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Musings

#29: Lemmings Don't Create Value
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Using a golf analogy, executives will sometimes say "keep it in the middle of the fairway." The basic construct is not to deviate too much from the norm. It is hard to get in trouble if you stick in the middle of the pack. It is also impossible to win the race!

Leaders must lead. You cannot be a lemming and follow the herd. This is especially important in our society today. Like most investors, I am spending lots of time on the phone or in zoom with executives talking about how to save expenses with the lack of revenue visibility. Sometimes I will hear the idea to cut 15% across the board. I couldn't disagree more. You have to be thoughtful about the expense reductions and right now, I would consider increasing your marketing spend. That is right. The lemmings are all cutting their marketing budgets to save expenses. According to the Chicago Tribune, the prices of Facebook ads are at record lows (having declined 35% to 50% in recent weeks) and "once abundant travel and entertainment ads have all but disappeared from Google." Google cost per click prices are down. Now is the time to go left when they go right. If you have the right value proposition to communicate, you just received a less-crowded market place to engage those consumers in your market who can still transact. So certainly don't cut your marketing budget and consider increasing it to take share while the lemmings are on the sidelines.

This "spend more in marketing" mentality assumes you are using measurable digital channels so you can calculate your cost of customer acquisition (CAC). As long as your CAC is lower than the lifetime value of that consumer (LTV), it is a profitable move over the long run – the marginal revenue exceeds the marginal expense. I am a fan of using gross margin lifetime value so you truly are measuring the profits the incremental consumer will generate. CAC/LTV ratio has become a key valuation metric for Software as a Service (SAAS) companies but there is no reason it can't be applied to other business models.

The herd mentality has been reinforced by the rise of social media and 24x7 news channels. Think about it. News stations are covering what random people are tweeting. What happened to proving your expertise so you earned the right to communicate on a broad platform like national TV? The challenge is that Ted Turner's 24x7 invention means the station needs something to talk about. It has to create news. This can create a false momentum where random social media participants get picked up by TV station #1 which gets picked up by TV station #2 and everyone is headed to the next Woodstock in Abilene. One tweet turns into a heard with amazingly quick speed. Don't follow them!

This is also playing out in the stock market. Historically, it is well documented that the majority of active managers underperform their benchmark index. This led to the creation of Exchange Traded Funds (ETFs) pioneered by Jack Bogle and Vanguard. An ETF is a basket of stocks meant to represent the market. You don't pay Vanguard to pick an individual stock – they just buy the basket and thus can charge lower fees. Tons of money has moved into the ETF/Passive Index space so now basically everyone owns the same stocks. The index gets momentum on the way up and momentum on the way down. The lemmings are riding a roller coaster with increasing volatility magnified by algorithmic trading. All of the action is in the last 30 minutes of the trading day when the computer's lemming-based algorithms decide where they want to close out. Now is the time to find a good active fund manager who can run counter the market trends.

Very smart people can unwittingly become lemmings. Think about the investors in Theranos (great book *Bad Blood*) or WeWork. They are some of the most accomplished in our capital markets. However, they lost their bearings and just followed the crowd. They lost all of their money. Sam Zell was calling the fallacy of WeWork long before its demise and against the trend. He is a leader.

Now is the time to innovate. Now is the time to think differently. A very successful private equity investor once told me that he got his best returns when he invested into a dislocating market and picked the right horse. There will be winners on the other side of the Covid 19 storm. Now is not the time to follow what others are doing. Now is the time to lead.

Be safe.

jml

Second Thought

The rapid rise in unemployment is not just an economic issue. According to David Brooks, "It is a giant stress test of our social solidarity." There is value in the "dignity of work." Most individuals do not want to be dependent on handouts. They want to work and take care of their families. To quote a recent good McKinsey piece: "*when people are stripped of their work, they suffer losses not just of income but also of dignity, meaning, and hope.*" See this link for the full McKinsey report click here