Beware of Any Business with a Lavish Head Office

News Article

Fifa Headquarters in Zurich

If you want to take measure of a company, look at its headquarters. The HQ of Fifa, football's scandal-hit governing body, for example, comprises 11 acres on a wooded hill overlooking Zurich. Its compound costs $255m, and includes five underground levels, clad in black Brazilian granite. The conference room has a floor of *lapis lazuli.* Not bad for a non-profit organisation.

Back in the real world, they do things a little differently. Some of the most successful entrepreneurs and business owners are almost clinically averse to spending cash. Tom Murphy, of Capital Cities Broadcasting (whose shares gave an extraordinary cumulative compound annual return of more than 22% over a period of 19 years), was nothing if not frugal. The business was based in a dilapidated former convent. When he joined the firm he was advised to project a more professional image to advertisers. He responded by painting the two sides of the building facing the road. The other half of the building he left untouched.

Making a virtue of frugality

Or consider TCI (which under CEO John Malone delivered a remarkable 30.3% compound annual return over 26 years). Its corporate HQ contained surprisingly few executives, even fewer secretaries, and a handful of peeling metal desks on a Formica floors. The company employed a single receptionist and incoming calls were routed to an answer phone. When TCI staff went on the road, they tended to stay at motels. Chief Operating Office JC Sparkman confesses, "Holiday Inns were a rare luxury for us".

Then there's one of the most celebrated investors of all time – Warren Buffett. His company's investment returns from 1985 to 2005 compounded annually at an astonishing 25%. But while Berkshire Hathaway has more than 270,000 staff, the corporate headquarters in Omaha, Nebraska, caters to just 23. Buffett lives in the same house in Omaha that he bought in 1958 for just $31,500.

As William Thorndike makes clear in his study of business managers, *The Outsiders*, the most successful CEOs tend to be the ultra-cautious when it comes to spending. As Thorndike emphasises, what every successful business manager and owner has in common is a fierce respect for shareholders' capital. They acknowledge every day that they are a custodian of their shareholders' money, and it is not to be squandered.

What are they hiding?

In fact, much of what we tend to associate with a successful business turns out to be a masquerade. Banks cultivate an image of opulence with the implied permanence of marble halls. This helps to disguise the poverty at the heart of many of their balance sheets. Many CEOs devote considerable time and effort to promotional activity. But some of the most successful business owners have shunned investor relations almost completely, preferring to let the share price alone do the talking.

So there are a number of corporate characteristics that represent red flags to the discerning investor. Lavish company HQs are among them. Thorndike points out that, over the last ten years, three media companies – The New York Times, IAC and Time Warner – have all constructed Taj Mahal-like edifices in midtown Manhattan at vast expense. Over the same period, not one of those companies has engaged in value-creating share repurchases or enjoyed market-beating returns.

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By contrast, not one of the outsider CEOs he profiles ever overspent on the company HQ.

Know what to delegate

What Thorndike's outsiders also have in common is an ability to delegate. Their organisations are typically highly decentralised – there are very few staff at the corporate HQ to begin with. But there are also limits to delegation. The very best executives are also masters of capital allocation, and they tend to keep this to themselves. Charlie Munger, Buffett's right-hand man, describes companies as "an odd blend of decentralised operations and highly centralised capital allocation", and the mixture of delegation with hierarchy seems to act as a healthy antidote to what Buffett has otherwise disdainfully described as "the institutional imperative" (to underperform).

The merits of sound capital discipline can be best observed when it comes to the topic of share buybacks. Many CEOs buy back their company shares without any consideration of relative value. But share buybacks conducted at a high premium to the company's inherent worth are value-destructive. The only buybacks that make sense are those conducted at a discount to the company's book value. Those are value-accretive. When managers of companies such as GlaxoSmithKline are willing to buy back stock at 1.1 or even 1.5 times book value, genuine vale investors will be watching with alarm.

Frugality in business is a wondrous thing.

Source: MoneyWeek

Fifa's famous boardroom

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