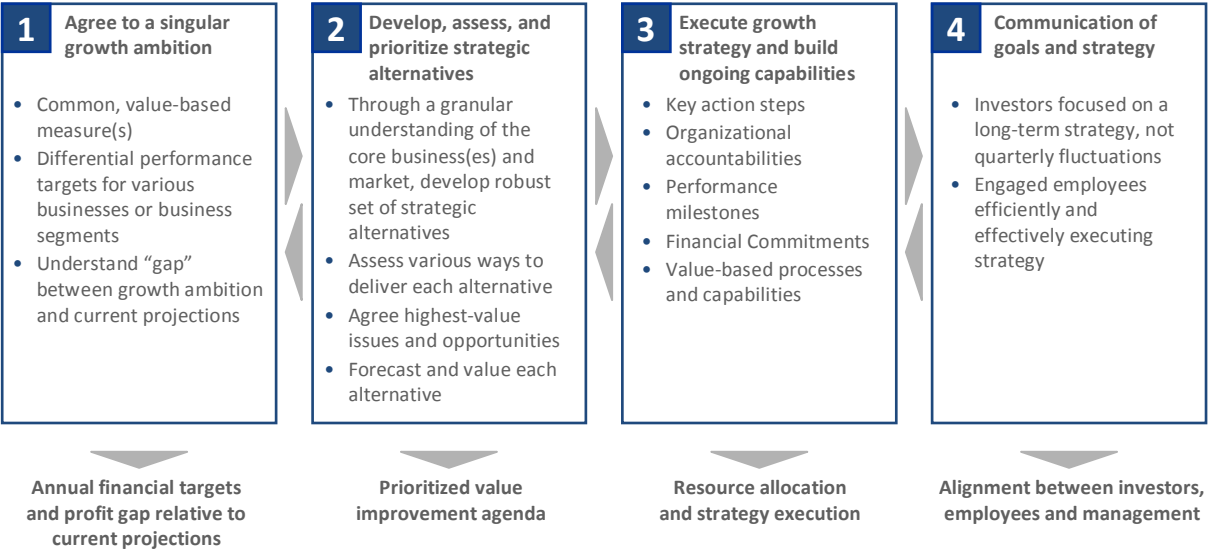
Where *facts and data are missing*, there is usually misalignment. Aligning around strategic priorities can be quite straightforward when everyone shares the same facts regarding market attractiveness, competitive position, key capabilities, opportunities and threats, customer and product profitability, etc. Justifying and prioritizing investment in targeted fact-gathering can be one of the most valuable outcomes of the alignment exercise.

### Align for Value

As you move to reconcile conflicting goals and perspectives, you will begin to create more clarity around a shared value-creation agenda for the company. Consider the benefits of this shared agenda:

1. A management team freed to focus on core value-based objectives that drive long-term, intrinsic value growth, rather than on board politics.
2. More clearly prioritized strategic initiatives according to their relative importance to internally consistent value-based measures.
3. Enhanced execution from a shared confidence in the value objective and key drivers for the company.
4. Clear and unambiguous communication of growth goals and strategies to employees and investors.

## Alignment of the Board and Management will Drive a Shared Value-Creation Agenda



In our next newsletter, we'll discuss how to use intrinsic value to credibly guide and evaluate strategic progress. In the meantime, developing a deeper understanding of how well your key stakeholders are aligned around current objectives will help you identify potential trouble spots and opportunities for achieving shared goals around intrinsic value going forward.

### *Re-examining Value*

(continued from page 1)... growth is a fool's game.

What's the alternative? When stock price is no longer considered a valid or appropriate benchmark, how does a management team establish effective, value-based corporate performance goals? How does it align its board and investors around those goals, cascade objectives to its operating units, and hold itself accountable for value growth?

We're not saying that stock price is unimportant. We are saying that short-term stock price fluctuations, unconnected to changes in intrinsic value (defined as the present value of expected future cash flows), are bad benchmarks. A better benchmark is sustainable growth in market value, and that comes only from real growth in the intrinsic value of the company.

Management efforts, board attention, investor communications, and management incentives must focus on intrinsic value and its drivers, not on changes in the stock price over finite time periods.

This isn't easy. Managing to intrinsic value means that sometimes bonuses will be paid when the stock price is down, and that sometimes bonuses will go unearned even as the stock price rises. Keeping everyone happy under such circumstances requires a shared view of intrinsic value, its drivers, goals, and growth strategies, among management, the board and investors.

There is no independent, objective arbiter of intrinsic value. Managing to intrinsic value requires a reliable methodology for determining what intrinsic value is, and a deep understanding of its key drivers. Management and the board must take an explicit position on intrinsic value, and that position will be only as good as the quality of data and the soundness and objectivity of the judgment behind it.

## About Avondale

Avondale Consulting advises corporations on how to create **profitable growth** and increase the financial value of their business. Avondale works with senior management teams across a range of industries to develop practical and actionable solutions that sustain long-term value creation.

## Upcoming Events

- Avondale Consulting will be hosting a table at the Chicago Booth Economic Forecast Luncheon on December 2<sup>nd</sup> in Chicago. If you are interested in joining us please contact Michael Aquilino via email, michael.aquilino@avondaleconsulting.com or phone, (847) 910-5003.
- In 2010, Avondale will be hosting a number of breakfast discussions in cities throughout the U.S. These intimate discussions will be among a small group of value-oriented senior executives and highlight specific issues facing our clients. Contact one of our principals (contact info below) if you are interested in receiving an invitation to an upcoming breakfast.

## Contact Avondale

For more information on Avondale Consulting, contact one of the Principals or visit [www.avondaleconsulting.com](http://www.avondaleconsulting.com).

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