THE POWER OF COMPOUND DECISION MAKING

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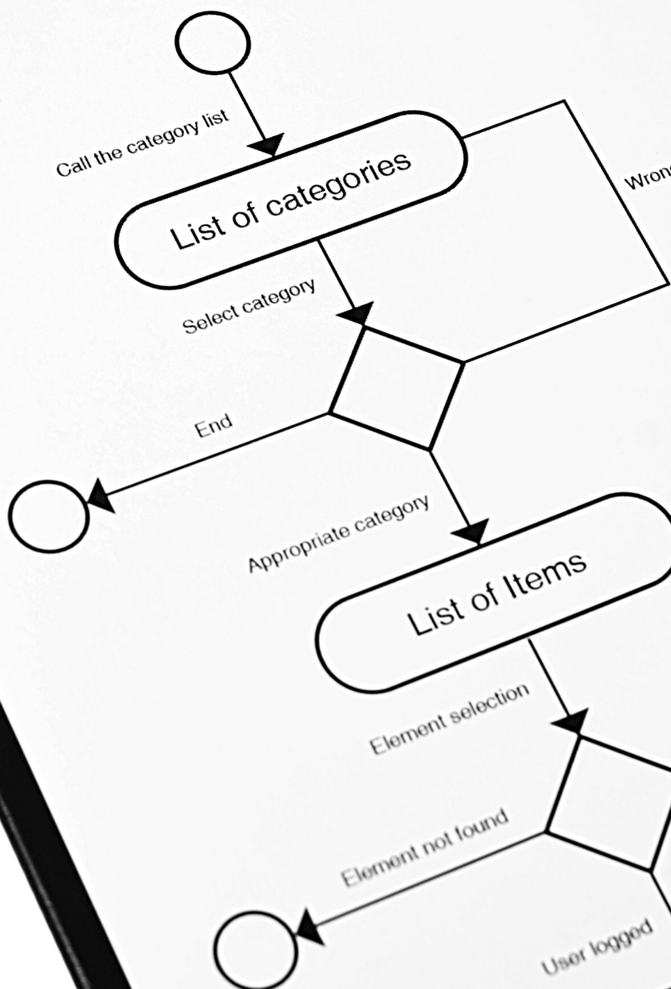


INVESTING VS. OPERATING

BY VIRAJ PARIKH

Having spent over a decade as a Wall Street investment analyst and portfolio manager prior to becoming a CFO, I would often think about the decision-making process of great portfolio managers versus CEOs of the many growth companies that I admired and studied. A common thread that defined success between the two disciplines: *do your homework, be decisive, and do not look back.*

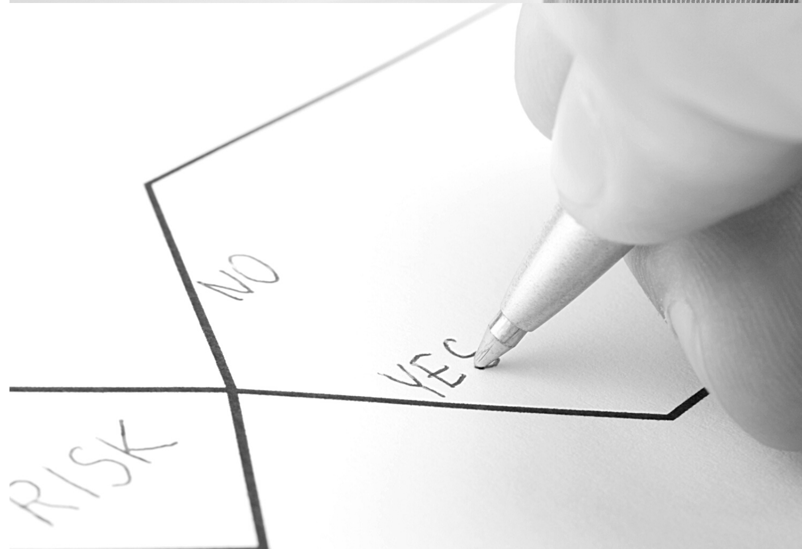
As a CFO and company-builder that has had the privilege of working closely with a variety of venture-backed growth companies, it is clear that **high-velocity decision-making is a hallmark of successful growth companies**. In Part 1 of this 2-part paper on rapid decision-making, the mental framework introduced below, as well as the merits of sacrificing quality for speed, will help CEOs achieve significant value accretion for their companies.

Navigating the markets is a humbling experience, as it requires making fast and significant decisions with imperfect information. At its core, the discipline requires an embrace of risk-taking. Every decision weighs risk versus reward, so good judgement is key. In the world of building businesses, there is no bigger risk (and potential reward) than being a founder operator, where being both prepared and decisive are prerequisites for success. Discussed below are three lessons I learned as an investment manager that I have taken to the young operating companies I advise through their growth journey.

1. HIGH-VELOCITY DECISION MAKING FOR PRIVATE GROWTH COMPANIES IS ESSENTIAL

For an investment manager, the weighted average gain or loss of each decision over the course of a year will yield an annual fund performance. Over a 10- to 20-year career of managing money, the compound effect of all those decisions is magnified exponentially.

A manager that returns 4% per year will double their money in 17 years, while one who returns just 3% more each year (i.e., 7% annually) will double their money in only 10 years. The glacial pace of each year results in a completely different long-term trajectory, separating superstars from mediocre performers. Warren Buffett acolytes know this as the “snowball” effect.



In the world of business-building, an operator may feel removed from the pressure of daily decision-making. After all, there is no mark-to-market scoreboard that tells a CEO the value of their company each-and-every day as in the stock market. Financial reporting happens just once-a-month, and even professionally run companies have board meetings only once-a-quarter, so it would be easy to feel removed from the pressure of daily decision-making.

While it is true that the glare and harsh judgment of the markets does not exist among early-stage companies, **the growth expectations for a VC-backed growth company far outpaces that of a typical S&P 500 manager, given that doubling your money is not expected every 5-10 years, but every 1-2 years**. Therefore, it stands to reason that decision-making velocity for private VC-backed companies should outpace that of a typical investment manager. As a business leader, if you are unsure whether your company is stagnating, ask yourself how many key decisions have been made in past week or month by your team. That will often be a key indicator whether your company is dynamic enough to achieve important milestones.

SAY WHAT YOU WILL ABOUT MARK ZUCKERBERG, BUT IT WOULD BE IMPOSSIBLE TO DENY FACEBOOK'S ABILITY TO MAKE FAST DECISIONS

Mark Zuckerberg’s famous quote “move fast and break things” neatly sums up this modus operandi. Facebook has broken many things over the years, but growth and profitability are not among them. Zuckerberg’s decision to eschew advertising revenue for many years in the early days led to far greater user growth than what would have otherwise been achieved. Compounding that growth was the decision to move fast on the acquisitions of Instagram and WhatsApp. And when Snapchat burst on the scene, he first tried to acquire it also; when that failed, he copied Snapchat’s key features with lightning speed. Same thing with Reels, Facebook’s answer to TikTok. Say what you will about Mark Zuckerberg, but it would be impossible to deny Facebook’s ability to make fast decisions.

2. FOCUS ON MAGNITUDE, NOT QUANTITY

Many leaders compensate for the fear of making big decisions by focusing on insignificant decisions or activities that fail to move the needle. It is not difficult to fill the days with meetings and information-gathering, but true leadership is about tackling the hard decisions that have a meaningful impact. It is natural to be fearful when making important decisions, particularly when trying to make them expeditiously. The obvious trade-off when moving rapidly is that many decisions may end up being bad ones.

Every investment manager feels this fear in their bones (George Soros would famously get a sore back), but another great lesson that can be applied to the operating world is that **it is the magnitude, not quantity, of good versus bad decisions that ultimately determines business success**. At the beginning of 2020, Warren Buffett owned roughly 10% stakes in four major U.S. airlines; after the pandemic hit, he ended up selling all of them near their lows. But Berkshire Hathaway's gains from its giant 6% stake in Apple dwarfed the losses in the airline stocks. Why care about four high-profile losers if one outsized decision more than makes up for it? Ultimately, you should safeguard your time and resources by not dwelling on small things if they prove to be bad bets.

In the operating world, Google has made countless bets outside of its core advertising business, but precious few have actually panned out, as less than 0.5% of its revenue comes from Alphabet Corp's "other bets." Nevertheless, its total dominance of paid search has given the Company a wide berth to try and fail at many other things as it swings for the fences in such initiatives as artificial intelligence (DeepMind) and driverless cars (Waymo).
Small failures are a perfectly rational and acceptable consequence of fast decision-making, as long as a leader is clear of the potential for huge upside rewards. Managed properly, failures will not kill you, and may even be laughed at as meaningless if you hit a home run or two.
Leaders must empower key deputies and line managers to make as many smaller decisions as possible, so that CEOs have the mental bandwidth and clarity to make faster needle-moving decisions.

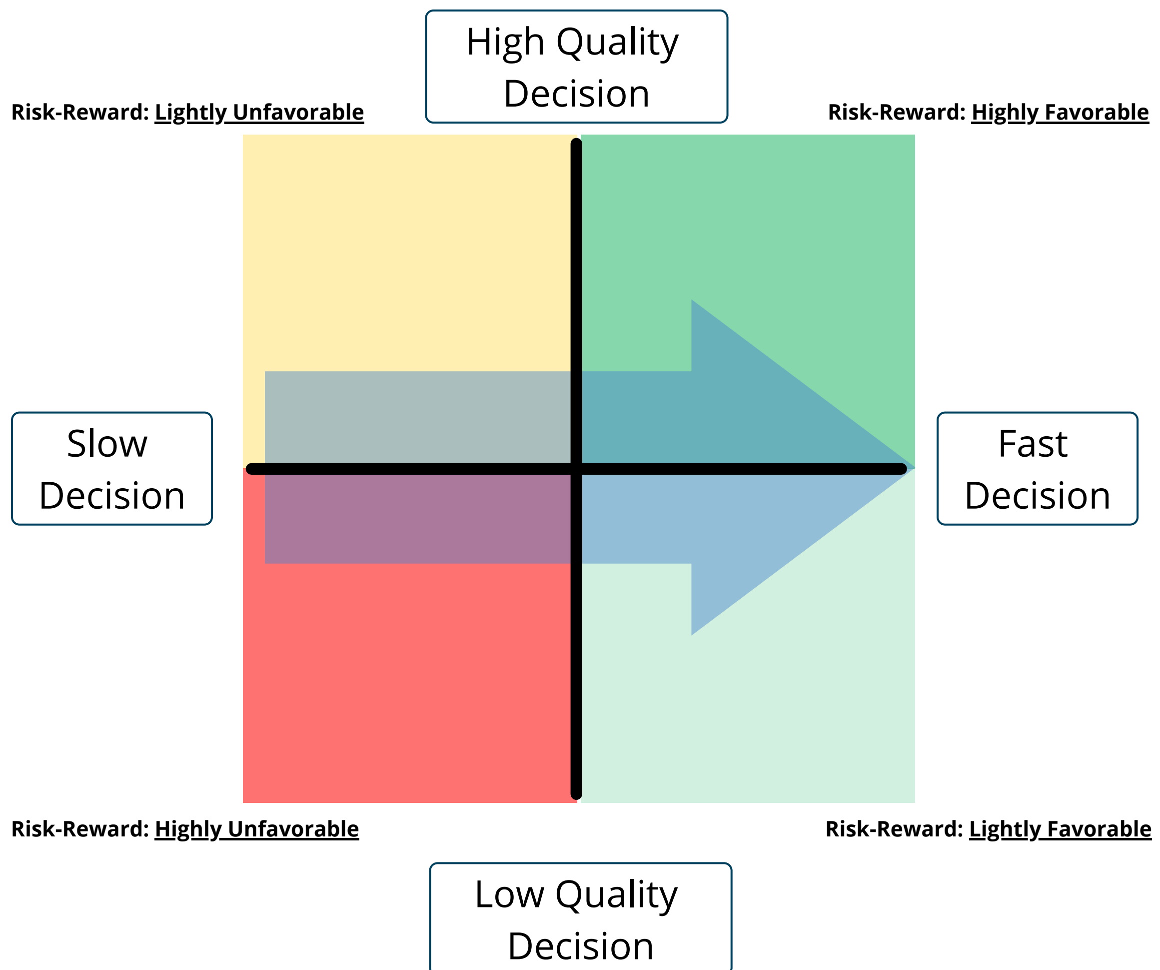
3. THE HIGH OPPORTUNITY COST OF INDECISION

A portfolio manager's buy and sell decisions are not the only consequential ones, as each decision to not buy or sell involves an opportunity cost. For example, not selling Netflix may mean having insufficient capital to buy Bank of America, which may have more upside going forward.

As an operator, taking too long to develop a new product feature or enter a new market are implicitly decisions, whether you realize it or not. Dwelling on decisions for too long can be financially debilitating, particularly for young companies with finite and depleting resources. It may feel costly to invest in growth initiatives, but the opportunity cost of standing still is often much higher.

CONCLUSION

The graph below illustrates the trade-off between decision-making speed versus quality, and the factors that lead to both. Plenty of empirical evidence suggests that speed trumps quality, at least for growth companies, provided that the bad decisions are not of a magnitude that they may kill you.



The blue arrow represents the directional bias that every manager of a growth company should embrace as they weigh risk versus reward. The overall thesis is that spending time on the right half (dark and light green areas) are more favorable than being in the left half. But it requires good judgement – do not allow a bad decision to kill you. Next , in Part 2, we will explore strong versus weak qualities of judgement, in order to help CEOs spend as much time as possible in the upper right quadrant. We will also explore the virtues of high-speed decision-making.

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