MANAGING ACROSS THE CORPORATE LIFE CYCLE: CEOS AND STOCK PRICES

The Myth of the Great CEO

The Lead In

- One of the big news stories of last week was Jack Dorsey stepping down as CEO of Twitter, and the market's response to that news was to push up Twitter's stock price by almost 10%. That reaction suggests, at least for the moment, that investors believe that Twitter will be better off without Dorsey running it, a surprise to those in the founder-worship camp.
- As the debate starts about whether Dorsey's hand-picked successor, Parag Agrawal, is the right person to guide Twitter through its next few years, I decided to revisit a broader question of what it is that makes for a "great CEO" and how the answer to that question lies in what stage of the corporate life cycle a company is in.
- In the process, I will also look at the thorny issue of what happens when there is a mismatch between a company and its CEO, either because the board picks the wrong candidate for the job or because the company has changed over time, and the CEO has not.

The Myth of the Great CEO: HBR

- The Harvard Business School, every student who enters the MBA program seems to be viewed as CEO-in-waiting, notwithstanding the reality that there are two few openings to accommodate that ambition.
- The Harvard Business Review, over the years, has published multiple articles about the characteristics of the most successful CEOs, and this one for instance, highlighted four characteristics that they share in common:
  - (a) deciding with speed and conviction
  - (b) engaging for impact with employees and the outside world
  - (c) adapting proactively to changing circumstances and
  - (d) delivering reliably.

The Myth of the Great CEO: McKinsey

Excellent CEOs approach the role's six elements with certain mindsets and adhere to 18 practices when fulfilling their unique responsibilities.

Focus on beating the odds

Vision: reframe what winning means
Strategy: make bold moves early
Resource allocation: stay active

Help directors help the business

Effectiveness: promote a forward-looking agenda
Relationships: think beyond the meeting
Capabilities: seek balance and development

Manage performance and health

Talent: match talent to value
Culture: go beyond employee engagement
Organizational design: combine speed with stability

Center on the long-term 'Why?'

Social purpose: look at the big picture
Interactions: prioritize and shape
Moments of truth: build resilience ahead of a crisis

Put dynamics ahead of mechanics

Teamwork: show resolve
Decision making: defend against biases
Management processes: ensure coherence

Do what only you can do

Office: manage time and energy
Leadership model: choose authenticity
Perspective: guard against hubris

McKinsey & Company

The Effect of Popular Culture

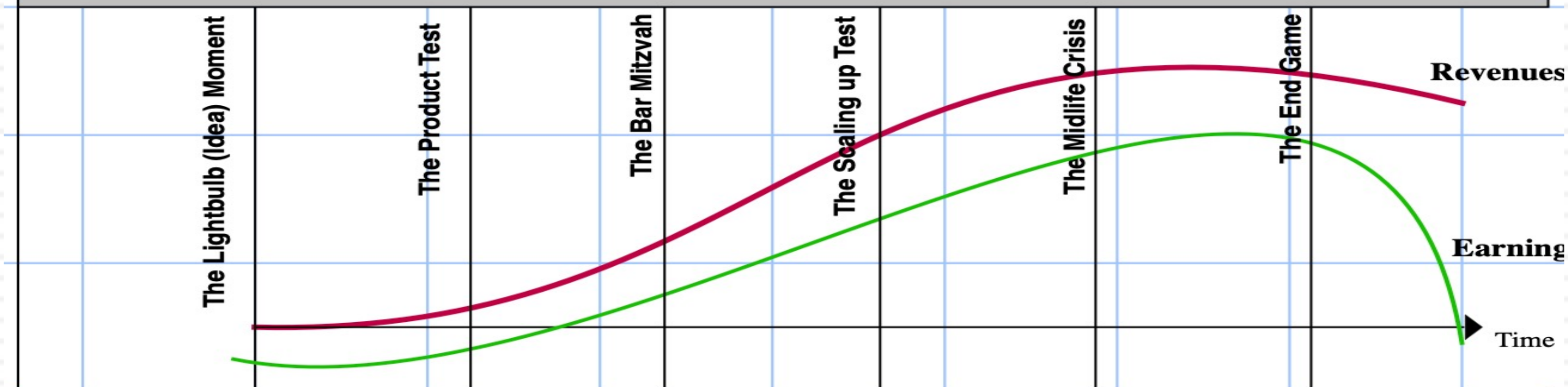
- That perspective also gets fed by books and movies about successful CEOs, real or imagined. Consider Warren Buffett, Jack Welch and Steve Jobs, very different men who have been mythologized in the literature.
  - Many of the books about **Buffett** read more like hagiographies than true biographies, given how star struck the writers of these books are about the man, but by treating him as a deity, they do him a disservice.
  - The fall of GE has taken some of the shine from **Jack Welch's** star, but at his peak, just over a decade ago, he was viewed as someone that CEOs should emulate.
  - With **Steve Jobs**, the picture of an innovative, risk-taking disruptor comes not just from books about the man, but from movies that gloss over his first, and rockier, stint as founder-CEO of Apple in the 1980s.

Why one-size-fits-all does not work…

- Even if all successful CEOs share the qualities listed in the HBR/McKinsey papers, not all people or even most people with these qualities become Successful CEOs. *So, is there a missing ingredient that allowed them to succeed?* If so, what is it?
- I find it odd that there are no questionable qualities listed on the successful CEO list, especially given the evidence that over confidence seems to be a common feature among CEOs, and that it is this over confidence that allows them to take act decisively and adopt long term perspectives. When those bets, often made in the face of long odds, pay off, the makers of those bets will be perceived as successful, but when they do not, the decision makers are consigned to the ash heap of failure. *Put simply, it is possible that the quality that binds together successful CEOs the most is luck, a quality that neither Harvard Business School nor McKinsey can pass on.*
- *There are clearly some successful CEOs who not only do not possess many of the listed qualities, but often have their inverse.* If you believe that Elon Musk and Marc Benioff, CEOs of Tesla and Salesforce, are great CEOs, how many of the Harvard/McKinsey criteria would they possess?

A Life Cycle View of CEOs

The Corporate Life Cycle: The "Right" CEO



Lifecycle stage	**Start-up**	**Young Growth**	**High Growth**	**Mature Growth**	**Mature Stable**	**Decline**
Key Business Test	Have an idea for a business that meets an unmet need in the market.	Create a business model that converts ideas into revenues	Build the business, looking for scaling benefits (moving to profitability)	Grow your business, with revenue growth & higher margins	Defend your business from competitors & find new markets	Scale down your business as market shrinks.
Key for investment success	Tell a compelling & plausible story	Stay consistent with story	Deliver numbers to back story	Keep story in sync with numbers	Adjust story to reflect maturity	Shrink the company
The Right CEO	**Steve, the Visionary**	**Paula, the Pragmatist**	**Bob, the Builder**	**Oscar, the Opportunist**	**Donna, the Defender**	**Larry, the Liquidator**

The “Right” CEO

- **The Visionary**: Early in the life cycle, as a company struggles to find traction with a business idea that meets an unmet demand, you need a visionary as a CEO, capable of thinking outside the box and with the capacity to draw employees and investors to that vision.
- **The Pragmatist**: In converting an idea to a product or service, history suggests that pragmatism wins out over purity of vision, as compromises have to be made on design, production and marketing to convert an idea company into a business.
- **The Business Builder**: As the products/services offered by the company scale up, the capacity to build businesses becomes front and center, as production facilities have to be built and supply chains put in place, critical for business success but clearly not as exciting as selling visions.
- **The Opportunist**: Once the initial idea has become a business success, the needs to keep scaling up may require coming up with extensions of existing product lines or geographies to grow, where an opportunistic, quick-acting CEO can make a difference.
- **The Defender**: As companies enter the late phases of middle age, the imperative will shift from finding new markets to defending existing market share, in what I think of the trench warfare phase of a company, where shoring up moats takes priority over new product development.
- **The Liquidator**: The most difficult phase for a company is decline, as the company is dismantled and its sells or shuts down its constituent parts, since any one who is put in charge of this process has only pain to mete out, and bad press.

Why CEO/Company Mismatches happen…

- A Mistake: The first is that the board of directors for a company seeking a new CEO hires someone who is viewed by many as a successful CEO, but whose success came at a company at a very different stage in its life cycle. (Jeff Immelt as CEO of Uber in 2017? Really?)
- A Gamble on Reincarnation: There are times when a board of director picks a mismatched CEO intentionally, with the hope that the CEO characteristics rub off on the company. This is often the case when you have a mature or declining company that thinks hiring a visionary as a CEO will lead to reincarnation as a growth company. While the impulse to become young again is understandable, the odds are against this gamble working, leaving the CEO tarnished and company worse off, in the aftermath. (Marissa Mayer at Yahoo! In 2012)
- Companies change: The third is a more subtle problem, where a company is well matched to its CEO at a point in time, but then evolves across the life cycle, but the CEO does not. Using the Uber example again, Travis Kalanick, a visionary and rule breaker, might have been the best match for Uber as a company, disrupting a highly regulated business (taxi cabs), but even without his personal missteps, he was ill-suited to a company that faced a monumental task of converting a model built on acquiring new riders into one that generated profits in 2017.

The Consequences…

CEO and Company Mismatch: Consequences

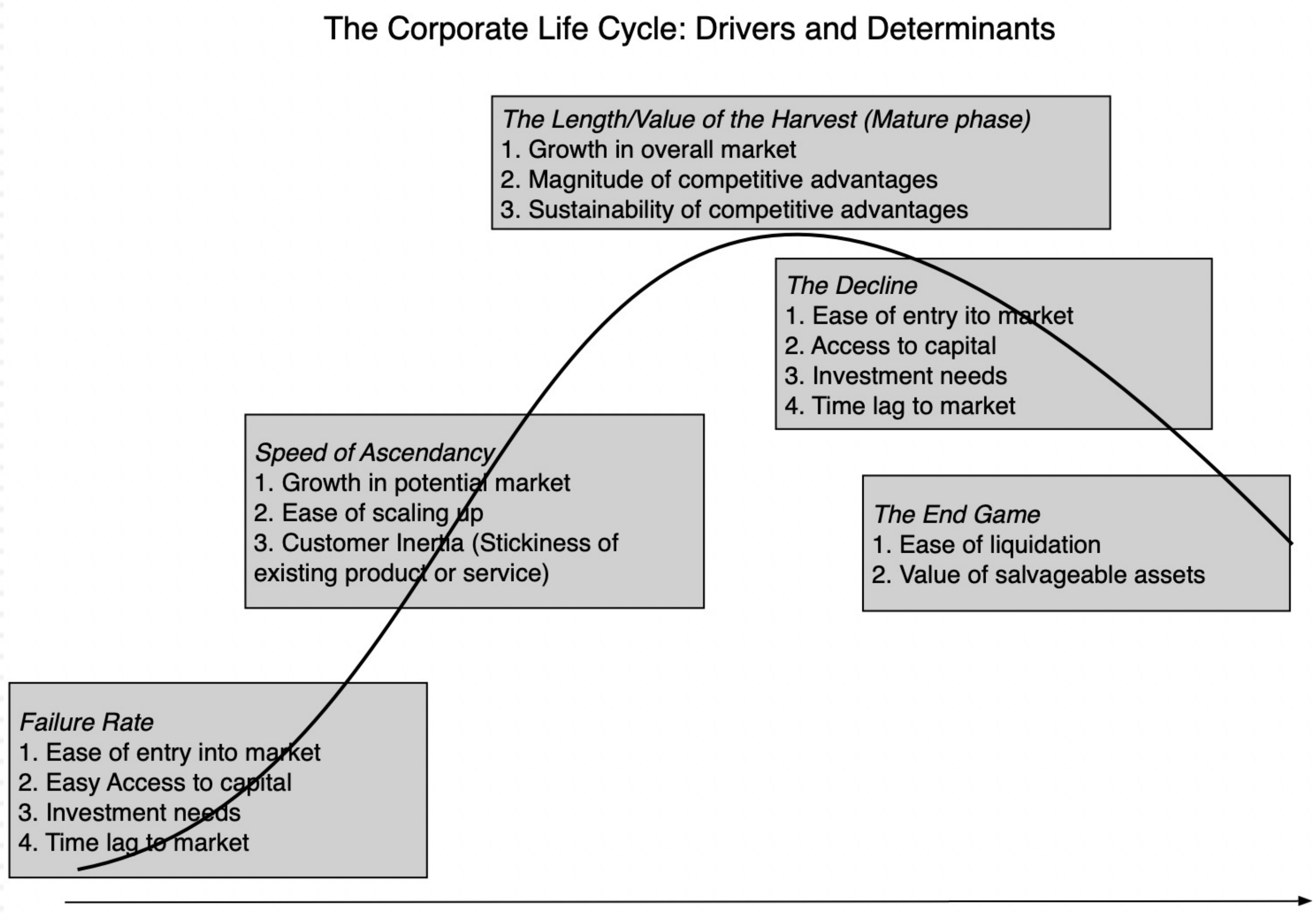
Benign Scenario	Intermediate Scenario	Malignant Scenario
The mismatched CEO recognizes the mismatch and gets a partner or co-executive to fill in the gap.	The intermediate CEO is replaced, albeit after damage is done, with longer waits leading to more damage.	The mismatched CEO, left unchecked and unchallenged, continues to act in destructive ways.

← *Effect on Value of the Company* →

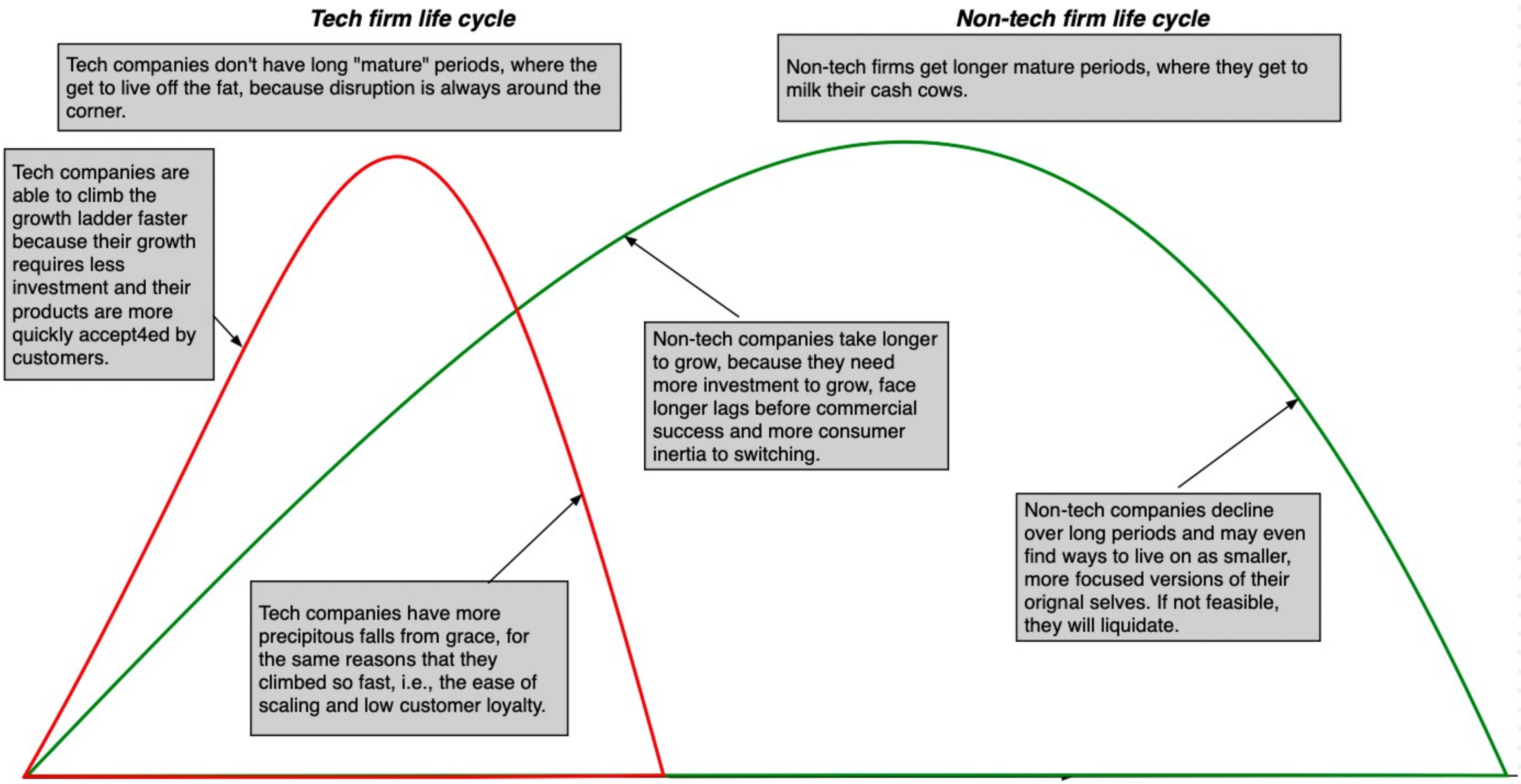
Low to non-existent

High to Catstrophic

Back to the Life Cycle



The Compressed Tech Life Cycle



Founder CEOs – Evidence on Turnover

- **Founder Displacement**: Using data on top management turnover at young firms, many of them non-public, he concludes that almost 30% of CEOs at these firms are replaced within a few years of inception, usually at the time of new product development or fresh financing. Much of this phenomenon can be explained by venture capitalists, with large stakes, pushing for change in these companies, but a portion of it is voluntary, and to explain why a founder CEO might willingly step down, Wasserman uses the concept of the founder's dilemma, where founders trade off full control of a much less valuable firm (with themselves in control) for lesser control of a much more valuable firm (with someone else at the helm).
- **Founder Worship**: The founders who do manage to stay at the helm of companies that make it through to early growth status are put on a pedestal, relative to CEOs of established companies. While that may be understandable, in some cases, it takes the form of founder worship, where founders are viewed as untouchable, and any challenge to their authority is viewed as bad, leading to efforts to change the rules of the game to prevent these challenges.

Entrenching Founder CEOs: The Peril of a Compressed Life Cycle

- In the United States, where prior to 2004, it was unusual to see shares with different voting rights in the same firm, it is now more the rule than the exception in many tech companies.
- Endowing CEOs with increased powers to fend off challenges seems like a particularly bad idea at tech companies, since their compressed life cycles are likely to create more, rather than less, mismatches between companies and their founder/CEOs, and sooner, rather than later.
- If I am an investor, I would worry more than ever before about giving up voting power to founder/CEOs, even if they are well regarded, because today's star CEO can become tomorrow's problem.

Implications for Investors

- I have long argued that when investing in young tech companies, you are investing in a story about the company, not an extrapolation of numbers.
- The compressed corporate life cycle and the potential for CEO/company mismatches that it creates adds a layer of additional uncertainty to valuation. In short, when assessing the value of a young company's story, you are also assessing the capacity of the management of the company to deliver on that story.
- To the extent that the founder is the lead manager, and the narrative-setter, any concerns you have about the founder's capacity to convert that story into business success will translate into lower value.

1. Amazon

- Many younger investors are surprised when I tell them that Bezos was not a household name for much of Amazon's early rise, and that it was The Washington Post acquisition in 2013 that brought him into public view.
- One reason that I attached lofty values to Amazon as a company, even when it was a tiny, money-losing company was that Bezos not only told the same story, one that I described as Field of Dreams story, where if you build it (revenues), they (profits) will come. but acted consistently with that story.
- He built a management team that believed that story and trusted them to make big decisions for the company, thus easing the transition from small, online book retailer to one of the largest companies in the world. It is a testimonial to Bezos' success that Amazon's value as a company today would be close to the same, with or without him at the helm, explaining why the announcement that he was stepping down as CEO on July 5 created almost no impact on the stock price.

2. Twitter

- I valued Twitter for the first time, just ahead of its IPO in 2013, and built a model premised on the assumption that the company would find a way to monetize its larger user base and build a consistently money-making enterprise.
- In the years since, I have been frustrated by its inability to make that transition, and in this post in 2015, I laid the blame at least partially at the feet of Twitter's management, contrasting its failure to Facebook's success.
- I don't know Jack Dorsey, and I wish him the best, but in my view, his skill set seemed ill suited to what Twitter needed to succeed as a business, especially as he was splitting his time as Square's CEO, and talking about taking a six-month break in Africa. In fact, eight years after going public, Twitter's strongest suit remains that it has lots of users, but its capacity to make money of these users is still ill-formed.
- One reason why the market responded so positively, jumping 10% on the news that Dorsey was leaving, is indicative of the relief that change was coming, and the reason that it has fallen back is that it is not clear that Parag Agrawal has what the company needs now. He has time to prove investors wrong, but he is on probation, as investors look to him to reframe Twitter's narrative and start delivering results.

3. Paytm

- A few weeks ago, I valued one of India's new unicorns, Paytm, an online payment processing company built on the promise of a huge and growing online payment market in India. In my valuation, I told an uplifting story of a company that would not only continue to grow its user base and services, but also increase its take rate (converting users to revenues) and benefit from economies of scale to become profitable over the course of the next decade.
- I valued Paytm at about ₹2,200, but in telling that story, I noted one big area of concern with existing management, that seemed to be more intent on adding users and services than on converting them into revenues, and pre-disposed to grandiosity in its statement of purpose and forecasts.
- In the months since, the company has gone public, and while the offering price, at ₹2150, was close to my value, the stock price collapsed in the days after to less than ₹1400 and has languished at about ₹1600-₹1700 since.
- If you were concerned about Vijay Sharma's capacity to convert the promise of Paytm into eventual profits, before the IPO, you would have been even more concerned after listening to him in the days leading into the IPO. It is still too early to conclude that there is a company/CEO mismatch, but if I were the top management of the firm, I would talk less about users and gross merchandise value, and talk and do more about picking up the abysmally low take rate at the firm.

Family Group Companies

- Much of Asian and Latin American business is built around family groups, many of which have roots that go back decades. Using a combination of connections and connections, these family groups have lived through economic and political changes, and as many of the companies that they own have entered public markets, they have stayed in control.
- To see how the corporate life cycle structure story plays out in family group companies, it is worth remembering that family groups often control companies that spread across many business, effectively resembling conglomerates in their reach, but structured as individual companies.
- Consequently, it is not only possible but likely that a family group will control companies at different stages in the corporate life cycle, ranging from young, growth companies at one end of the spectrum to declining companies at the other end of the spectrum. This intra-group capital market becomes trickier to balance, as family group companies go public, since you need shareholder assent for these capital transfers. With weak corporate governance, more the rule than the exception at family group companies, it is entirely possible that shareholders in the more mature and cash-generating companies in a family group are being forced to invest in younger, growth companies in that same group.

Implications for CEO Turnover: A Life Cycle View

- Studies consistently show lower forced turnover, when a company is led by a family member CEO, which can open up mismatches between companies and CEOs at family groups. Here are some things that family groups can do to reduce this mismatch problem.
  - First, power has to become more diffuse even within the family, away from a powerful family leader and towards a family committee, to allow for the different perspectives needed to become successful in businesses at other stages in the life cycle.
  - Second, there has to be a serious reassessment of where different businesses, within the family group, are in the life cycle, with special attention to those that are transitioning from one phase to another.
  - Third, if top management positions are restricted to family members, the challenge for the family will be finding people with the characteristics needed to run businesses across the life cycle spectrum.
  - As many family group companies enter the technology space, drawn by its potential growth, the limiting constraint might be finding a visionary, story teller from within the family, and if one does not exist, whether the family will be willing to bring someone from outside, and give that person enough freedom to run the young, growth business.
  - Finally, if a mismatch arises between a family member CEO and the business he or she is responsible for running, there has to be a willingness to remove or move that family member from power.

Implications for Investors

- Are family group companies, in general, better or worse investments than investments in other publicly traded companies? The evidence, not surprisingly, is mixed, with some finding a positive payoff, which they attribute to a better alignment of long-term investor and management interests at these companies, and others finding negative returns, largely as a result of management succession problems.
- To address why family control can help in some cases, and hurt in others, it again helps to bring in the corporate life cycle.
  - In the portions of the corporate life cycle, where patience and a steady hand are required, the presence of a family CEO may increase value, since he or she will be more inclined to think about long term consequences for value, rather than short term profit or pricing effects.
  - On the other hand, if a family CEO is entrenched in a company that is transitioning from growth to mature or from mature to declining, and is not adaptable enough to modify the way he or she manages the company, it is a negative for value.
  - Family group companies composed primarily of companies in the former grouping will therefore trade at premiums, whereas family group companies that include a disproportionately large number of disrupted or new businesses will be handicapped.