The Insightful Leader Podcast Transcript

Dialogues: “This Is a Time for Management Teams to Earn Their Stripes.”

Woody MARSHALL: It takes a long time to build a reputation. It takes a very short time to rip one down. And this is the time when management teams and founders will realize whether they made the right call on what firm that they backed.

Jessica LOVE: Welcome to a special bonus episode of *The Insightful Leader* from the Kellogg School of Management. When we planned our podcast season, we didn’t plan on a global pandemic and the tremendous economic and social disruption that would follow. So over the next few months, we will be periodically sharing some of the conversations that are occurring between Kellogg faculty and business leaders, looking ahead at what comes next for these leaders, their companies, and their industries.

The uncertainty of the COVID-19 crisis has introduced a whole new layer of risk to the private equity and venture capital space. With little idea what the economy will look like in even six months’ time, it can be hard for investors to know where to double down, where not to, and how they can best support the companies in their portfolios. So how do you make these calls?

Woody Marshall is a general partner of Technology Crossover Ventures, or TCV for short. Marshall is a veteran venture capitalist, who’s been working in the industry since 1995. His portfolio is focused on investments in fin-tech, internet, and digital media. Marshall spoke with Linda Darragh, the executive director of Kellogg’s Innovation and Entrepreneurship Initiative and a clinical professor at Kellogg. Their conversation occurred back in April as part of the Initiative’s Tuesday Tech Talks, where Kellogg alumni talk about their own experience in the tech sector.

In the conversation you’re about to hear, Darragh and Marshall discussed what the investment landscape might look like post-COVID, and why leadership is more important now than ever.

Linda DARRAGH: You've been involved in many different industries, but you have been through these economic upheavals. You've seen the dot-com bust. You started TCV in June 2008, just before the 2008 debacle. You’ve been through these. How does this compare?

MARSHALL: I think with all of these upheavals, there are lots of similarities, and when you think about a playbook or lessons learned, there are things you can go back to. This one is very different. And when you think about it, it's not the fact that you have some suspect business models, it's not a financial issue that's created with leverage and bad investments. This is a black swan event. You've got an absolute massive demand shift being zero for some industries. And obviously, this is the tale of two cities. You have some companies that are in industries that are benefiting from this. The big question we'll talk about is, how durable are some of those changes, but I'm sure people at home that haven't used meal delivery or grocery delivery before have been using those, pretty aggressively.

And you just look at the number of employees that the Amazons and the Instacarts and the DoorDashes of the world are trying to hire. And then on the other side, you have things like travel and hospitality, entertainment. The issue is not that they have a downdraft in demand, the demand is zero, right? Before this happened that was not a believable downside scenario. The point is that there are certainly lessons about how you deal with a stress.

Those are consistent with whether it's dot-com bust or the global financial crisis 12 years ago. The issue here for some companies, the magnitude of it is unprecedented. And then one of the big questions is, what is the timing? Right? This is the hardest thing for any company, because they don't know. While there are lessons, there are things here that everybody's going through for the first time, but I think there are leadership and management principles that you can certainly hold on to.

DARRAGH: So, I really want to unpack a lot of what you've said. But let me just step back a bit and just make sure that everyone's on the same page, and they understand what TCV is. So maybe give a quick overview.

MARSHALL: Great. We're in our 25th year. TCV was founded 25 years ago by a Northwestern grad and Northwestern Trustee Jay Hoag. From the very beginning, we had one foot in the public market and one foot in the private market. But one of the things I think is a differentiator is, fundamentally, it's about investing in growth companies in technology.

DARRAGH: So you've got Netflix, Peloton. And then the other side you've got some of your restaurant travel, you've got Airbnb. This is a mixed bag. How are you guiding each of these segments? The ones that are winning, and some are really, really struggling?

MARSHALL: It's obviously nice to build a diversified portfolio. So I think with every one of the companies, the first thing that you're asking everybody to do is do your situation analysis, right? And we have companies, in travel, and events, ticketing, concerts and things like that. What you initially do is when you do your situation analysis, I'm sure every investment manager's doing the same thing. You are stack ranking your companies. Is it green, is it yellow, is it red? You're doing your scenario planning about how long this is going to last.

The companies in that red space, many of those companies have done significant reductions in force, furloughs, salary deferments, everything. It's everything about getting to the other side. One of the metaphors that I've used with CEOs is, if you remember the movie Forrest Gump, they're out in the shrimp boat in the hurricane, and the only thing that they have got to do is survive, right? And when you get to the other side, they're the only boat remaining and the fishing is good. And, yes, there's going to be fundamental changes with some of these markets, but travel is going to come back, maybe it'll come back slightly differently.

You want to be prepared for when the market comes back. In some ways, the red ones are easy, right? You got to cut you got to do it quickly. You know, one of the differences here as opposed to in this crisis versus others, is you don't know how long it's going to last. While you want to be able to cut once, and then, hopefully not have to worry about it again, there will be some companies, I think in some of those affected markets that may have to go into some level of hibernation. Then you have folks that are in the middle in yellow, where they're seeing an impact. They may be well capitalized. Everybody does the easy things which is, "I'm going to freeze hiring. I'm going to pull my discretionary expenditures." Marketing is one of the first things that that gets cut. Your travel and entertainment budgets right now are zero at companies but that's not impacting anything.

But those are companies that have to be really clear on trends, because you can go from yellow to red pretty quickly. Now the other thing is, you can also go from yellow to green, and you have to be prepared for that. We try to not have companies worry as much about, "Maybe I shouldn't curtail some of my spending because if this becomes an opportunity, I want to be able to pounce on it." One of my partners referred to this as everybody will talk about making changes in a company as real time as working on the engine of a race car that's going on the track. And my partner mentioned this the other day where he said, everybody's car's in the garage right now, so you're not going to miss anything. We've been preaching conservatism because again, you want to make sure that you will capitalize when normalcy comes back.

And then the companies that are in the green that either are not affected, or are seeing positive signs to their business, you want to invest behind that, but you're also very cautious about how aggressive you're going to be. Because, there's a lot of correlation in this market with one market going down, pulling consumers down, I would say anything that's a consumer discretionary item, and you can look at—lots been written about the increase in home video watching whether it's a Netflix or Hulu, the rise in home fitness, all of these items. Well, if we go into a prolonged recession, one of the questions is how recession-proof are those businesses going to be. But I think the issue, Linda is, you got to do a pretty detailed scenario analysis with all the companies. And then when you think about our usual planning cycles, you've got annual budgets, you've got quarterly board meetings, that's a world that doesn't exist anymore.

As we told all of our companies when this happened, "forget your 2020 budget, it doesn't exist anymore," right? Now, you can put a new budget together, but let's talk about what your Q2 budget is. And your Q2 budget's made up of, April, May and June. What is the real time data? For most of my companies, I'm either getting a daily or weekly flash on at least some level of activity, so you get a sense of, are you staying in yellow, are you in green? Are you trapped? Which way are you trending, and how should you be thinking about that?

DARRAGH: So there's a lot of tough decisions here. There's a lot of uncertainty. Have you seen some great examples of leadership managing these issues right now?

MARSHALL: Absolutely. I think this is, if you go back and take a look at companies that were formed in the dot-com bust, or companies that were formed in the global financial crisis, you earn your stripes, right? This is a time for management teams to earn their stripes. This is the time when leadership is not just words, it's not just the inspirational poster on the doctor's office wall. You know, some of even the classes and the leadership seminars I took when I was at Kellogg, it all seemed like old camp tales. This is the time when those stories are earned, and when reputations are earned.

And especially companies that have to make really, really tough decisions. It's about being decisive, it's about the whole concept of adapt and learn quickly. But you as leader, you have to be a leader but you can't do it on your own. You have to drive an attitude in an organization and you have to grab accountability, but there has to be some level of commonality with the team. When you do something as a leader today, and I tell this to the CEOs and the senior executives, everybody's watching, everybody in the organization. This is what you stand for. You be respectful, you be transparent, but again, while it sucks, if you're going to lay off 30% of your organization, you do have a responsibility for 70%. And unfortunately, those are some of the tough decisions that have to be made.

[musical interlude]

DARRAGH: So we've been talking about industries and specific companies. What's the landscape for VC and PE going to look like after this?

MARSHALL: It's a very good question. As I said when I was talking about TCV, we're investing our 10th fund, we've been around for 25 years, right. It takes a long time to build a reputation. It takes a very short time to rip one down. And this is again the time when management teams and founders will realize whether they made the right call on what firm that they backed, right? It's easy to raise money when everything's great. And, there's a lot written on some new firms that have come into the market, maybe multibillion dollar firms, 100 billion dollar firms that are struggling with supporting some of their companies because of the way that they've reserved. Nobody's expected a situation like this. And you will have a combination of unfortunate decisions that will have to be made and also unfortunate behaviors that some, probably newer firms are going to make just because they haven't been through this before.

So it was easy for a lot of firms to raise money. But they could be one and done, depending on how they behave when the chips are down.

DARRAGH: Out there, we see a lot of these mega funds. You raised your 10 fund just a little over a year ago. So you're in a position where you do have, as they say, some cash dry powder there. But we see a lot of the smaller funds that have come on to the market recently. That's going to be a tough one because they're in their first or second, maybe even a third fund, but they're still really small.

MARSHALL: It will all depend. Right? Just like in the tech world, it's going to be the tale of many different cities. Everybody's going to be different depending on what the companies they have, how they support their companies if need be. But suffice it to say, it could be tough for some earlier in their maturity firms and funds to raise additional capital. Now, you can also make the argument with, the 10 year bond earning less than what's it, 60 basis points now? Private Equity and Venture Capital is still a very attractive long term asset class. The question is just going to be how people will balance, the ability for illiquid, longer term returns with short term liquidity means.

DARRAGH: That goes to the point too. Right now, you're focused on your portfolio companies. Are you thinking about investing in anything new at this point?

MARSHALL: Absolutely. Totally. We're lucky enough because we have a portfolio operations team. Now, the portfolio operations team on a daily basis pre-COVID was focused on helping our companies accelerate product and technology and sales and marketing because we want them to continue to grow fast. We have a group of, former operators, experts in their field that help in those areas. Well, we have a portfolio operations SWAT team is now spending their time a little bit differently in helping with the portfolio triage. I'm spending a lot of time with folks on the portfolio side because I have a pretty large portfolio. But now is a great time to be investing, right? Because the great companies that you've identified before, many people are going to be a little more conservative about how they capitalize themselves. There are also people that are going to need liquidity, so there's an opportunity to buy secondary stock. And the point is, if you are very, very focused on particular themes, what are the areas that you're most excited about? Go to those best companies that you've been building relationships with. For TCV on average, when we invest in a company, we've known the company for four years. So we have these long term relationships. We have a list, think of it as 50 to 100 companies, that would be the companies that if somebody said, you could invest in five companies today, what would they be? That's where we're spending time today.

DARRAGH: What about acquisitions? Some of these larger companies could be buying up all kinds of firms?

MARSHALL: Absolutely. The discussion that we have with some of the companies is, is it they catch the falling knife, right, because some of these smaller companies may be struggling. And the question is, what exactly are you buying? But every one of our companies is looking opportunistically at the M&A side. Just because a lot of companies that thought that they were on their way to going public, now maybe they're not fully financed. Maybe they're looking at, doing a significant riff, maybe they did do a significant riff and something like that could plug right into some of our larger companies. Again, we always try to be active with our portfolio there. I would imagine that the opportunity set’s probably higher. I don't know if the conversion rate if you think about your funnel of opportunities that you look at and what's going to make it to the bottom. I can't tell you that it's going to be significantly higher. But certainly, as you said, the activity level is much improved in that area.

DARRAGH: So if people want to look at VC or look at portfolio companies right now, what would you say are the most important job functions, expertise?

MARSHALL: So, fundamentally, every company today is thinking about, have there been fundamental changes in the demand side of their business? And what does that mean going forward? Is it just, I get to the other side, we get to normalcy, everything's back to normal? I think every smart company, even the ones that are doing well are thinking about how this impacts—what is the impact this has on their customers? When I think about marketing, it's not just at your price, Kraft Macaroni and Cheese, and maybe we'll go with the dinosaur shapes versus the little squiggly pasta shapes or anything like that. Here's the important thing, what does your customer need? What does the customer need? How are those needs changing? That's all about marketing, right? Interacting with that marketing perspective into building the product.

If you are going to be in customer-facing things, whether it's sales and execution, marketing. From product, to front of house, think of Product Development all the way to the customer. That's not a need that goes away. You need it more and more than ever. To me, I go back to what I said earlier, which was with our companies we're typically accelerating product and technology, and sales and marketing. Those are skill sets that every company will need.