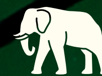
November 2019

Small is Beautiful

When it comes to the optimal team size for investment management, sometimes less is more



Stewart Investors
Sustainable Funds Group

Famously, Jeff Bezos thought that team size ought to be capped by the 'two pizza rule'; if a team couldn't be fed with two pizzas, it was too big.

This rule of thumb was coined in order to combat a common challenge facing teams trying to solve complex problems. In pursuits like investing, there is a tendency to increase the number of people providing input to the point that the team gets bloated and functions less efficiently.

Intuitively, we tend to think that adding more people to a process will help it get done more quickly or better. This appealingly simple idea certainly holds for certain types of tasks. If the goal is to dig a hole, the more people helping the better. Many hands make light work, and the hole will undoubtedly get dug faster with a larger team.

Investment, though, is quite a different type of task. Investing is a complex, constantly-evolving problem-solving exercise, where the outcomes attained by individuals and teams are highly dependent on intangible factors like motivation.

We believe success in investing requires passion and intense curiosity. Without an environment that cultivates these, team members can quickly feel alienated and unmotivated.

Drilling into the accounts of a Japanese consumer company in a way that yields useful insight requires the analyst to feel that the effort is worth it, in the sense that the work can impact client portfolios directly and meaningfully. Investigating the links between Board members of an Indian IT company and former government ministers is akin to detective work, and if an analyst doesn't feel determined to get to the bottom of things, both for their own intellectual curiosity and to support client outcomes, he or she is unlikely to do a good job.

It is therefore essential to cultivate a sense of team belonging, a feeling of collective ownership for portfolios and of individual empowerment. These are crucial characteristics which are, in our view, far easier to achieve in a smaller team

Undoubtedly, greater team size facilitates the gathering of more information. But good investment decisions do not follow automatically or even naturally from more data points. Usually, insight arises not from knowing more than anybody else, but from being able to identify the small handful of very important points from the sea of noise.

> A small team is often much better placed than a large team to focus on the few salient points of an investment case

In most investment cases there are probably four or five central considerations which, in our view, constitute 80% of what one needs to know in order to approach investing: the competence and integrity of management, the sustainability of the business model and its profitability, the quality of the financials and a simple approach to valuation.

But there is almost no end to the amount of extra information one could, if inclined, supposedly seek to bolster the robustness of an investment conclusion.

One very likely outcome in our view, though, is that you end up with a 'woods for the trees' situation.

All that extra information serves only to disguise the key points on which the investment ultimately turns.

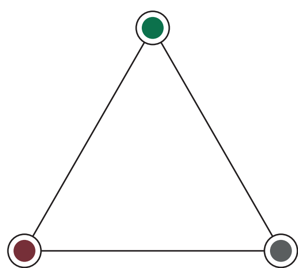
This is very common because the investment industry has tended to encourage a high degree of specialisation, with analysts providing 'coverage' of a particular sector. A sector specialist may be able to value the shares of their allotted companies to the second decimal point, but be unable to undertake meaningful comparative analysis across countries or synthesise insights from indirect sources and other industries.

A small team is often much better placed than a large team to focus on the few salient points of an investment case, and to utilise collective ownership and widely dispersed knowledge.

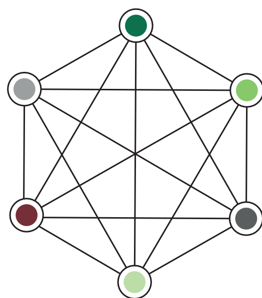
And of course there are obvious acute downsides which come with large teams. With a tight-knit team of three, there are just three relationships – or 'communication pathways' in the parlance of psychologists – which the team has to nurture and manage.

But as more members are added, this number grows exponentially. Between six team members, there are 15 relationships. At 12 members, this jumps to 66 links. By the time you have a team of 50 analysts, there are 1,225 different relationships within the team. It is impossible for a team above a certain – quite small – size to be internally cohesive.

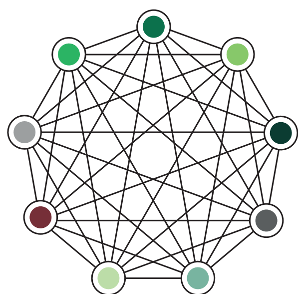
Communication Pathways



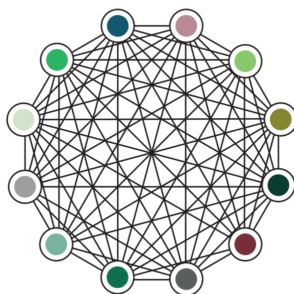
3 people = 3 lines



6 people = 15 lines



9 people = 36 lines



12 people = 66 lines

In practice, it is very difficult for anyone to maintain strong working relationships with more than a relatively small handful of other investors, especially if these colleagues are spread around the globe. And without a strong sense of mutual respect, trust, and ultimately friendship, robust investment discussions become harder.

The ability of an analyst to take challenging questions on their work and ideas in their stride is greatly aided by having mutual understanding built on many hours of interaction over years. Such strong relations between colleagues are, simply due to the numbers outlined previously, much easier to attain in smaller groups.

And there is a real sense in which an individual in a large team can very often feel that their voice is not easily heard, especially if that person is relatively junior. We know from our own team that when we have in the past tried to have 30-something voices around a table on video-conference, it is nigh-on impossible to discuss constructively a company's approach to its supply chain or the quality of its accounting.

More junior people, younger people and introverts are far less likely to make their views known in such a setting, denying the team the benefit of their opinion. In such crowd-like environments, it is often the person who speaks loudest or most forthrightly who gets the most air-time, rather than the one who has the most to offer the conversation.

In order to preserve the efficacy of the team's investment process, we have strived to maintain a structure which enables small teams to thrive. In 2015, the First State Stewart team split to form two separate teams: First State Stewart Asia and Stewart Investors, in order to allow both teams to preserve investment outcomes through reduced team sizes.

The success of Stewart Investors going back to the 1980s has always been built on small, tight-knit investment groups who feel passionately connected to the companies in which they invest and to portfolio outcomes. We will continue to evolve our structure in order to enable small teams to flourish and aim to deliver attractive risk-adjusted returns for clients. For our approach, small remains beautiful.

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