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THE CASE OF WEWORK – RISE & FALL

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Abstract

There is a start-up fervour going on all around the world and a few hundred companies are started each year with investors backing them with billions of dollars. Even many bright students after getting their university degrees opt for building their start-up rather than a fat purse job. While many start-ups are getting started but only a few taste successes, this is because for any start-up to succeed there must be a well-planned approach to the business and its corporate governance and its ability to provide excellent returns to its early investors and to have a positive cash flow, which many start-ups sadly could not. This case study is a novel attempt to reveal the problems surfaced owing to unethical corporate governance practices, extravagant spending by WeWork which rejoiced the status of start-up unicorn, A company that got too much money too fast with no effective oversight on how to spend it while making wrong investment & its hasty business decisions, and nil corporate governance. From this case study, one can learn from the mistakes of WeWork & its impact on the business, the importance of corporate governance in companies & enable entrepreneurs to make appropriate decisions in their Start-ups.

Keywords: Business Ethics, Co-Working Space, Corporate Governance, Start-Up Ecosystem, Business Model, Entrepreneurial Competence.

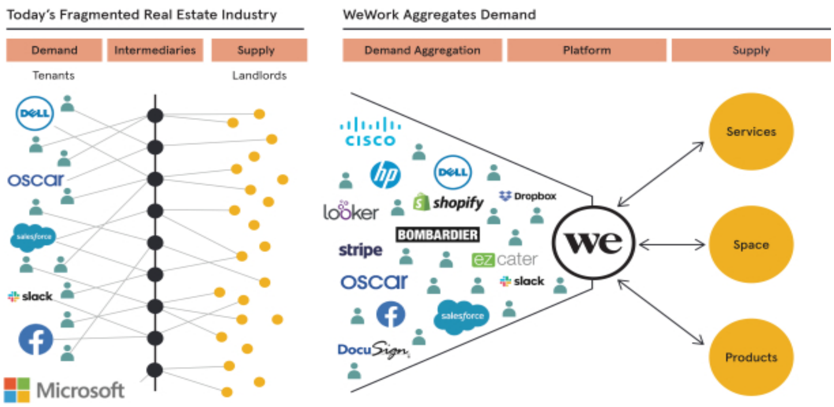
Introduction

Case study

The start-up phase

WeWork a start-up commercial real estate company that provides shared workspaces to firms & businesses [refer to Figure-I] was started in 2010 by Adam Neumann, Miguel McKelvey in the SoHo district of New York (Aydin, 2019). WeWork' s model was simple. Leasing space from landlords, renovating offices, and then finding new tenants. With Adam Neuman as CEO, the company has grown exponentially within a short time, as of 2019 the company's valuation before its IPO is at $47 billion [refer Figure-II] making it the 2nd largest IPO in 2019 after Uber.

Figure-1 Business model of WeWork

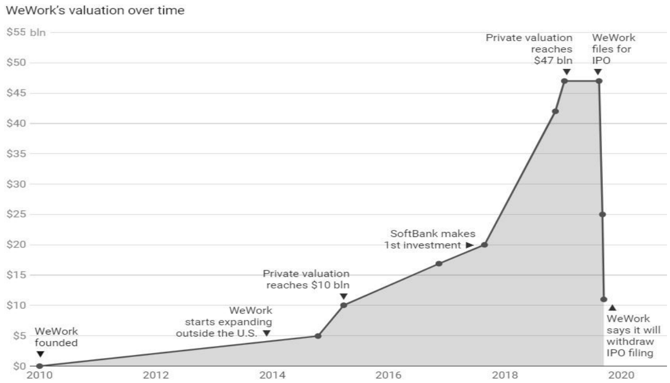


Source: - We Company; https://www.sec.gov/Archives/edgar/data/1533523/000119312519220499/d781982ds1.htm

The company during its initial roots does not want only to be a normal commercial real estate company but also wanted to provide a platform for young entrepreneurs, freelancers come together as a community to help each other out. Neumann in an interview "Community, being surrounded by a like-minded individual, being part of something bigger than yourself inspires people to work harder, spend more time at work and just have fun doing it" (Sheftell, 2011). This brought in a cult-like following among the entrepreneurs who liked the idea of community, cost & free amenities. These features brought even more customers to the company and in turn attracted many investors & venture capital firms to invest, this made the company be the largest growing lessee of new office space in New York. The companies like Consumr, Coupon Follow, Fitocracy, HackHands, New York Tech Meetup, Reddit, Turf, and Whole Whale were first to sign in with WeWork as they found opportunities for growing their business and have a good chance of networking (Shontell, 2013), As of January 2015 firm had 51 coworking locations across the U.S., Europe, and Israel –

twice as many as it had at the end of 2014. In 2016 WeWork was chosen by Fortune magazine as one of its three unicorns to bet against, at that time the company had a valuation of $10 billion (Nusca, 2016).

Figure- II: - The We company Valuation history



Source: -Reuters http://bv-wework.com/

Ties with Softbank

In 2017, Soft bank invested $5 billion in WeWork raising the company's valuation to $20 million (Brown et al., 2017). With the investment from SoftBank the company started to gain global footprints, In September 2017, WeWork acquired Singapore based Space mob and set aside a $500 million budget for its growth, as of 2017, WeWork raised $500 million from SoftBank &Hony capital for heavily expanding in china and forming separate entity- WeWork China (Zhu & Barreto, 2017). From 2017 to 2018 SoftBank invested $8 million in WeWork and in 2019 Softbank planned to invest $16 million in the company thus giving them a controlling stake in the company but due to the public outrage, SoftBank scaled back its investment back to $2 billion this increased the company's valuation to $47 billion. This valuation put WeWork in the top tier start-ups such as Uber, Airbnb. With the investment, the company started to open offices in big cities of America, Brazil, Argentina, India, China, Vietnam, Germany, Israel, Japan thus taking the company to the international level.

The Down Phase

With investments from SoftBank, the company started to make some wayward investments– As a commercial real estate company WeWork invested $13.8 million in Wavegarden, an artificial wave pool company (Brown, 2017). The company CEO Adam Neumann brought a Gulfstream G650 plane from the company's fund for him and his family's personnel use for $60 million in 2018 (Rapier, 2020). WeWork invested in school WeGrow with Adam Neumann's wife Rebekah Neumann as CEO.

No one in the public knows the company's actual growth or its metrics until the company in august 2019 decided to file for an Initial public offering which let the public investors look behind the curtain, WeWork's actual performance and its corporate governance which was a huge shock to the people who saw mishaps happened in the company. The company has burned through its cash and needs money to run its business, so the idea of going public was taken by then CFO Artie Minson.

For instance, the company paid $5.9 million to CEO Adam Neumann for the copyright "WE" which was owned by Neumann, and WeWork paid rent to Adam Neumann as its corporate headquarter was owned by him. And WeWork gave Adam Neumann loans at a very less interest rate which he paid back but was a big revenue loss to the company (The We company, 2019).

Information from SEC-fillings

In SEC filling the voting rights of CEO Adam Neumann was 20 times that of other shareholders and Neumann's would retain control of we work in the event of Adam's death with Rebekah Neumann who had been elevated to co-founder would be holding the right to pick his successor (The We company, 2019). The company's revenue and loss [refer Figure-III]. The company's cash flow statement in the recent period is presented in the negative [refer to Table-I].

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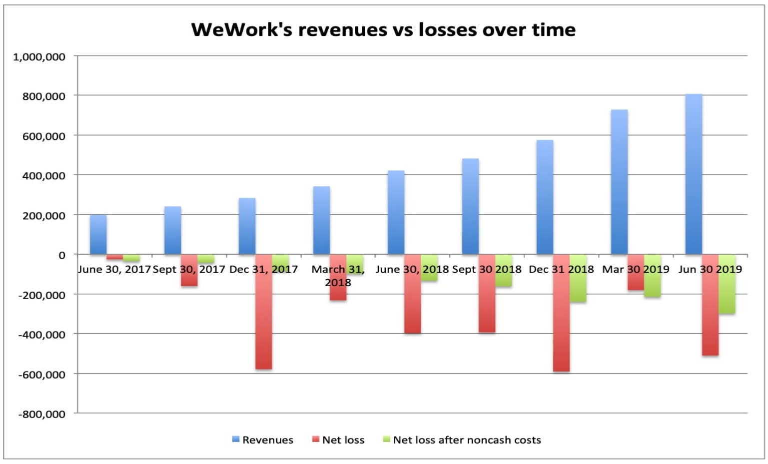
Figure-III: - The We company's revenue & loss



Source: - We company; https://www.sec.gov/Archives/edgar/data/1533523/000119312519220499/d781982ds1.htm

Table I: - The We company cashflow

Cash flow from operations - years	Total cashflow
2016	$84,027
2017	$1,590,777
2018	-$7,177

Source: - We company https://www.sec.gov/Archives/edgar/data/1533523/000119312519220499/d781982ds1.htm

The company uses a high discount rate of 8.2% to calculate the present value of its operating risk, this discount rate is used to understate the liability and the company has a higher chance of defaulting during a recession (The We company, 2019).

Another area of shock for investors is "non-cancellable operating lease commitments" and its liabilities in 2019 of $4 billion and it is estimated to rise to $39 billion by 2024. [refer to Figure-IV].

Exhibit IV: - The We company's lease liabilities.

(Amounts in thousands)	Remainder of 2019	2020	2021	2022	2023	2024 and beyond	Total
Non-cancelable operating lease commitments (1)	$ 868,895	$2,164,826	$2,322,922	$2,383,279	$2,426,278	$23,787,202	$33,953,402
Finance lease commitments, including interest	4,206	8,531	8,610	8,561	8,007	45,408	83,323
Construction commitments (2)	340,098	86,291	1,684	313	—	—	428,386
Asset retirement obligations (3)	487	490	137	2,051	1,139	107,013	111,317
Long-term debt obligations, including interest (4)	37,051	75,129	91,750	800,029	58,773	794,743	1,857,475
Convertible related party liabilities (5)	2,945,005	—	—	—	—	—	2,945,005
Total	$4,195,742	$2,335,267	$2,425,103	$3,194,233	$2,494,197	$24,734,366	$39,378,908

Source: - We company https://www.sec.gov/Archives/edgar/data/1533523/000119312519220499/d781982ds1.htm

After a failed IPO

After looking at the figures in the SEC fillings & blunders in corporate leadership (Molla&Ghaffary, 2019), the investors started to value the company as less as $10 billion and on September 17, 2019, WeWork officially postponed the IPO (Eavis& de la Merced, 2019). After its failed IPO, on September 24, 2019, Adam Neumann resigned as CEO, the Board of directors appointed Sebastian Gunningham, and Artie Minson as Co-CEOs. After their appointment, they closed WeGrow -the school, Adam Neumann's $60 million jet, and planned to layoff thousands of its employees (Huet& Tan, 2020) but the company not being able to afford to provide them their severance package, the company was quickly running out of cash until Softbank decided to bail the company out by injecting $9.5 billion into the company which is now valued less than $8 billion, for which Softbank has received Neumann's chairmanship and his voting rights. Softbank paid $685 million to Neumann for his $970 million worth of shares.

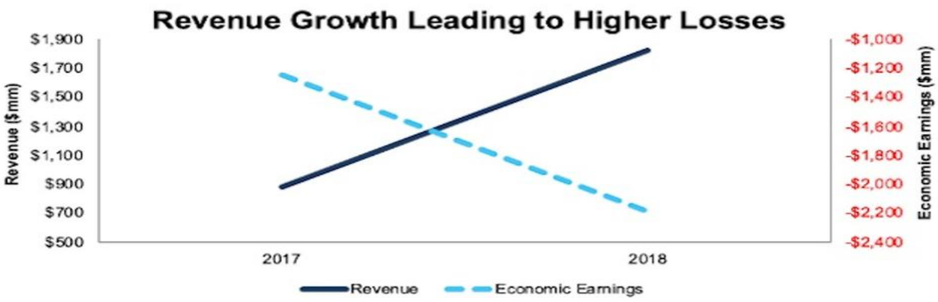
The business model of WeWork

WeWork's failure can be partially attributed to its core business model that is getting buildings on longer lease while this allows WeWork to get cheaper annual rents and offer premium office leases at competitive prices. however, the long-term lease is riskier during an economic downturn where the company will lock into the expensive leases and no sub-tenant to cover the expenses of the rent. The average lease term of WeWork is 15 years and WeWork does not have the option to mitigate its risk which may result in negative cash flow during an economic downturn (The We company, 2019).

WeWork business aims to capture business between short term and long-term rental cost, For the stakeholders of business Landlords want guaranteed cash flow and stability, while companies want the flexibility to grow, shrink, move their office and willing to pay a higher price for this flexibility, also WeWork sweetens the deal with renovations, customer support, a place for networking, enhanced amenities such as coffee machines, free beers, and pool games. This model is suitable for the time of economic growth but not for the time of recession (The We company, 2019).

WeWork follows a high-risk growth strategy which allowed it to grow 106% in the financial year 2017 to 2018, but its economic earnings are down from $1.2 billion to -$2.2 billion in a year, the company is not operating with its profit but simply burning its investment cash. [refer Figure-V].

Figure V: - Revenue to Earning Relationship the We company



Source: - We company; https://www.sec.gov/Archives/edgar/data/1533523/000119312519220499/d781982ds1.htm

WeWork's s growth is very quick in these recent years the company had no board oversight; the company was running in an unprofitable manner for a long time and no long-time plan was in place, this led to ultimate fall of WeWork.

Questions for discussions

- What are the mistakes done by WeWork from their start-up phase?
- What are the problems in the business model of WeWork? What can be done to mitigate the business risk associated with the model?
- After the downfall what will be the task of the future CEO to bring confidence and growth to the company?

Teaching notes

Before answering the questions, a rough timeline can be drawn so the different phases of the company can be viewed. Moreover, the Figures data provided is useful in knowing the company and for more information please refer to the company's S1-form from the SEC website.

Also, during a class or in a training session, this case can be provided as a part of group activity where through brainstorming sessions you can ask participants to perfect the business model, solutions for the mistakes of WeWork, by solving this case it may improve decision-making skills of the participants. Sample answers are provided below for reference.

What are the mistakes done by WeWork from their start-up phase?

- The first mistake is there is no board oversight for the start-up, there is no one to advise CEO Adam Neumann on corporate governance and his high-risk strategy.
- There are no checks & balances in the company like giving loans to the CEO at a low-interest rate, buying 'WE' copyright from the CEO for $5.9 million.
- Handling the company as the family enterprise is another mistake of the CEO, like having the by-law that in event of the death of Adam Neumann his wife has the right to choose his successor.
- Many companies went bankrupt because of their wrong investment decisions like WeWork, a real estate company investing in an artificial wave pool & buying a private jet for his personal use is wrong.

- CEO Neumann did not address the problems in the business model where he did not mitigate risk and there is no long-term approach to his business plan, all companies did was to increase its valuation.
- IPO strategy of WeWork is flawed as its multi-class stock structure (not followed in India), where CEO Neumann's one stock is worth 20 voting rights, by this the effective control of the company is with Neumanns.
- These powers to Neumanns bring the game of thrones type chaos in the company means the CEO can fire anyone on board with his super rights and the members on the board can potentially become Yes-men.
- WeWork classifies itself as a technology start-up which it is not, but a real estate company.
- Running a company without profit for the long run will harm its future decisions and will not bring in investors to the company.
- The company has huge liability in the form of lease, which is increasing year on year, and with no profit, it will be a burden for the company. There are no retained earnings in the company to sail past the recession period or the strategy for it.
- If we look at the economic earning in the Figure, we can see the graph it is going down. Economic earning represents true earnings for the shareholders and debt investors.
- Because of the investment in WeWork Softbank, Softbank's venture fund is in danger as it is overexposed to WeWork. Investments from Softbank could have used with proper care and planning which could have saved the company chaos it is in now.
- Without proper control in place the company going public is a suicide, as investors fear their interest could not be safeguarded, this factor will not bring in the investors.

What are the problems in the business model of WeWork? What can be done to mitigate the business risk associated with the model?

First WeWork in its failed IPO positioned itself as a Tech company, but after seeing the business model is of essence not more than the middleman between the landlords and the tenants while offering some extra amenities, this business model is in the market for decades and this business model has even led many companies to bankruptcy.

The problem with the model is great when there are more start-up companies started in the market and the economy is doing great, but when the business start-ups reduce and the economy is in recession, WeWork is left with the Long-term lease payments and no sub-tenants to cover the lease amount.

Because of this model if the company goes into bankruptcy the landlords will become creditors that is when liquefying the company major chunk of the property goes to the debtors and then only given to the investors.

By seeing their high-risk strategy, the company spent many dollars in leasing the building so it can push competitors out of business and gambled they can monopolize the entire co-working industry, which did not happen, and the company ended only with massive debts.

The increase in Work from a Home culture has left a dent in the WeWork model because Start-ups have started to think about why shrink or increase the office and pay extra but start work from home.

WeWork has kept all its business in one basket which has a high failure during the recession if there is diversification in their business model it could have gained profit from one basket when one basket is down.

Ways to mitigate risk

The business model is doomed to fail because of its long-lease commitment and its aggressive high-risk strategy, to mitigate the risk in the company can provide services like Airbnb for co-working space like acting as an aggregator without taking an actual lease of the building.

While these alone cannot be a viable strategy, both can be used at the same time to increase the sales and generation of profit for the company, with this WeWork can be identified as Tech-company.

WeWork model is concentrated only in big cities, this does not affect geographic arbitrage offered in rural areas where the lease is low cost. The company could have started slowly and started growing in a steady phase this could have helped to achieve stability in the business model, strategy.

After the downfall what will be the task of the future CEO to bring confidence and growth to the company?

The first thing future CEO should do is scale down its leasing and should sell its assets like private planes, its unwanted assets for cash and he must speak with the landlords and get into an agreement in cutting down the lease amount so there could a cash flow in the company or a revenue-sharing agreement with the landlords to reduce debts there must be a major overhaul in the board with evicting Neumanns from the board and company.

The company must be right staffed with downsizing the unwanted staff and reducing costs made to employees as salary and benefits. Because of its IPO fiasco, many tenants are clearing the offices to retain them discounts that can be offered to make them stay.

After a complete overhaul of corporate governance, the company can be taken public with no multi-class stock structure and gaining confidence with the investors and the public. The company must overhaul its value-added amenities like offering part restaurant and offices to cater to the tenant's need for meeting in restaurants.

Because of its failed IPO, no banks will provide debt capital to the company, to save their capital SoftBank must help bailout WeWork and take WeWork as its subsidiary.

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