

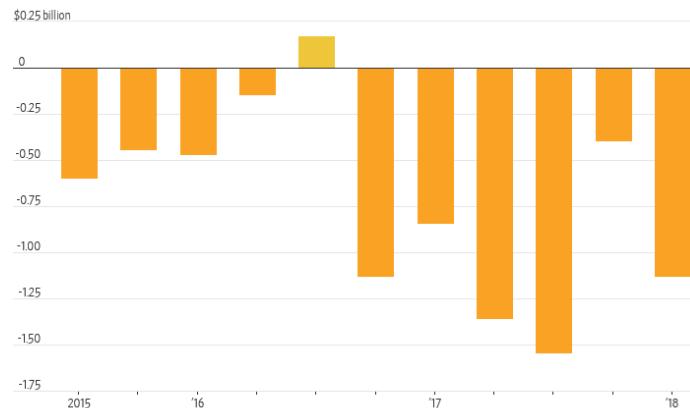


“You could argue there’s never been a moment in history where a private-company founder has more power...” Adam Epstein, an adviser to CEOs on issues regarding corporate finance¹ recently stated in an article for the Wall Street Journal.

Indeed, this is an age in which the market’s quest for the next superstar Zuckerberg, Bezos or Jobs has empowered CEOs to superhuman levels. Where else but on Wall Street and in what other sector would it be acceptable for a company with no profits, debilitating debt and a belligerent CEO to be valued in the billions? In the tech industry, particularly, the market seems to be overlooking sound financial performance and inflating the market value of companies that are not profitable, financially irresponsible and, in many cases, not following the basic principles of good corporate finance.

Corporate governance, **which dictates that a company must be managed in a manner that ensures accountability, fairness and transparency in a company’s relationship with all its stakeholders**, has taken quite a beating, particularly in the tech world. Among many recent notable examples is Elon Reeves Musk, the outspoken CEO of Tesla (Nasdaq: TSLA), an electric automobile vehicle company. Mr. Musk seems to be doing the **opposite** of what is expected by a public company CEO and is being rewarded --- even idolized – by the financial markets. His undeniable power appears to go uncontested by analysts and investors alike. And, despite the outraged outcries by the financial media and the sell-side analyst community, Tesla’s stock price and market value continue to rise, seemingly supported with nothing but promises and arrogance.

Figure 1: Tesla’s Operating Cash Flow



Most recently, during the company’s 1Q18 conference call, Mr. Musk demonstrated just how little he values the market’s opinion, with **dismissive and rude responses to logical questions regarding CAPEX, reorganization of the company, as well as delivery of its Model 3 vehicle**, which is lagging in production. Adam Jonas, Managing Director and Head of Autos & Shared Mobility Research, commented that it was “the most unusual call I have experienced in 20 years on the sell-side”. Some excerpts:

- **When moving on to the Q&A session:** “...we’re going to go as long as there are good questions to answer...”
- **When asked about specific capital requirements:** “Boring, bonehead questions are not cool—next,”
- **When asked about Model 3 reservation holders’ order:** Silence. Then “We’re going to go to YouTube, sorry. These questions are so dry. They’re killing me...”

¹ The Age of Tech Superheroes Must End, Wall Street Journal, Christopher Mims – June 7, 2018



Figure 2: TSLA 6M Performance

recently, accused his competition with potentially sabotaging the company via a line fire at one of the operations that destroyed a Tesla and halted production for several hours, for the fourth time this year. Currently, the company's estimated market value is over US\$ 57 billion as of the date of this report, at par with brick-and-mortar car manufacturers like GM and Ford.

Why does the market continue to invest in CEOs like Elon Musk?

In the tech world, there is an influx of capital that hasn't been seen since the 1990's. And, just like in the 90's, investors are spending like there is no tomorrow, and will continue to do so until the bubble bursts. Over the years, tech industry founders have also learned not to yield control of the companies they created, by **implementing measures to ensure that they retain unquestionable authority** with regards to votes, decision-making, board of director composition and the day-to-day operations. Elon Musk is no exception; he has full control of the company, with 22% of the shares. Like him, other technology companies' CEOs have similar setups:

- Facebook's Zuckerberg, Founder, Chairman and CEO holds nearly 60% voting rights in a combination of Class A and B shares.
- WeWork's Adam Neumann, Co-Founder and CEO has 65% voting rights and sits on his own compensation committee.
- Theranos' Holmes held shares that gave her 100 votes per each share held by other investors.

The most highly-valued U.S. startups include companies like Uber, Airbnb, SpaceX (also owned by Musk) and WeWork, valued way over their brick-and-mortar peers. WeWork, which is still not publicly-listed, is currently valued at over US\$20 billion. The "physical social network" company, headed by Adam Neumann is one-fifth the size of IWC PLC, a leading real estate company, but has a market value that is eight times that of IWC. Another WeWork peer, Boston Properties Inc. (BSX), is publicly-traded and has roughly the same market value, but owns *five times* the square footage. With no actual assets – WeWork does not own its own buildings – and holds risky, long lease contracts with the property owners, making it financially precarious.

In the days following his bizarre performance in May, the stock fell by over 5%, shaving off nearly US\$3 billion of the market cap value virtually overnight. Moreover, several analysts cut price targets for the company based on concerns that Mr. Musk was "deflecting" instead of addressing the company's real problems.

However, the punishment was short-lived; in the following weeks, the stock once again gained momentum --- even after the company announced layoffs for 9% of its workforce and a setback in its 5,000 Model 3 production. These events, added to more bizarre behavior by Mr. Musk who, more





So what is the difference? Mr. Neumann.

Somehow, Mr. Neumann's idea of snapping up office space and repackaging it as a "community", essentially transformed an office space rental company into a technology play. And while his qualifications are scarce --- he was a small-time entrepreneur prior to hitting it big with the WeWork concept out of Brooklyn, New York --- he is currently worth over US\$3 billion, and the company's investors include Benchmark Capital, who quickly came in with US\$17 billion in a 2012 funding round. Benchmark was followed by Goldman Sachs, J.P. Morgan Chase, Jefferies and T.Rowe Price.

WeWork is not yet a public company, and the ownership structure is unclear. What is certain is that in 2014, Mr. Neumann altered the voting structure so that he would have full board control and a voting majority as the main shareholder. However, Mr. Neumann is known more for spending investor money than making it. Valued at US\$20 billion, WeWork posted annual revenues of only US\$436 million at the end of 2017. However, aside from the dubious nature of the business, Mr. Neumann spends money on lavish parties, such as renting out an entire amusement park for a company party, hiring famous bands for entertainment, as well as offering expensive tequila to visitors at his headquarters. Investors don't seem to mind for now, and the company continues to be a top pick among tech-focused portfolio managers.

Dictators are not Just Tech-Based



Shares of National Beverage (Nasdaq: FIZZ) fell 16% two days after the SEC questioned its internal sales measurements, namely their use of VCO (*velocity per outlet*) and VCP (*velocity per capita*) language in two corporate announcements in May, which the SEC stated needed to be explained and compared with prior periods. But the outspoken octogenarian Chairman and CEO, Nick Caporella, declined to respond or provide additional clarity, and the market greatly penalized the stock.

Known for his colorful and often unspecific comments, Mr. Caporella holds an undisputed 73.5% of the company's shares. He not only manages all facets of the company as Chairman and

CEO, in early June 2018, the company altered its corporate charter to allow shareholder removal of directors without cause and eliminate the need to garner minority shareholder support for any merger or acquisition.

What Makes a CEO a Leader versus a Dictator?

This brings up the question, what makes a CEO a true leader? Is it just *perception* or is it indeed, true value as an individual working to increase company market value? It is clear the technology realm is a special case and the types of CEOs that are in that space would probably never make it in traditional brick-and-mortar companies. However, the essence of a real leader transcends all industries. Let us take a step back to determine what, in general terms, determines a true leader:

In a study conducted in 2017, known as The CEO Genome Project, "What Sets Successful CEOs Apart" boils down success for CEOs to 4 behaviors, 2 of which – we believe – clearly reflect the difference between a true leader and a dictator. For one, a leader is able to take the company in a certain direction and bring *all* stakeholders along for the ride. In the study, which took over 10 years and assessed information from over 2,000 CEOs, this trait was labeled as the ability to **Engage for Impact**. In Elon Musk's case, he seems to be able to excite the support of many, if not all, of his stakeholders. In terms of the financial markets, for example, he is engaging no one. Instead he is pushing many of them away, straightforwardly telling them that if volatility frightens them, they should not invest in Tesla. This goes against the study which claims that "CEOs who

"This information is as secretive as the formulas of our beverages and should not be disclosed to our competition," Gregory Cook, the company's controller, wrote in a response to the SEC. (source: WSJ)



deftly engage stakeholders...were 75% more successful". In Mr. Neumann's case, however, he is a master of engagement. Not only are his investors completely on board, so are his employees and friends. It would seem that the only ones not buying his story are his competitors, the ones who understand the business best, yet have the most to lose.

Also in this study, another trait that stood out was **Delivering Reliably**. That is, the CEOs ability to produce results and to do so in a reliable fashion. "Boards and investors love a steady hand, and employees trust predictable leaders." In Mr. Musk's case, so far he has seemed to be clearly lacking in reliability. For one thing, it is certain that he cannot be counted on to say the appropriate things in an investor call or to the media. His track record demonstrates volatility of actions as well as "bizarre" behavior that can be described as anything but reliable. In terms of delivering reliably, many of the tech CEOs have nothing to show, as nothing has really been delivered to the market. This is particularly true of both of our examples, Tesla and WeWork.

The other two traits were **Deciding with Speed** and **Conviction and Adapting Proactively**. Whether the CEOs for Tesla and WeWork actually hold these attributes is still not yet certain. We will probably not know that for several years.

In another study conducted in 2017 by the Harvard Business Review, 200 global CEOs were analyzed and found to have these 7 common traits:

1. **Curiosity** – "The smartest CEOs are the most vulnerable, open to hearing what they don't know, always trying to learn."
2. **Purpose** - "CEOs tend to show a greater sense of purpose and passion for what they do than other members of company leadership."
3. **Risk** – "(they are able to) embrace risk..."
4. **Organization** – "...successful CEOs remain organized in their approach to solving problems within the business..."
5. **Communication** – "...know the value of soft skills...devote time and effort to refining their communication skills for the betterment of the team and the company as a whole."
6. **Realistic Optimism** - "There is a difference between...daydreaming about ideas that sound great in theory but have no real-world application, and realistic optimism."
7. **Vision** – "Without vision, the CEO is merely a celebrated facilitator."

"Articles Related to Desirable CEO Traits:

<https://www.forbes.com/sites/deeppatel/2017/06/15/7-personality-traits-every-ceo-should-have/>

<https://www.inc.com/stephanie-chung/10-personality-traits-every-ceo-should-have.html>

<https://hbr.org/2017/05/what-sets-successful-ceos-apart>

<https://www.forbes.com/sites/rogertrapp/2016/05/31/four-crucial-traits-of-ceos/#2b9f02235b26>

<https://www.inc.com/leigh-buchanan/why-entrepreneurs-make-the-best-ceos.html>

What kind of executive are you – **Dictator or Leader?**

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