Can a New CEO Really Make a Difference?

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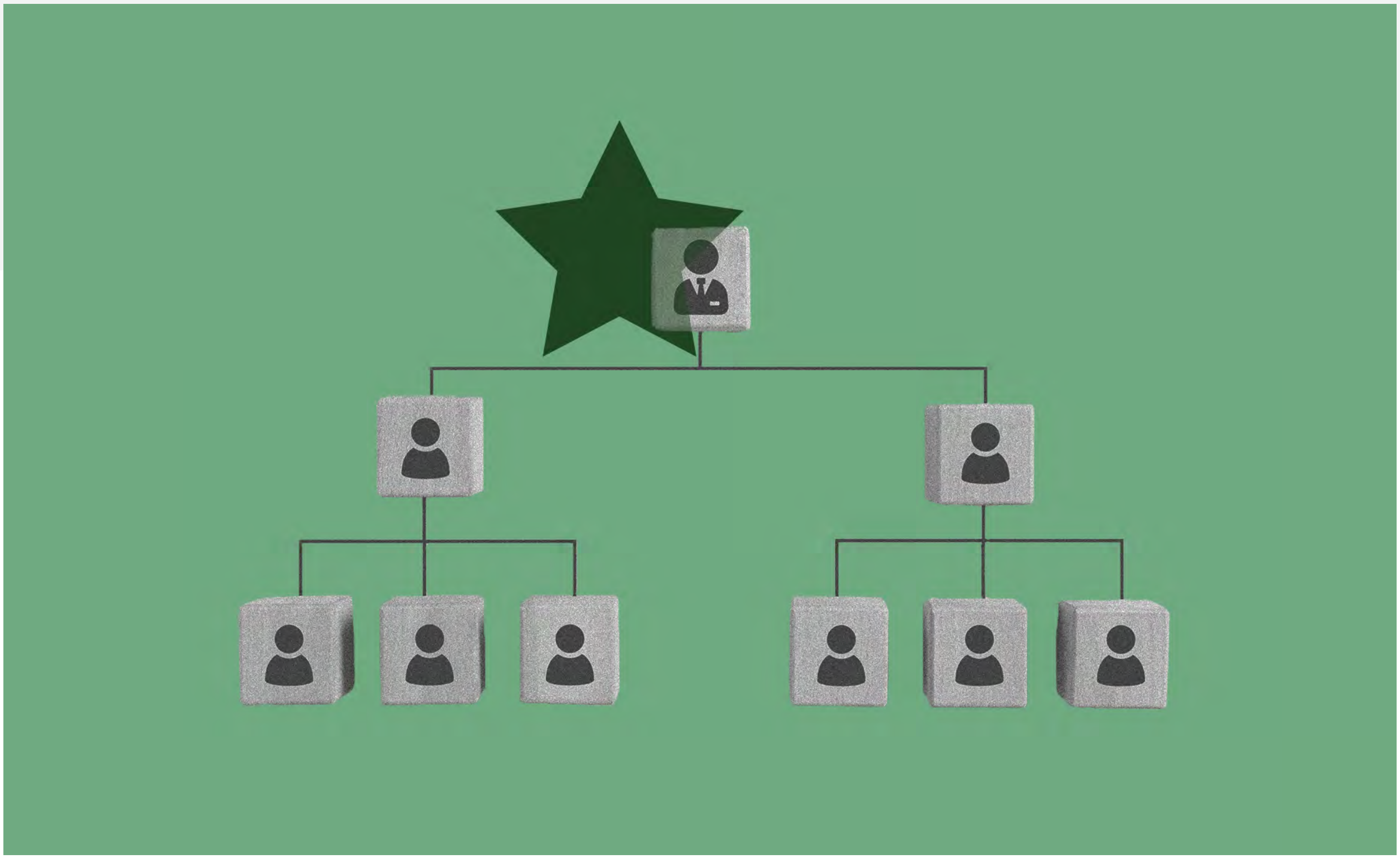

Intel and Schneider Electric along with some other big companies decided to replace their chief executive officers in recent months. As investors wonder what effect new leadership might have on these businesses, they should start by asking themselves two questions: Is the company changeable? And would change be a good or bad thing?

It's tempting to think that a new CEO can reshape a business overnight. Yet investors often overlook how the timing of a CEO's appointment is a factor in that person's ability to steer the company in a new direction. While a CEO controls key decisions—pertaining to hiring, spending, corporate strategy, and workplace culture—those efforts can only gain traction if the company is one in which change is possible. And that isn't meant to be an abstract observation. Rather, a company's susceptibility to change is partly reflected in a quantifiable metric found in every 10-K filing: its asset life.

Asset life is the estimated duration over which a company's assets remain useful to the business. Assets can be physical structures, such as property, plants, and equipment, but they can also be intangible, such as investments in research and development.

By examining average asset life, investors can gauge how long capital expenditures made in the past will continue to shape the company's capabilities and cash flows. Shorter asset lives allow new leadership to shift investment priorities relatively quickly. Conversely, longer asset lives mean that earlier investments remain in place for years or even decades, limiting the new CEO's ability to quickly implement large-scale changes.

A related metric is the ratio of net property, plant, and equipment (PPE) to gross PPE. A high ratio indicates the outgoing CEO heavily invested in the company's facilities and equipment. A declining ratio suggests that the outgoing CEO invested little to maintain or upgrade them—or as some might say, management was "sweating the assets." The latter scenario constrains the next CEO's ability to implement significant changes. Think of it as the difference between buying a well-maintained house and one needing extensive repairs: The same renovation budget would achieve far more in the well-maintained house, while at the fixer-upper the money would need to be used for necessary but less exciting projects.

Take Intel as an example. Once the leading chip designer and manufacturer, the US company has fallen behind rivals such as NVIDIA and TSMC. Its CEO was pushed out in December, and shareholders are hopeful that his replacement can restore Intel to its prominence. The challenge is that Intel is not easily changeable. Chipmaking is intricate and capital intensive, and the process relies on specialized tools, machinery, and facilities that last for many years. According to its filings, Intel's manufacturing assets can remain in service for up to eight years, with some facilities lasting over two decades. Despite recent capital investments, the net-to-gross PPE ratio hasn't dramatically improved, suggesting legacy infrastructure still defines the firm's capabilities. A quick pivot is tough.

The other question to ask about an incoming CEO is whether change at the company would be a good or bad thing. Generally speaking, change is more welcome for a business that is in a position of weakness, such as Intel, than one that is in a position of strength, such as Schneider Electric. Schneider's competitive edge in providing electrical solutions continues to be a source of sustained profitable growth, particularly as it sees heightened demand from data-center customers. While the industrials company replaced its CEO in November, investors are unlikely to want drastic changes. Fortunately, with Schneider's long-lived assets providing operational consistency, the new CEO has limited room—or need—to meaningfully change things.

Consider the potentially very different implications of a new CEO for a company such as Intel compared with a company such as Schneider:

	Company is changeable	Company is not changeable
Company is in a position of strength	**Risky** CEO choice is crucial	**Positive** CEO choice may not matter much
Company is in a position of weakness	**Promising** Turnaround may be possible with the right CEO	**Negative** Little ability for any CEO to execute a turnaround

The quadrant to steer clear of is the bottom right, because a weak company that is difficult to change doesn't leave a lot of options for a CEO, no matter how skilled they may be. It all comes back to something Warren Buffett once said: "When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact."

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