

J. Michael Locke

Musings

#117: Musing March 13, 2021

This past week marked one year from the first “musing.” At that time, there was no idea of an ongoing “publication.” It started simply by me creating an email list of CEOs I worked with as an investor and wanting to provide some advice as Covid hit. Great to see what it has turned into. Thanks for reading and engaging in our “old school” exchange of ideas by email. (Let me know if you want to add someone or be deleted from my recipient list.)

The first “musing” was pretty simple. Here it is (unlike Jack Dorsey, not trying to sell the NFT...more later on that):

You guys are all leading companies at this unprecedented time. Here are my 2 cents

Watch your liquidity — run sensitivity models. Business (and society) is coming to a halt. You likely have no visibility. People are not focused on making buying decisions. Bookings will dry up. Halt any hiring.

I assume everyone has already moved to remote work. Keep people connected. Host synchronous sessions. Over communicate. Daily virtual huddles at the department level. My point is don't let team get “disconnected”

Lean in and help customers if you can. Call client CEOs and check in. Show you care

Innovate! You are all leaders in technology. Society just became more tech centric (I had a virtual cocktail party last night with FaceTime). Now is a time to quickly adjust, innovate using technology and lead. Speed is key

Watch your bandwidth. Networks are going to get stressed. Make sure you have enough.

Personally I think the health aspect is overblown and this is a bad storm that will blow over in 3-6 months.

Hope this unsolicited advice might be helpful

Besides the huge miss on how long this would all last and how severe the health situation would be, the rest stills looks ok. The basic message of this first communication was about “managing forward.” You have to be looking ahead and around the corner. Reprint of old musing this week about this practice below.

It is a good practice to look back at predictions. For example, many private equity firms go back and “re-underwrite” their deals looking at how companies have performed against what was modeled when agreeing to buy the business. Where there are significant diversions, it is important to understand why

so you model better next time. For instance, the much predicted shortfall in states' tax revenue due to Covid did not happen. [states-expected-covid-19-to-bring-widespread-tax-shortfalls-it-didnt-happen](#)

I have written about zoom fatigue which is affecting everyone. A friend shared this with me: *"There is the 7-38-55 'rule' which is a concept concerning the communication of emotions. The rule states that 7 percent of meaning is communicated through spoken word, 38 percent through tone of voice, and 55 percent through body language. Video can optimistically get us to about 50 percent of the way to fully emoting, but that is a lot left unsaid. The punchline is that most communication is 'nonverbal' in nature. Communication is certainly greater than 50 percent just to transact effectively, and much more to establish a meaningful and sustaining connection."* Get your teams back in the office interacting with each other.

The move to digital continues. Now we have NFTs – "non-fungible tokens." These are digital collectibles which leverage blockchain technology (which is behind cryptocurrencies like bitcoin) to prove authenticity and indicate ownership. The Twitter CEO is selling his first tweet as an NFT. There is a booming market for sports moments like NBA. Listen to a quick story on NPR: [whats-an-nft-and-why-are-people-paying-millions-to-buy-them](#). A digital piece of art sold online at Christie's for almost \$70mm! I must say I don't get it because others can still view the digital asset online and there are no royalties so unclear to me what ownership gets you. Let me know if you understand it.

Congrats to Jack York, Lisa Taylor and the iN2I team on their deal with Vista Equity Partners. [in2I-announces-strategic-growth-investment-from-vista-equity-partners](#). It has been a pleasure to serve as Chairman. It is a classic entrepreneurship story with Jack York leaving a successful career selling technology to launch a business focused on providing technology to senior living. He was driven by his mom Dorothy and the mission. Lots of credit card debt, worries about making payroll, and last minute runs to UPS to get product shipped. For Jack and most successful entrepreneurs, the financial reward is secondary to the pride in building an organization and creating jobs. To quote Jack – *"people living with dementia had as much to gain from tech as anyone else."* Here is a great email I received from a member of the team – *"Because of iN2I, I have been able to purchase my first home, my first car, pay off \$30,000+ in student loans (almost done!), and launch my career in senior living."* That is what it is about. "Entrepreneur" is actually a French word which referred to people in the building industry that set up sites with various tradesmen.

Personally, I think one of our societal issues is the wealth being generated by some without a corresponding creation of good jobs for others. Bill Ackman is a very successful hedge fund manager. His net worth is approximately \$3 billion and his firm has generated tens of billions in gains. According to smartasset.com, *"In March 2020....Ackman informed investors in the firm's public fund that it had made \$2.6 billion off a \$27 million bet that the coronavirus pandemic would cause U.S. stocks to sink."* The firm employs under 30 people. We need more people following Jack York and less following Bill Ackman. Say what you want about Jeff Bezos but last year Amazon hired over 400,000 people.

One challenge for Jack York wannabes is access to capital. Enter search funds. While I find the SPAC craze to be irrational, I do like search funds which are growing in popularity. In a search fund, the "searcher" sells units (let's say 10 units of \$30,000 each) to raise money to pay the bills while they look for a small business to buy. The searcher then goes hunting and has two years to do a deal. If they get one signed up, the initial investors have an opportunity to buy their share of the equity or get their initial money back. The searcher then moves to wherever the business is and runs it with an established

incentive equity plan based on investor returns. With the graying population, there are lots of business owners who don't have a family member to pass a business to and searchers are generally talented, entrepreneurial executives (many of who receive the musings!) Returns have been good. Here is a primer from Stanford: [search-funds/primer](#)

Do I really care about Harry and Meghan? Great article from Peggy Noonan on why so many do.

[why-we-care-about-the-royal-family-feud](#)

Jml

Reprint: 4/10 Musing #19 – Managing Forward

Good leaders are always looking over the horizon. They are the captain of the ship ensuring no icebergs ahead.

I am frustrated when I read about organizations surprised by developments in the market that creates an existential threat. I am not talking about a Black Swan event like the current Covid-19 situation. I am talking about any retailer who in 2020 does not have meaningful online capabilities. Amazon became a public company in 1997!

The leader's job is to manage forward and predict what is going to happen in the market and with employees. The job is to take preemptive action to mitigate risks. One way to do this is to constantly seek inputs from competitors, customers and other constituents. Asking questions and listening (see Musing #16: The Importance of Listening).

To have something bad happen is business. To be surprised by it is inexcusable.

You need to establish KPIs (key performance indicators) which provide you with visibility. The better the KPIs, the more time you have to react. Like your car's headlights on high beam. Sales create the revenue which then covers the expenses. However, good management should be able to forecast sales. Especially in today's digital world, you should be able to measure traffic on your website or volumes of calls. Then you should have the statistic models on how those potential buyers convert in various steps through the funnel. While every specific buyer is unique, when you aggregate them up, the demand should behave in statistically consistent ways. Make your sales leader give you a projection not just the budgeted number.

Think about how the healthcare system has been preparing for Covid-19. They have models on the rate of infection and what percentage will need hospitalization. They know how many days from test result to needing a ventilator so they can take the testing results today and figure out the ventilators needed in a week.

One unfortunate model is the correlation of third grade reading level and adult incarceration. Some states use their third grade reading tests to figure out how many prison beds they will need in 10 years. That is managing forward in a sad way.

In a business, your CFO needs to be your partner in this endeavor. I am not a fan of the basic annual budgeting cycle where a budget is set and a year later, wash and repeat. Rather, executives need a rolling four quarter forward projection. As you finish a quarter, you add another one on the other end. This should be a complete three statement model: income statement, balance sheet, *and cash flows*.

One common mistake people make is to do annual budgets and miss the “run rate” they have going into next year. You need to know the full year amount of the expense structure you have built up by either taking the fourth quarter x 4 or December x 12. When you add an expense midyear, it only hits your P&L for a part of the year and you can miss the annualization of the impact.

The Covid-19 crisis has made managing forward difficult. There are so many unknowns. Don’t let that stop you from projecting! Rather, project ranges rather than specific numbers as volatility has increased and create scenarios under different assumptions.

The best leaders I know right now are discussing the equilibrium of reversion (thanks Jamie Cowie for the term). Things will not go back to where they were before Covid. The world will be more digital now – more telehealth, more online education, more remote work. The question is how much reversion will there be? How far back to the pre-Covid world will we go?

The best leaders are also contingency planning. What if we are still dealing with latent Covid issues in the fall? Right now, consumers have accepted subpar quality of online delivery because it was rushed out in a crisis. The consumer won’t be as forgiving in the fall. Good leaders will invest in their digital capability now so if they have to use it in the fall, they are ready. They are managing forward. No Leo and Kate on the bow of their ship.

Be safe.

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