

Excess Returns

Monthly insights for investment marketing and sales professionals



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The incorrect address, the misplaced form, the embarrassing typo, the neglected piece of critical information ... all the tiny shortcomings that day after day, mistake after mistake, make our lives more difficult and cost us money. This issue of *Excess Returns* considers the impact of carelessness: what causes it, how it may be affecting investment companies and what can be done to prevent it.

With best wishes,

Liz Hecht

Founder, Principal and Director of Research

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Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.

Alpha Partners LLC
435.615.6862
www.alphapartners.com

The Cost of Carelessness

My family's recent decision to change banks, money managers and telephone systems has plunged us headlong into a whole new world: the world of carelessness. I already knew, only too well, that this world existed. But the vast, impenetrable extent of it was new to me.

We decided to change banks, money managers and phone systems in the first place because of carelessness (as in one mistake after another) combined with a growing sense that no one, well, *cared*. Changing service providers, however, required that we fill out numerous forms and become acquainted with hitherto unimagined levels of exactly what we sought to avoid: carelessness. When I explained to a potential new phone system salesperson that almost every piece of information on the contract she had provided, including the phone number, was incorrect, she said, "That's strange." I thought to myself, "No, it's not strange at all. It's a routine part of the cost of doing business in today's world."

What does all this have to do with investment marketing and sales? Plenty. Carelessness is alive and well in the investment business and its insidious presence may compromise your firm's ability to win and keep assets under management in ways that you haven't even considered.

Is Anyone Paying Attention?

Carelessness at investment management companies manifests itself in a number of obvious and painful ways:

Incorrect information. A War Story on our company's website describes how several firms lost business purely because they neglected to include the prospective client's full and correct name on the cover of their presentation books. (See "[You Can Judge a Book by Its Cover](#)" in the Alpha Partners' War Story archive.)

Bad grammar and misspelled words. Think of all those teachers on the boards of teachers' retirement systems. Will they want to pay your fees if your marketing materials contain grammatical errors, typos and all manner of inconsistent usage? The average teacher almost certainly understands the difference between a compliment and a complement. Yet some investment company professionals, in my experience, do not. What is a teacher to think when being asked to pay millions in fees annually to a company that misspells commonplace words? Or to a company that indulges in total schizophrenia regarding how to spell its products? (I have seen companies spell the name of their leading product three different ways — Small Cap, SmallCap and Small-Cap — in the same document. As in, "We can't decide how to spell what we're selling, so we're going to spell it however we like.")

A July 2011 [BBC News article](#) comments on the rise in online sales after spelling errors were corrected on a consumer website selling tights. If consumers are sensitive to spelling errors when buying a pair of tights, just imagine how sensitive they are when buying asset management.

The absence of (or failure to adhere to) a well-defined process. The investment process is one of the critically important four Ps (philosophy, process, people and performance) required for success in institutional (and, increasingly, retail) investment marketing. Yet where is the process when it comes to ensuring that critical marketing documents are not filled with typos? Where is the checklist defining systematic procedures — i.e., who does what when to ensure quality? The style guide defining consistent usage? The intranet FAQ providing consistent answers to routinely asked questions about the investment strategy? The will to pay attention to these things when they do, by some miracle, actually exist?

And speaking of process, what does a humdrum mistake such as a spelling error say about a firm's ability to follow its investment process? If a company cannot spell the name of its flagship product consistently, what does that say about its ability to conduct effective due diligence on potential investments?

Of course it's all about process. The major cause of carelessness is not laziness, stupidity, overwork or the escalating complexity of daily life, although all of these factors come into play to varying degrees. The primary culprit is the aforementioned lack of process. Process alone, however, is not enough. People have to believe in the process and implement it consistently. And yet there is still a certain class of person in business who believes that fussing over details is somehow demeaning. These people see themselves as fighting the great strategic fight at the forefront of leadership and change. This mindset unfortunately has little to do with what ultimately really matters: execution.

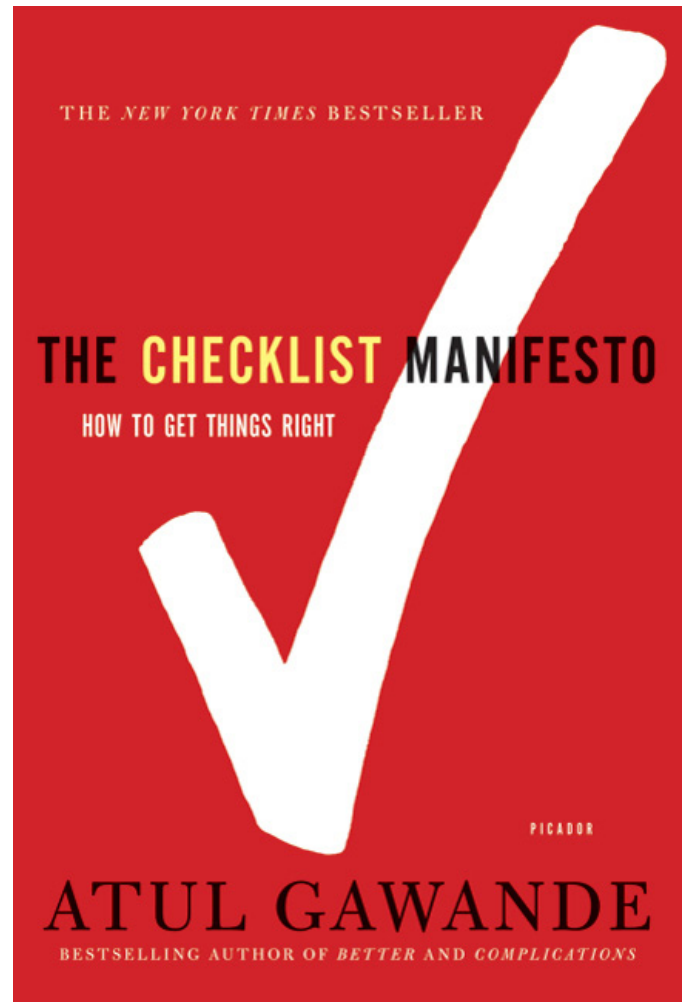
The Checklist Manifesto

A checklist, when you think about it, is process in its purest, most practical form. In [*The Checklist Manifesto: How to Get Things Right*](#), surgeon [Atul Gawande](#) considers the importance of using a checklist effectively in endeavors ranging from surgery to flying a plane to money management. In a chapter entitled “The Hero in the Age of Checklists,” Gawande explores how checklists benefit professional investment managers. He describes how one money manager created a checklist based on studying past mistakes (his own and those of other prominent investors). Each mistake is paired with an action item on the checklist. For example, the failure to consider the potential impact of the dot-com bust on a furniture rental company leads to the checklist item: *Confirm if revenues might be overstated or understated due to boom or bust conditions.*

Dr. Gawande further describes a [study](#) of 51 venture capital investors by [Geoff Smart](#), a PhD psychologist who was at Claremont Graduate University at the time of the study and is a co-author of the best-selling business book, [Who: The A Method for Hiring](#). Mr. Smart’s 1998 study profiled different research strategies pursued by venture capitalists. His findings showed that the most effective approach was methodical and checklist-driven. He calls the group of venture capitalists who follow this approach “the Airline Captains” and their results validate the effectiveness of this methodical style of investing: a median 80% return on the investments studied versus 35% or less for those pursuing different research strategies.

But (and here is the truly interesting part) even when checklists have proven to be wildly successful, one practitioner tells Gawande, people are reluctant to use them. “I got pushback from everyone,” says this money manager. “It took my guys months to finally see the value.” “To this day,” writes Gawande, “[this successful money manager’s] partners still don’t all go along with his approach and don’t use the checklist in their decisions when he’s not involved.”

Perhaps this is because people see checklists as being unnecessarily time consuming? Paradoxically, however, notes Gawande, investors who use checklists find the process to be “more thorough but faster.” Without the checklist, says one money manager who was able to research hundreds of bargains swiftly in late 2008, he “could not have gotten through a fraction of the analytic work or have had the confidence to rely on it.”



“Checklists,” says Mariko Gordon, Founder, CEO and CIO of Daruma Capital Management, “make sure that all the windows and doors of our investment process are locked, and that we haven’t forgotten to put the alarm on, so to speak.” In the [December 2012](#) issue of her company’s newsletter, Ms. Gordon, a longtime fan of Dr. Gawande, describes checklists as one of several approaches to building the conviction required to manage concentrated portfolios.

The Checklist Manifesto makes it clear that, when it comes to saving lives (surgeons) or making money (portfolio managers), those who create and use a well-thought-out checklist are more likely to succeed. And yet the idea of checklists, I fear, is unlikely to gain many converts in the investment world — not because following a checklist is too difficult but because it may be perceived as too simplistic. Indeed, as Dr. Gawande laments toward the end of the book:

“We don’t like checklists. They can be painstaking. They’re not much fun. But I don’t think the issue here is mere laziness. There’s something deeper, more visceral going on when people walk away not only from saving lives but from making money. It somehow feels beneath us to use a checklist, an embarrassment. It runs counter to deeply held beliefs about how the truly great among us — those we aspire to be — handle situations of high stakes and complexity. The truly great are daring. They improvise. They do not have protocols and checklists ... Maybe our idea of heroism needs updating.”

This is at once genius (Gawande’s laser-sharp perception of the problem) and very troubling (the notion that people are unlikely to act as effectively as they might because doing so conflicts with some swashbuckling idea of themselves).

To conclude on a more positive note, those of you who do want to use checklists effectively can start with [A Checklist for Checklists](#) at www.projectcheck.org.





The Great Typo Hunt

The Great Typo Hunt: Two Friends Changing the World, One Correction at a Time was written for those of us who feel a tiny stab of despair every time we see a typo. Jeff Deck and Benjamin D. Herson travel the US armed with markers, chalk and correction fluid pursuing a singular mission: to identify and correct typos wherever they find them. In shop windows, fliers, marquee and chalkboards, they find commas gone missing, errant apostrophes, all the usual misspelling suspects and just plain bad grammar. The two friends offer commentary not only on correct usage but also on the large misunderstandings that can result from small typos.

When asked by his girlfriend why typos need eradicating, Jeff Deck writes:

"It's the creeping menace of carelessness!" I said, not even understanding the question. To me, the iniquity inherent in typos was as plain as a swath cut through virgin forest, or dog feces upon a white beach. It was like asking why armed robbery was a problem."

Amen.

If you enjoyed this newsletter, you also might like to (re)visit the [April 2012](#) issue of *Excess Returns*, which considers the joys of being systematic.