Investment Field Research

Hill Country Reflections | March 2024

Introduction

In the highly competitive endeavor of public equity selection, sustained outperformance is incumbent upon the successful execution of a multi-faceted formula. One critical component here is the disciplined adherence to a first principles-derived investment philosophy. Another is the development of skill. This is a broad concept that encapsulates technical ability (e.g., financial statement analysis), interpersonal aptitude (e.g., managerial evaluation), situational inference (i.e., pattern recognition), and emotional stability. Less frequently discussed is the pursuit of differentiated informational inputs within the process itself.

The potential to derive enduring investment advantage via this last vector compels us to look beyond the consumption of public disclosures or perusal of broadly disseminated expert network call transcripts. Our team of generalists leverages a functionally unlimited field research budget, racking up frequent flyer miles and hotel points. They do so in search of learnings that would cause our expectations for a given enterprise's future path to differ materially from consensus.

In fact, our emphasis on this Carmen Sandiego-like approach is sufficiently profound that BCM lore is filled with tales of memorable research junkets. Many such stories center on an unusual or unfortunate logistical element. These include a multitude of forced airport overnights, the use of a pontoon-bearing sea plane to access the remote outpost of a company executive, and blizzards that served to test our (admittedly lacking) winter weather driving skills. Others feature bizarre observations, such as when one analyst witnessed a scientific demonstration involving a barehanded grab of a high voltage electrical line. Also fitting into this category is our viewing of a chess competition in which a company founder simultaneously took on a dozen challengers.

To be sure, the inevitable mishaps inherent in a robust travel schedule can prove trying at times. Both this reality and the significant resources required to effectuate such a strategy limit industry-wide efforts to replicate our "go and see" approach. We pride ourselves on a willingness to tolerate these inevitable, episodic difficulties, taking satisfaction in the knowledge that this perseverance serves to bolster our odds of investment success. And with said feeling being buoyed by each "high signal" field research interaction, our team of travel junkies enters each quarter in eager anticipation of the opportunities available to expand the firm's collective knowledge set.

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Origins

Phil Fisher is widely credited with pioneering the concept of field research. The second chapter of his well-known 1958 treatise, *Common Stocks and Uncommon Profits*, introduces the concept of "scuttlebutt." In it, he notes:

> *"The business 'grapevine' is a remarkable thing. It is amazing what an accurate picture of the relative points of strength and weakness of each company in any industry can be obtained from a representative cross-section of the opinions of those who in one way or another are concerned with any particular company. Most people, particularly if they feel sure there is no danger of their being quoted, like to talk about the field of work in which they are engaged and will talk freely about their competitors. Go to five companies in an industry, ask each of them intelligent questions about the points of strength and weakness of the other four, and nine times out of ten a surprisingly detailed and accurate picture of all five will emerge."* [1]

He goes on to note that competitors are not the sole source of such information, indicating "it is equally astonishing how much can be learned from both vendors and customers about the real nature of the people with whom they deal." [1]

Buffett himself made considerable use of this approach. For example, in the 1960s, he worked with stockbroker friend Henry Brandt to inquire upon Omaha-area Travelers Cheque users, bank tellers, restaurant operators, and credit card holders.[2,3] The purpose? To determine whether recent news of a salad oil scandal had diminished respondents' trust in a well-known financial services provider. This work, which was buttressed by conversations with competitors and produced a "foot-high stack of material," led to Buffett's investment in American Express.[3] The position is now worth ~$32bn.

Similarly fruitful was Buffett's Saturday morning train ride – as a Columbia Business School student – to the Washington, D.C., offices of GEICO, where, upon arrival, he humbly asked for someone who might be willing to explain the company's business.[3] He spent the next four hours discussing the insurance market with Lorimer Davidson, a company vice president, and, according to biographer Roger Lowenstein, left "enamored" with the company. He proceeded to meet with three industry experts upon returning to New York. This, of course, was the spark that led to a career of investing success within the insurance industry. Said career, it should be noted, featured more than a few trips to a state regulatory office to gather intelligence on otherwise-unknown players (e.g., Home Protective, National American Fire Insurance, National Indemnity, and Cornhusker Casualty).[2]

Other, less frequently cited stories abound, including a road trip entailing stops at the headquarters of Jedd-Highland Coal Company (Hazleton, Pennsylvania), Kalamazoo Stove and Furnace Company (Kalamazoo, Michigan), and Greif Brothers Cooperate (Delaware, Ohio).[3] More memorable is a Buffett/Munger visit to Disneyland that purportedly involved a ride-by-ride dissection of the operation's finances and culminated in a meeting with Walt Disney.[2,3] The follow-on is that, despite his now-famous avoidance of M&A due diligence, field research was clearly seminal to Buffett's success. Speaking to this, Alice Schroeder summed the legendary investor's process as follows:

> *"It was lumberjack labor, but he loved doing it. This was nothing like the way most people invested: sitting in an office and reading reports that described research performed by other people. Warren was a detective, and he naturally did his own research."* [3]

Execution

Field Research is Inherently Situational

More than two decades of experience has taught us that the optimal approach and expected value to be derived from field research differ materially from company to company and industry to industry. In fact, even businesses with similar models can call for dramatically different fieldwork strategies. For example, in the world of online marketplaces, interviews with merchants carry much greater import for a business that is fundamentally supply constrained than one that is demand constrained. This places the burden on the analyst to identify the appropriate course for each particular enterprise.

With the above in mind, our team begins thinking about possible vectors for field-based research as part of the initial analysis on each company. As key questions for further investigation are catalogued, brainstorming is performed to identify potential avenues for exploration.

While the idiosyncratic nature of fieldwork cautions against the establishment of hard-and-fast rules, a few general principles help guide our plan development:

> First, conversations with customers tend to be more valuable within the context of business-to-business (B2B) companies than their business-to-consumer (B2C) counterparts. This is a function of the greater levels of homogeneity typically present among B2B buyers. Also at play is the more considered nature of most B2B purchases. Both constructs serve to increase the informational value associated with a given response. More to the point, we routinely find that discussions with a relatively small sample of precision testing instrument buyers can vividly elucidate the core purchase criteria for a given solution category while also highlighting the relative standing of all relevant players. In contrast, discussions with consumers as to, say, their athletic apparel purchasing habits tend to yield highly personal responses that cannot be widely extrapolated.
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> Second, deeply involved, industry-specific third parties (e.g., industry consultants, system integrators, distributors) oftentimes represent the best sources. This stems from their ability to observe behaviors across the industry, identifying decision/outcome patterns that are not visible to a single customer.
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> Third, for nearly all types of enterprises, there is merit in going to the point of value creation and observing how business is conducted. Much of this is common sense. It is not hard to

imagine how visiting the stores of a given retailer could provide otherwise hard-to-grasp insights into that company's operations, highlighting the business' merchandising strategy, staffing model, and overall aesthetic. However, the same holds true for a manufacturer. A tour of a production floor can provide insights into such factors as (i) key inputs, (ii) the degree to which component production has been internalized, and (iii) the general hygiene of business operations. Likewise, time spent in the central processing center of a mortgage originator can illuminate the sales culture that pervades as well as the degree of emphasis – or lack thereof – placed on technological development.

Field Research Menu

In attempting to identify the optimal course, analysts are typically selecting from a diverse menu of potential options. Several of the most frequently utilized elements are highlighted below.

Industry Conversations - Personal Network Outreach: A frequent first step in field research is for the sponsoring analyst to reach out to relevant contacts within his or her own network. This bucket is not limited to friends, family members, and past colleagues. Rather, it extends to contacts made as part of prior research efforts. Given our conscious strategy of spending a disproportionate amount of our time on those industries most amenable to sustained corporate outperformance (e.g., enterprise software, precision instruments, business services, industrial distribution), it is not uncommon to find an established connection with relevant expertise. The benefits inherent in beginning the outreach journey here are myriad, with the pre-existing rapport allowing for unusually candid conversations and opening the door to peer referrals.

Industry Conversations - Network Extenders (e.g., LinkedIn): After exhausting our direct network, we typically look to the team's extended web of contacts. Former employees of the company in question, competitors, and customers are the focus here. Where possible, we attempt to leverage mutual connections to facilitate warm introductions. Doing so naturally serves to increase the response rate. However, we've also had significant success with cold outreach efforts, particularly when publicly available information allows for a personalized approach. Perhaps the most fruitful tactic here is to scan industry publications for relevant white papers, commentaries, and informational articles. Upon finding such documents, we catalogue authors and quoted sources, using direct references to the associated writings as a means of separating our entreaty from the lifeless messages that have become LinkedIn's norm.

Industry Conversations - Attendance at Industry Events: In conjunction with these office-based outreach efforts, we look for relevant events that provide the prospect of in-person access to industry participants. Often, several available options are immediately evident. For example, enterprise software companies typically host an annual user conference, with these gatherings providing a highly efficient means of obtaining direct product feedback from a broad base of existing customers. Likewise, many sectors have flagship events that draw broad swaths of industry representatives. ConExpo, which is held biannually in Las

Vegas, fills this role for the construction equipment business, while Inman attracts many of the key figures within the residential real estate space.

We typically attempt to buttress attendance at these “flagship events” with participation in smaller gatherings. We find that these venues, while sometimes lacking in “industry celebrities,” commonly allow for richer, more extended conversations with individuals that sit closer to the work itself. For instance, attendance at the Ohio Safety Congress, a gathering of occupational safety practitioners in the Buckeye State, has provided us with a particularly vivid view into the industry positioning of an industrial distribution company that has been the focus of our research. Likewise, local user group gatherings found via Meetup have allowed for a recurring series of extended discussions with subject matter experts on such narrow topics as advanced data analytics and multiphysics simulation testing. These would have otherwise been difficult to source.

Prior to our arrival at any event, we will perform advance research on notable exhibitors/presenters and prepare a tailored list of questions to be explored with each individual. Once on site, we pursue a variety of avenues, attending select keynotes, interacting with vendors in the expo hall, and engaging in conversations with previously unknown fellow attendees on the conference floor. A few tips, which we pass down to each new analyst, have proven helpful in this quest.

> First, we always recommend attending the last day of a given gathering, as, by that point, (i) sales reps have achieved their business objectives, (ii) an event full of observations have been accumulated, and (iii) distractions are increasingly welcome.
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> Second, given the unique nature of our entreaties and the potential to “spook” prospective contacts, significant effort must be taken to both disarm the conversation counterparty (best accomplished through a humble approach, in our experience) and succinctly explain the (non-threatening) nature of our questions. We are transparent about our role as investors. Our objective is to further our understanding of an industry’s competitive dynamics and the competence and execution of strategic decision makers. Short-term insight into sales or earnings is obviously avoided.
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> Third, and as alluded to above, individuals lying on the periphery of an industry often boast of the greatest insight. For example, system integrators have the benefit of observing a wide array of software selection processes and, as such, may be in the best position to speak the relative merits of a given software solution.
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> Fourth, and more tactically, we posit that the designated smoker’s section at any given event is a particularly ripe area of opportunity. While admittedly introducing some carcinogenic exposure, venturing into this domain provides direct access to a captive and unusually outgoing crowd.

Within areas of particular interest, we will often become repeat attendees at those gatherings that have proven useful. In addition to providing a time series view of the industry's evolution, and, in turn, a chance to test previous hypotheses, any encore visit also benefits from past network cultivation efforts in the space. To this point, we will routinely look through our stack of business cards for contacts gained from the prior year's edition and reach out in advance of the gathering to arrange a 1x1 discussion.

Management Meetings: Perhaps the most commonly explored element of field research, management meetings provide an opportunity to engage directly with a company's decision makers. We use these conversations – with both the subject company and its competitors – to delve more deeply into matters of strategy, competitive positioning, opportunity set, and capital allocation. Such meetings can occur anywhere, with industry conferences and financial junkets being a commonly offered option. However, our strong preference is to connect at the company's headquarters. A headquarters visit typically allows for a longer discussion with less distraction, introduces the opportunity for a concurrent facility tour (discussed further below), and facilitates serendipitous observation. Likewise, while standard investor relations practice is to propose a meeting with the company's Chief Financial Officer, we typically ask to sit down with the Chief Executive Officer or a key business head. We find these individuals are generally better suited to respond to our detailed, strategically oriented lines of questioning.

Tours/Site Visits: As noted above, a tour of company facilities can be illuminating. Over the years, we have visited a wide array of property types, including (i) headquarters offices, (ii) retail stores, (iii) distribution centers, (iv) manufacturing plants, (v) research and development centers, and (vi) training facilities.

With most such visits, the analyst has little choice but to be accompanied by a company representative. Where possible, however, we seek to supplement these official tours with a non-chaperoned visit. The associated comparison often highlights key areas for questioning/analysis. This is most prevalent in retail-oriented businesses, where unannounced, mystery shopper-type trips can provide greater insight into the true state of company operations.

Avoiding Bias

One of the greatest challenges associated with field research lies in avoiding bias. Each input gleaned is affected by at least some degree of inherent prejudice. This is most pervasive in conversations with management teams, as the relationship between public company executives and investors is defined first and foremost by salesmanship. Management teams understand the benefits conferred by investor support, which include higher compensation, public acclaim, and the ability to use company equity as a currency. They also tend to be unusually persuasive. This comes as most have successfully risen through the ranks of the bureaucratic structure, in part, via an ability to convince and cajole.

Recognizing the potential pitfalls here, we typically seek to save discussions with the subject company for the later stages of our fieldwork process. By doing so, we enter these conversations armed with cross-verified insights, including those gleaned from competitors. The result is both a more insightful conversation and the ability to push back against any overly rosy assertions made. And because human nature is such that early memories tend to exhibit unusual staying power, capturing more objective insights upfront helps to limit the weight ascribed to this subsequently obtained, sales-driven commentary.

Unfortunately, problems of biased commentary extend well beyond management conversations. Even seemingly objective third parties can be inadvertently swayed to articulate improperly skewed observations, with this reality stemming from the fact that humans are generally conflict avoidant. Said tendency will often compel respondents to craft responses in a manner they believe amenable to the questioner. This is particularly the case if the interviewer fails to take an impartial approach to the conversation.

The dynamic of conflict avoidance extends to the desire for internal consistency, with industry contacts seeking to justify past decisions, overriding memories of their subsequent experience if necessary. For example, the hedge fund operations professional tasked with selecting an electronic brokerage service may feel compelled to praise the merits of the chosen solution even if post-implementation difficulties have revealed that a competing option would have been preferred.

We seek to limit these biases in a myriad of ways.

> First, we are careful about population selection. Conversations with users of a given product must be balanced with those of the competing product. As such, we will intentionally pursue venues where respondents have opted not to select the products or services of the company being researched, with these data points offering a counterpoint to management commentary. Speaking with executives and former employees of competitors serves a similar role.
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> Second, we are careful in how we approach individuals, typically describing ourselves as research analysts intent on better understanding the space. We take pains to avoid stating that we are interested in a particular company within that universe. If specifically asked as to our research angle, we will generally provide an example of both a favorable and unfavorable comment we've gathered. This is to illustrate that information of either type would be welcomed.
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> Third, and as alluded to above, we look to develop relationships with industry contacts over time. Through this ongoing dialogue, sources can (i) gain comfort that any commentary will not be published or attributed in any way, (ii) better understand the nature of our interest, and, eventually, (iii) begin to view us as a trusted reciprocal source of industry insight.
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> Fourth, we endeavor to dig deeper when receiving outlier comments. The general temptation here is to discredit any information that is inconsistent with other insights gleaned, particularly when the source appears to lack independence. Recognizing this investigative shortfall, we will seek to understand the context and, where possible, present that datapoint to trusted sources within the space for additional feedback.

Finally, we seek to mitigate the bias lying within the analyst themself. Fundamental to the accumulation of subjective viewpoints is the potential to misinterpret any commentary gathered. After investing the time and energy associated with fieldwork, there is a natural desire to receive good news. Put more simply, no cross-country trip is undertaken with hopes of yielding disconfirming evidence.

We have found that analyst bias mitigation is best solved through a combination of structural methods. One such tactic, equating to a form of segregation of duties, is selective participation in field work activities by portfolio managers. More specifically, we limit portfolio manager involvement to the later stages of the research process and focus these efforts on determining whether observations gathered at the event align with takeaways from previous field activities. Another method of bias curtailment lies in the qualification stages of our research process, with the bulk of our team providing feedback in ascending order of seniority. Feedback in this progression encourages freedom of expression and offers those with little direct investment in the process an opportunity to challenge key conclusions. Lastly, we have come to recognize the benefits of a forced “cooling off” period between the qualification of an idea and the establishment of a position in the name. A waiting period provides an opportunity for any excessive enthusiasm resulting from recency bias to dissipate while also providing any opportunity to see whether subsequent data points conform with expectations.

Conclusion

When done right, field research can provide a degree of clarity into industries and companies that is not possible through the mere consumption of public disclosures or perusal of broadly disseminated expert network call transcripts. With other firms lacking the resources/discipline required to effectively pursue such workstreams, we believe a field research-infused approach to business analysis offers an enduring potential for variant perception. As such, we are committed to the continual honing and methodical execution of this key element of the investment craft.

Cited Works

1. Fisher, Philip A. *Common Stocks and Uncommon Profits*. New York, Harper & Brothers, 1958.
2. Lowenstein, Roger. *Buffett The Making of An American Capitalist*. New York, Broadway Books, 1995.
3. Schroeder, Alice. *The Snowball Warren Buffett and the Business of Life*. New York, Bantam Books, 2009.

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