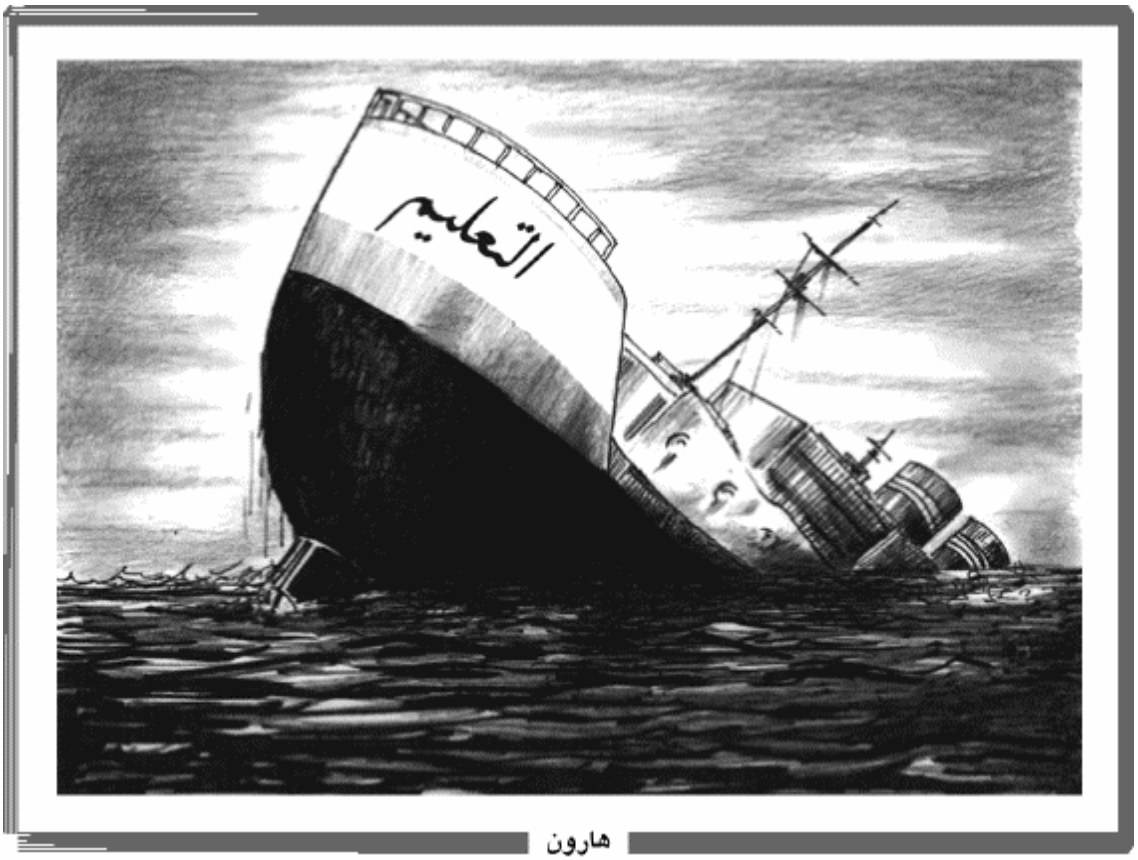
Why Are My Investments Sinking?



The distance a chief executive is capable of looking out onto the horizon is critical to his or her ability to successfully navigate through the turbulence that will confront any corporation.

Sixty-five percent of corporations listed on the TSX do not return their cost of capital and we should be compelled to ask why not? What is missing in the governance of publicly listed corporations that is allowing this disappointing statistic to prevail? And, how are investors and directors responsible for this dismal performance? Those Canadians who are diligent enough to plan for their retirements by investing into mutual funds or directly into the market face the prospect of seeing very little real growth over time. Couple this with mutual fund management fees and the effects in recent years have been results that return little more, if anything above increases in inflation. Your fund manager is apt to reply indicating that business has been facing a prolonged recession or that we are now operating within a complex global free market economy. It is obvious that the fund managers as well as the CEOs are failing miserably at responding to this complexity.

Every mutual fund manager will caution an investor that he or she should be invested for the long haul and that timing the market is risky yet the only apparent manner that a

decent return can be captured today with a majority of publicly traded companies appears to be associated with the volatility experienced with the market. Granted there are exceptions; Warren E. Buffet's Berkshire Hathaway being one and within the corporate arena companies like General Electric. What do they have that others are missing? Between 1964 and 2004 Berkshire Hathaway returned average compound annual returns of 21.9%, twice the performance of the S&P, and if one reads Buffet's annual message to Berkshire shareholders there is little doubt regarding his capability in terms of understanding the abstract world of economics. If he were a ship's captain he would certainly know where the storms were brewing and where the currents were apt to affect the safe passage of the voyage. Jack Welch left similar impressions when he headed General Electric and under his leadership GE realized unprecedented growth. Jeffrey Immelt has continued the trend and obviously Welch understood the significance of succession planning. In business for over 100 years GE has only had twelve individuals at the helm; some leading the organization for as much as twenty or thirty years in the top post.

So what do Buffet and Welch and Immelt have that others don't possess? Is it that magical competency or leadership characteristic that eludes so many others? The simple analogy is it is the distance they are capable of looking out onto the horizon. The late Elliott Jaques references this ability to look out as discretionary time span, or the length of time of the longest tasks the individual is working on and this complexity can be observed in the language used by the individual. It is no coincidence that Warren Buffet indicates in his 2004 shareholder message that he expects his managers to manage their assets as though it was the only asset that the family would own for the next 100 years. Why pick 100 rather than 50 or 25? The simple answer is Buffet's discretionary time span probably reaches out 100 years. In Jaques' classification this would be consistent with stratum eight, or abstract bi-conditional complexity of mental processing. Most of us mere mortals (approximately 80%) are either stratum one or stratum two thinkers with comparable time spans of one day to twelve months and recognizing that many of these same individuals are invested in the market it is understandable why fund holders and corporations become fixed on quarterly and annual returns even though these short durations are insignificant in their relationship for planning one's retirement or gauging the long term performance of the fund or the corporation.

Many executives are rewarded for similar short duration performances with lucrative annual incentive schemes and stock option plans that allow them to capture the volatility of the market. Absent strong governance these compensation systems can become incentives for the corporate officers to forego the long-term interests of the business in favor of short terms results. Immelt and Buffet on the other hand will be managing their enterprises so that the short-term interests are compatible with their long-term growth strategies. The annual return is but a vehicle for generating the essential cash flow that is necessary to fuel corporate growth.

Dr. Jaques, among other considerations has defined a system of felt fair pay for executives and employees at each level in the organization, as well as the ideal manner for structuring organizations to ensure that value is created at each level within the organization. Succession planning and developing the talent pool in the organization are among the managerial practices that he defines as essential to every organization. It is no accident as a consequence that a highly capable CEO like Jack Welch had Jeffrey Immelt available to succeed him and you can rest assured that he had a few other options and contingencies in play too. In today's world of revolving doors for Chief

Executives and society's easy bake instant gratification mentality the challenge is looking beyond the quarterly and annual returns and making investments based on these inconsequential statistics and looking out on the horizon; not necessarily to navigate through the complexity but rather to understand who is piloting the ship. As long as you're on board the right ship you can expect a safe passage.

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About the Author

Al Gorman is a freelance author with an innate curiosity about the effectiveness of organizations and the manner in which people behave within organizations as an expression of the functional capability of organizational structure and systems. His specialized interest is centered on designing requisite organizations and an expansion of stratified systems theory pioneered by Dr, Elliott Jaques. He has written and published a management book as well as several articles related to organizational effectiveness. He has had extensive managerial experience within industry.