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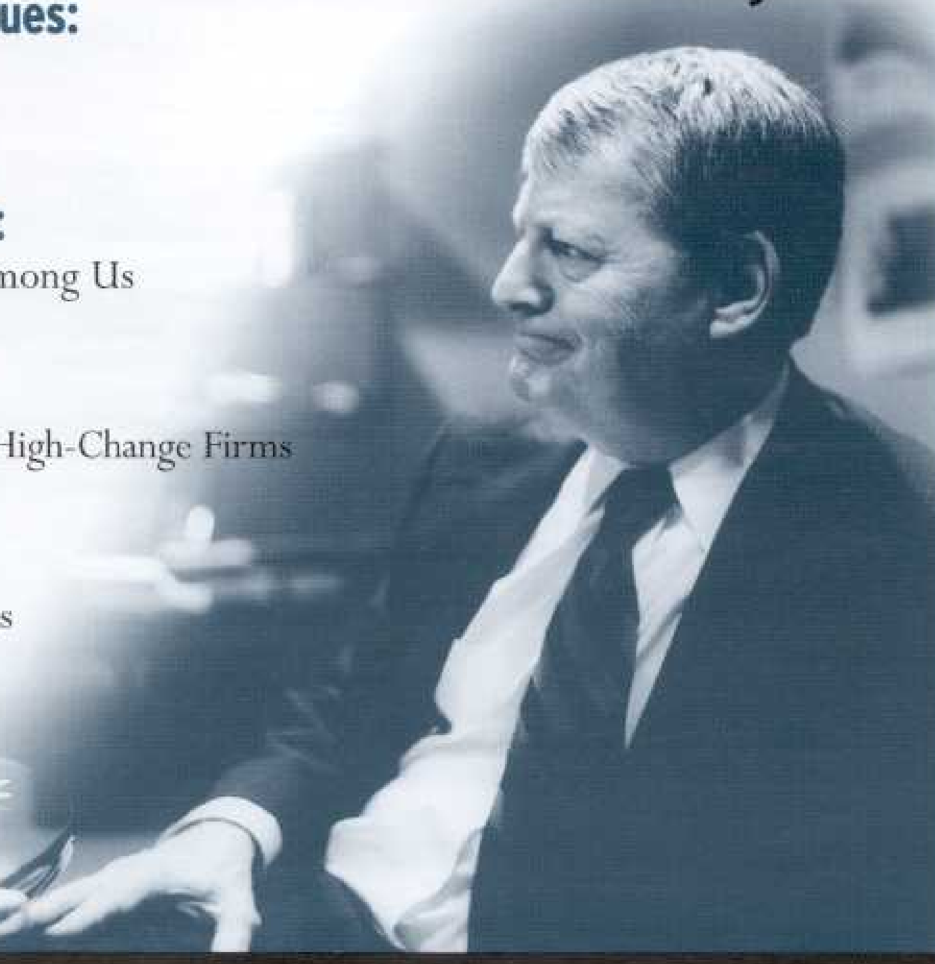
Executive Talent™

Branding New Leaders

How Adman Tom Watson Drives Omnicom's Growth Engine



By Dr. Theresa M. Welbourne

IPO.itis at High-Growth,

The IPO process has a "dark side" that can drive a company into a downward spiral, hurting employee productivity as well as stock prices. Honest communication with employees offers a strong dose of medicine that helps prevent diseases such as "Everybody else has more than me.itis" and "Oops, the stock went down.itis" in the critical first year following an IPO.

Once again, Wall Street Interactive hit my computer screen with a lead story reading "Tech Shares Lead Steep Decline In Stock Market." As a result of the volatile stock market for young firms, those employees who were riding high with millions and concerned about what has been called "sudden-wealth syndrome" may now be suffering from "sudden loss syndrome." Stock prices for many newer firms are dropping, and employees are finding their stock option exercise price to be higher than the price at which their firm's stock is currently trading.

Employees are confused and concerned; many are watching stock prices daily — maybe even minute by minute — as the ticker symbols and prices scroll across their computer screens. You must be wondering what this means for your workforce. What are the implications for retention? Does this problem affect large as well as small firms, or only recent initial public offerings (IPOs)?

IPOs have drawn much public attention with the rush of dot-coms and the huge success stories that have been published, but the reality is that they have been around for years. And with all the successes, there have been many failures. My research over the last eight years has focused on IPOs, and as someone recently told me, studying IPOs is like studying the fruit flies of management. That's because they live and die quickly, and in this type of high change environment, important lessons can be learned that can be transferred to other types of organizations.

The research involves obtaining data on cohorts of firms that go public in a given year, profiling them by coding the data contained in each prospectus, supplementing with surveys sent to members of the management teams, and then doing statistical analyses to predict firm performance, which may be stock price growth, growth in earnings per share, or firm survival.

The first IPO study that I did with Alice Andrews[1] examined 136 firms that went public in 1988; a later study conducted with Linda Cyr[2] examined 535 that did their IPOs in 1993. Since then, I have collected data on the nearly 1,000 firms that did their IPOs in 1996, and the research effort continues

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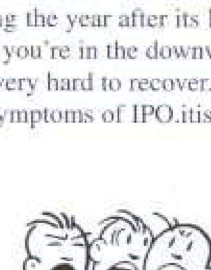
High-Change Organizations

with the 500+ firms that completed IPOs in 1999, and tracking all IPOs in 2000. In addition to the studies of yearly IPO cohorts, I have done case studies of individual firms going through their IPOs. This method involves interviews with employees and managers in addition to surveys being collected from all employees in the IPO organizations. It is the combination of large-scale empirical studies and in-depth case studies that leads to several conclusions.

"Dark Side" of IPOs

One observation from the IPO research is something that could be called the "dark side" of the IPO. The hypothesis is that firms which could otherwise be successful are harmed by the IPO process itself. The phenomenon is tied to the fact that the first year after the IPO is very critical for new organizations. The observation is that if you don't do well the year following the IPO, you can fall off the investors' radar screens, stock will not trade, and you can suffer tremendously. You have the potential to become part of the "living dead" — firms that are still public but whose stock is stagnant. As you may guess, this is not a pretty place to be. And, it is not a place where good employees want to come to work.

Why and how do you enter the "dark side"? You enter because the IPO is a critical and important organizational change event, and most people don't understand the IPO in that way. The IPO is often seen as an outcome or an end event; it's the time when participants cash out. But life goes on after the IPO, and if the IPO process is not managed well, a firm can easily fall prey to something called "IPO.itis." Once this occurs, a business can quickly enter into the downward spiral during the year after its IPO. And once you're in the downward spiral, it is very hard to recover. Here are the symptoms of IPO.itis:



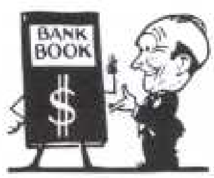
Symptom #1:

CEO.itis. Prior to the IPO, the senior management team goes on the "road show." They visit with potential investors and tell the company story over and over again. They get lots of attention. They waited for this event, and now it's finally happened. The CEO (and other members of the top team) feel pretty good about themselves; in fact, they feel really great about themselves. And sometimes they forget that the company is not just them. They can come back from the road show and the hype of the IPO and be very much "into themselves." Some people quit listening to employees. The top team is wealthy — they buy lots of stuff. They show up to work with new cars; they buy yachts and mansions.

And employees see this. CEO.itis can have an effect on morale, on feelings about equity, and on the CEO's ability to make decisions. When CEOs stop listening to employees and start believing they are as great as people tell them they are, they can start to lose touch with the reality of their business.

Symptom #2:

Everyone else has more than me.itis. This is prevalent in all firms. People don't know who's a millionaire and who isn't — but if they're not incredibly wealthy, they're sure the person next to them is. Perceptions of inequity are real, and they have an immediate impact on morale. In fact, it starts before the IPO, when employees guess who has how many shares and calculate how much various people will make on IPO day.

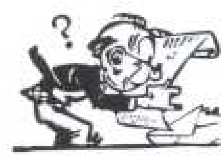


Symptom #3:

Investment banker.itis. Not only is the management team focused on themselves, but as the IPO details proceed forward, management enters into the world of quarterly results (when most had really thought longer term prior to the IPO). Executives are responding to calls from the bankers, and they are taking time away from managing the firm to deal with managing the investment community.

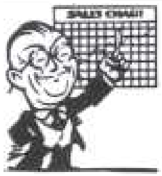
Symptom #4:

I'm now left out.itis. A lot of companies that make it to the IPO get there because they developed a culture that thrives on fast growth. Many of these cultures are open; managers share information with their employees (e.g., financial, sales, production, ideas, etc.). But now, as a public company, its information is sacred. It cannot be shared until made public. Employees who felt part of something, and who felt part of an inner circle because they had information, are now left out. The culture changes, and to most people, it's not for the better.



Symptom #5:

Oops, the stock went down.itis. One thing we know from the research that has been done in the field of finance is that initial stock value (at the IPO) is usually underpriced. That means there is a very good chance the stock price will go up considerably immediately after the IPO. And in a few cases, stock stays up. But in most cases, stock goes back down. Start-ups strive to go public; employees and management see it as a major event. And the psychology around stock price is amazing. Every company I've met with thinks it will be the one to go up — and up — and up, and stay up. But reality kicks in quickly, and people are disappointed. Consider the next symptom.



Symptom #6:

Correlation.itis. As part of my IPO research, I collected weekly data from employees who went through the IPO process. The measurement and communication process that was developed to study IPO firms has since grown into a business called eePulse, Inc. (www.eepulse.com). The team at eePulse collects weekly data from employees in high-growth, high-change organizations. In addition to open-ended comments, a one-item metric that assesses employee pulse or energy at work is also collected. Studies conducted by eePulse show that the correlation between the weekly pulse measure and week-ending stock price is anywhere from 0.40 to 0.90. That means that as stock price goes up, employee energy goes up. When stock price goes down, employee energy goes down.

Now, combine this tidbit with the fact that odds are very high that stock price will go down after an IPO. And what's the cause-effect relationship? Short term, the direction is that stock price drives employee energy at work. Consider how readily available daily, hourly, or minute-by-minute stock price is with today's technology. Employees watch stock price, and they react. Longer term, the result can be the "downward spiral."

Here's what happens: Stock price goes down. Employee morale goes down. Good employees leave. Employees take company-specific knowledge with them. Employees who stay don't feel as good about their job. Real customer service is affected. Real sales are affected. Real production is affected. And then, real earnings are affected.

Real earnings affect stock prices. Enter the downward spiral. And in most cases, management does not know how they got there. Why? Because they are busy with the other symptoms.

Symptom #7:

First year.itis. If you enter into the downward spiral in the first year after the IPO, and you don't stop it, it's very hard to recover. Bankers lose interest in you; the press releases are negative; it's hard to find good employees; and the management team becomes distressed.

Avoiding IPO.itis

How do you successfully do an IPO and not enter into the spiral? First and foremost, educate the management team — and keep educating. And while educating, keep the management team humble enough so that everyone in the group will sincerely listen to all employees. It is impossible for management to know everything that is occurring in their companies, and as rate of change increases (which happens with an IPO), it's even more important to listen. If you listen, then you can head off problems before they spiral out of control.

Additionally, each IPO firm should invest time to teach employees that stock price is unpredictable. And it's important to continue sharing this message with employees. If they work only for stock, and stock price goes down, your company can quickly enter into the downward spiral. I have done focus groups with employees and showed them graphs depicting the correlation between stock price and weekly employee pulse.

Comments from employees are usually some variation of "we worked so hard that week, why would they [the market] do that to us?" Many employees, like most people in general, don't understand the stock market. And the hype down the road to the IPO is strong — particularly if you live in a geographic area that has a lot of start-up activity, such as Silicon Valley. The press is focusing on the successful cases, but there are more than enough failures or near-death experiences to make managers take IPO.itis seriously.

Companies should bet on themselves and their own success. And my research shows that success comes from the inside — from your employees. Multiple studies found that companies with a high-energy culture succeed when they value their employees. Success means stock price growth maximized, earnings per share growing, and surviving when others do not.

Case Study: Indus International

One of the IPOs I studied in depth is that of a firm called Indus International. The CEO, Robert W. Felton (Bob), gave me access to his organization as it went through its IPO in 1996. In exchange for studying all employees at Indus, Bob asked me to share overall trends and alert him to any critical issues raised by employees. I studied Indus's IPO through a weekly e-mail system that allowed me to collect data from employees and then aggregate my findings in weekly reports.

I knew Bob and Indus for three years prior to the IPO, and I found Bob to be a visionary CEO who listened to his employees. As Indus entered into its IPO, he wanted to maintain the clear and continuous communication that he had been able make a key component of Indus's culture. And to his credit, he understood the temptations on the road to the IPO. He wanted to stop rumors and misunderstandings before they occurred, and he wanted critical, honest feedback from his own management team and employees.

As the weekly data revealed trends and potential problems, Bob responded to them. He did not wait until it was too late; he communicated with his employees extensively during the IPO. At the end of long and grueling days spent with potential investors during the road show, Bob took time every evening to write to all employees in what he called his "road show diary." He shared the experience with all employees, thus making them partners in the road to the IPO. And as important issues arose via our weekly communication process (that we called pulse), Bob and his management team responded to issues even while they were on the road show. I think that keeping in touch with the employees not only helped communications, but also kept the management team and Bob humble during a period of time when maintaining any sense of humility is a very difficult task. Thus they avoided CEO.itis.

Rumors of CEO Departure

As Indus employees expressed their fears and communicated rumors that were only starting, Bob communicated to reassure them, and he made changes when appropriate. For example, early in the IPO process a rumor started that Bob was going to leave immediately after the IPO. The rumor was not based on fact, and Bob quickly wrote to employees assuring them that he was not leaving Indus.

Additionally, employees wrote about problems with vesting, and the management team made last-minute changes to ensure more participation by employees. They thus helped minimize another symptom of IPO.itis (Everyone has more than me.itis).

After the IPO, when we studied the data and found the correlation between stock price and pulse, Bob and the management team met with employees, sent e-mail messages to them, and did their best to explain the reality of the stock market (thus minimizing Correlation.itis and Stock went down.itis).

With employee data on the radar

Comments from employees are usually some variation of "we worked

Notes

1. Welbourne, T.M. & Andrews, A.O. 1996. Predicting performance of initial public offering firms: Should human resources be in the equation? Academy of Management Journal, 39(4), 891-919.

2. Welbourne, T.M. & Cyr, L.A. 1999. The human resource executive effect in initial public offerings. Academy of Management Journal, 42(6), 616-629.

screen, the management team avoided the temptation to focus solely on Wall Street (avoiding Investment Banker.itis). Even though the management team could not immediately share as much of the information as they once had been able to communicate with employees (due to regulations associated with being a public company), maintaining the ongoing weekly communications that we

so hard that week, why would they [the market] do that to us?"

started as part of the IPO study ensured that Indus did not suffer from "I'm left out.itis."

The symptoms of IPO.itis are complex, but the remedy may be simple. Ongoing, sincere, and honest communication with employees can be a key variable in helping a firm maneuver through the IPO. Indus successfully avoided First year.itis and entering into the downward spiral. This is not to say that they have not struggled after the IPO. But under Bob's direction, Indus avoided many of the pitfalls of a new IPO firm. And those lessons learned were used to help the company as it went though further growing pains, including a merger, international expansion, and changes in the top executive team.

Lessons for Other Organizations

IPO.itis is a disease that can attack an organization when it goes through a particular organizational change event, the initial public offering. But you don't have to have an IPO to grow your business and/or experience significant change. That means you do not have to be an IPO to experience symptoms such as those found in IPO.itis. Any organizational change can engender the same types of human responses, and therefore you can minimize the negative impacts of growth and change with the same remedy — constant communication and learning. Fortunately, with today's Internet-based technology, information and processes to enhance fast and real-time communication are readily available to organizations.

However, the keys to success are not only getting information but also being willing to answer employee questions, make change happen, and communicate back to employees. Bob Felton made his communication tool work by listening and responding. He did not respond to every comment made by employees, but he carefully chose issues that he knew were key to firm success and that were brought up by multiple employees. Entities such as Citigroup, Honeywell and the University of Rochester also make the weekly tool work because the managers utilizing the system are anxious to take action in response to information provided by their employees. And their responses to employee suggestions have led to positive change that has translated into improved productivity, morale, quality, and firm performance.

The downward spiral starts because stock price causes changes in employee energy level at work. But a company continues downward or escalates upward because employee energy affects real company productivity, sales and earnings. And these real outcomes eventually affect long-term stock price growth. Companies that are here to stay and that care about creating long-term value for their customers, whether IPOs or not, can benefit from understanding organizational change through the eyes of their employees. If they do so, they can learn more and be better equipped to handle the types of change that successful firms must master. ET