

Our Approach to Evaluating Corporate Management Teams

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Executive Summary

- Leadership quality can significantly impact a company's performance, strategy, and long-term value creation.
- We mitigate the impact of behavioral biases throughout our investment process, including our evaluation of management teams.
- We believe that evaluating a corporate management team requires a multifaceted approach that combines quantitative analysis of financial and operational performance with qualitative assessments of leadership qualities, strategic vision, and alignment of interest.

Companies Don't Run Themselves – People Matter

The Cornerstone investment team reviews hundreds of companies each year, from small family-controlled industrial distributors to cutting-edge technology companies worth trillions of dollars. While AI may eventually take over the world like Skynet, for now at least, people matter, from the factory floor to the C-suite. The decisions those people have made, particularly those in management roles, have had lasting impacts on a company's future track record and its value, and will in the future as well. Evaluating corporate management teams is critical to our team's investment process. Below, we walk through the role of management assessment in our fundamental investment process.

Strong Management Can Help Drive Value Creation

Leadership quality can significantly impact a company's performance, strategy, and long-term value creation. We consider several key factors to assess a management team effectively and employ various analytical techniques.

First and foremost, we examine the management team's track record. We evaluate the company's financial performance under their leadership, including metrics such as revenue growth, profitability, return on invested capital, and shareholder returns. We compare these figures to industry benchmarks and competitors to gauge relative performance. Additionally, we consider how the team has navigated challenging periods or industry disruptions, as this can provide insight into their adaptability and crisis management skills.

Capital allocation decisions represent a core element of a management team's track record. We assess how they prioritize investments in the business, acquisitions, dividends, and share repurchases, among other uses of capital. We ask ourselves whether these decisions align with the company's strategic goals and shareholder interests.

Next, we assess the management team's strategic vision and execution capabilities. We review their stated objectives and compare them to actual results. Are they consistently meeting or exceeding their targets? Do they have a clear, coherent strategy for long-term growth and value creation? Is it consistent with the past or has the strategy evolved or changed?

Leadership style and corporate culture are also critical factors. We analyze the team's communication with shareholders, employees, and other stakeholders. Do they foster transparency and accountability? We find significant value in listening to and watching earnings calls, conference presentations, and interviews, as we assess management teams. As discussed below, we do not seek to meet directly with corporate management. C-level executives often possess outstanding sales skills, and we seek to avoid allowing them to "sell us" on their company's prospects!

Alignment of interests matters a great deal. At Cornerstone, every investment professional allocates personal capital to our investment strategies and owns equity in our firm. We expect the same from the teams that manage our portfolio companies. We evaluate executive compensation policies detailed in proxy statements and prioritize management teams that are heavily invested in their companies and increasing their levels of ownership.

We Mitigate Behavioral Biases When Evaluating Management

We seek to limit the impact of behavioral biases on our investment process while also taking advantage of the behavioral biases to which other market participants fall victim. As a matter of course, we do not seek to meet with the management teams for our portfolio companies. Management teams often possess outstanding sales skills which can lead investors toward overconfidence bias, and we have no interest in having them “sell us” on their companies’ prospects. While we are mute when it comes to interacting with management teams, we are certainly not deaf.

We Will Not Compromise Business Quality for Strong Management

Additionally, we note that our assessment of a corporate management team follows our assessment of a company’s underlying business model. We refuse to sacrifice business quality in order to add an exceptional management team to our portfolio. In Berkshire Hathaway’s 1980 shareholder letter, Warren Buffett and Charlie Munger state that “when a management with a reputation for brilliance tackles a business with reputation for poor fundamental economics, it is the reputation of the business that remains intact.” We could not agree more.

Management Teams Matter

In conclusion, we believe that evaluating a corporate management team requires a multifaceted approach that combines quantitative analysis of financial and operational performance with qualitative assessments of leadership qualities, strategic vision, and alignment of interest. By examining, discussing, and debating these elements, we can seek to comprehensively understand a management team's capabilities and potential impact on the company's future performance and value creation.

We encourage you to reach out to us if you would like to learn more about our investment process. Please contact Paul Slakter, Partner and Head of Business Development, at Slakter@cornerstone-ip.com or 813-240-6191. We have built a unique approach to equity investing with strong near and long-term performance that speaks for itself, and our investment team values every opportunity to share our story.

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