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Book Review: Is "radically rational" still the key to CEO excellence?

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In his 2012 book, "The Outsiders: Eight Unconventional CEOs and their Radically Rational Blueprint for Success", author William Thorndike explores the management approaches and traits of eight seemingly different and relatively uncelebrated CEOs of large US companies that managed to outperform their better-known peers (such as GE CEO Jack Welch) and produce exceptional returns for their shareholders over decades – annual returns that eclipsed the S&P 500 Index by over 20 times and their industry peers by over seven times.

I was curious about the book given that Warren Buffett ranked it #1 on his famous Recommended Reading list in the 2012 Berkshire Hathaway Annual Shareholder Letter – perhaps partly because Buffett himself features as the eighth case study? Thorndike has had a long career in private equity investing and research, having co-founded private equity firm Housatonic Partners, so it came as no surprise to me that savvy capital allocation is one of the major themes he addresses across his corporate examples.

In the interest of brevity, I won't go into each of Thorndike's examples, although they all offer the reader very interesting and educational lessons. Instead, I want to highlight the main characteristics the CEOs shared that helped drive such extraordinary success for them and their shareholders.

Anti-conglomerate structure

Many of the companies grew through acquisitions over time – making even hundreds of corporate acquisitions -- but the CEOs defied the conventional wisdom of creating an overarching central structure with centralised decision-making power and a large, multi-layered management hierarchy. This was deemed to be costly, as well as disempowering for local managers. Instead, they decentralised authority and motivating staff by giving them more responsibility on the ground.

Says Thorndike: "There is a fundamental humility to decentralisation, an admission that headquarters does not have all the answers and that much of the real value is created by local managers in the field."

Strict cost management and operational excellence

The CEOs, faced with challenges such as economic downturns, inflation or tough new regulations over the years, opted for hard choices like cutting jobs (including downsizing management), selling their weaker, less-profitable businesses and growing the stronger ones. Some, like Capital Cities Broadcasting CEO Tom Murphy, focused on what they knew best rather than diversifying across multiple industries. All optimised their operational structures and processes, and took other measures to preserve profitability. Their critical eye and "radically rational blueprints", as the author terms it, produced outstanding company results and shareholder returns over time.

Excellent capital allocation*

Each of the CEOs demonstrated excellence in deciding how to allocate capital over time, recognising that its efficient use was vital in creating long-term value. Teledyne CEO Henry Singleton leveraged Teledyne stock very successfully to buy companies in the early 1960s when its stock was overvalued, and pioneered buybacks over many years when it was undervalued. Berkshire Hathaway CEO Warren Buffett is particularly famous for his successful capital allocation, and Thorndike recounts his excellent example. However, lesser-known Ralston-Purina CEO Bill Stiritz was also a particularly active capital allocator who repurchased stock in the 1980s over resistance from the company's Board and bought companies with strong brands and cash flows with excellent long-term growth prospects to improve the group's own cash flows. He also spun off businesses where shareholders could choose to sell the new shares or hold them. Meanwhile, several avoided using debt and/or equity to grow when market conditions weren't appropriate, and all consistently asked how each dollar available to the company could best be put to use.

Corporate culture

Dick Smith, the CEO for General Cinema for 43 years, actively encouraged his executives and middle-management to take critical views and disagree with him, rather than creating a "cult of the CEO" around himself. This instilled an open and more free-thinking environment in which better decisions – and fewer mistakes-- were made and created a broader sense of ownership and engagement that can be rare in large companies. Equally, several of these companies succeeded in developing entrepreneurial cultures where good managers were motivated and rewarded for strong performance and the poor ones moved out, which went hand-in-hand with de-centralisation as noted above.

In conclusion, as an employee of a capital allocator myself, I would agree with many of the observations made by Thorndike in this book, which stresses that one of the chief determinants of an outstanding CEO is their ability to focus on generating excellent long-term returns for shareholders. It is not their celebrity, the total amount of company earnings or sales, company size or adherence to conventional wisdom. There are many valuable take-aways from this book, particularly for investors or entrepreneurs seeking successful growth models. However, it is also an example of capitalism at its purest (or should I say most hard-core?), reflecting the fact that it was written 12 years ago in the US -- before other considerations such as environmental, social and governance (ESG) factors (like the fight against global warming), gained more importance and began to play larger roles in investment decisions. Today, these "softer" but equally positive factors deserve more attention in a CEO's decision-making and accomplishments; in my view a CEO these days should also be judged on the ESG impacts their company has had on the world.

*As Thorndike explains: "Basically, CEOs have five essential choices for deploying capital—investing in existing operations, acquiring other businesses, issuing dividends, paying down debt, or repurchasing stock—and three alternatives for raising it—tapping internal cash flow, issuing debt, or raising equity. Think of these options collectively as a tool kit. Over the long term, returns for shareholders will be determined largely by the decisions a CEO makes in choosing which tools to use (and which to avoid) among these various options. Stated simply, two companies with identical operating results and different approaches to allocating capital will derive two very different long-term outcomes for shareholders."