Guest Blog

The most important question

As passengers on a journey, while we have little control, it matters who the driver is. Similarly, "who am I backing here" becomes an investor's most important question.

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You've got to ask yourself one question: 'Do I feel lucky? Well, do you, punk?'
– Dirty Harry

Sound judgment is about asking the right questions. In turn, right questions are a function of our objective. For a speculator, with a timespan of listing day or weeks or months, question that matters most is **"Do I feel lucky?"**. For an investor, looking to own an understandable business over many years, most important question is **"Who am I backing here?"**. This is the zeroth bullet-point of my investment thesis.

Investors are passengers. Sure, we check tyres, fuel gauge, vehicle condition and route map before hopping on. But it's really up to the driver how bumpy our ride is, how long it takes, whether we get cheated or whether we even make it. Route is often blocked, and not all drivers figure out Plan B. We get to nag occasionally, but drivers are used to ignoring backseat chatter. Truth be told, we're on a ride we have little control over, apart from freedom to jump off the vehicle should it get too queasy.

Sure, this analogy might resonate, but can I be more specific about why this is my most important question?

A few big decisions each year …

Every business confronts a few big judgment calls each year, which are very different from everyday operational decisions. Some are about what not to do: drawing red lines on values (how euphemistic is that?); choosing to avoid fashionable yet risky segments; shooing away bankers bearing 'transformational' deals; dissuading managers from empire building outside the core. Some are about what to do: continuing investments in capacity expansion and R&D amidst recession; deploying surplus cash prudently; driving long gestation projects (e.g. new technology, rural push, international expansion); prioritizing employee health and partner payments during covid-lockdown; setting business margin of safety (not merely cash on balance

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Anand Sridharan looks at the what the ownership construct means for a long-term investor, in a series of five blogs that were originally posted on https://buggyhuman.substack.com/*. These have been consolidated in this long-read.*

sheet, but things like supply chain resilience); occasionally correcting senior-level hiring mistakes. No decision is easy and every decision is consequential. These are holistic judgment calls, made on incomplete information, keeping in mind what's better for long-term health of business.

Disproportionately influence long-term trajectory …

In any industry, there are leaders and laggards. Where a company falls on this spectrum is determined by soundness of aforementioned big decisions. When demand rebounds post-crisis, one company is short of capacity while another isn't. One has motivated employees and partners, while another shafted them to cut costs. One is perpetually fighting fires at a 'transformational' acquisition, while another grows its core with boring predictability. Amidst crisis, one is solely focused on business problems while another is scrambling for cash. One has a sharply defined brand that stands for something, while another is a diffused mess. One has a happy channel with consistent policies, while another never feels settled. One leads the way into adjacent spaces, while others play catch-up.

There's usually a consistent pattern across decisions. Some just can't get it right. Others make it look easy to do the right thing again and again. Net effect is multiplicative. When industry grows 10% a year, one makes a steady 15% look easy, while another struggles to unevenly maintain 7%. Over decadal timeframes, small differences in compounding lead to sizeable divergence in where businesses end up and how I fare as a passive co-owner.

And only one person can make those calls

While routine decisions can be made by line managers, big judgment calls bubble up to the very top. They need a bird's eye view of the entire franchise and long-term impact on the same. They need to factor in fuzzy aspects like what the company stands for, how much risk is acceptable and where to operate on the spectrum from unethical to illegal. It becomes imperative, for the person at whom the buck stops, to have long-term orientation, skin in the game and perspective to determine what is best for the business, especially when short-term consequences are negative. Incentives need to be realigned so that others aren't penalized for adverse consequences over the short run. Top person's motivations and judgment shape the company's identity, values, culture, risk, quality and prospects.

When I spot an outstanding business, there's usually such a person with a long history of sound judgment behind that impressive track record. When I spot a laggard, I also spot the opposite characteristics in whoever is in charge. That's why I view "who am I backing here" as my most important question.

I digress to clarify that I judge that person solely based on reality, not perception. It's long-term business performance, not first-hand impressions, that I use as a barometer of sound judgment.

I deliberately avoided giving this person a label, although 'promoter' is the natural choice in the Indian context. However, it's more complicated than that. Not every business has a promoter. Not all promoters are same. Occasionally, promoters can change abruptly. Some are promoters of multiple businesses, not just the one of interest to me. Some promoters aren't very owner-like in behavior. Occasionally, lifer CEOs can turn out owner-like.

A generic, oversimplified label doesn't do justice to all the situations that an investor encounters. So, the answer to my question takes many forms. Over the next few essays, I'll elaborate on some common forms: **focused owner, diffused owner, misaligned owner, no owner, new owner, manager (some of whom are owner-like), renter.** Phew. These have varying impact on my professional wellbeing. Some forms are preferred, while others are highly avoidable. I'll share my good-bad-ugly view on this spectrum of answers to "who am I backing here", while offending as few people as I can.

Part 2: Ideal answer - focused, longstanding, trustworthy promoter

This second essay in the series 'My most important question,' spells out the authors preferred investment construct.

Let me start with the most boring answer (ideal construct). I'll get to more fun parts (avoidable constructs) subsequently. My objective is to lay out a framework for assessing different types of business owners, and their implications for a long-term shareholder.

A caveat before diving in. My prism is that of a permanent owner. At the least, **I invest with the idea of holding indefinitely, unless something material about the business changes for the worse.** What follows is specific to my context and somewhat extreme in how finicky I am about who I back. Most investors operate under more difficult constraints. They cannot afford to shrink their investable universe by too much. 'How finicky' is a subjective judgment call linked to personal preferences and institutional constraints. So, I request you to view what follows directionally, not literally. The issues I raise are relevant to any fundamental investor. But answer need not be. As always, answer is the least important part. This is about a way of thinking through an important problem. We can reach different conclusions with the same thought process.

My preferred answer is easy: good promoter. I am backing **a longstanding trustworthy focused promoter,** with a track record that scores well on governance, prudence, and competence. This is effectively the promoter's only business. There's meaningful ownership. Even if this promoter didn't start the business, generational transitions happened with a sense of continuity. This business means everything to promoter, not merely in terms of net-worth, but in terms of (professional) selfworth. Promoter has a long history of treating others fairly. Since such a promoter's lifelong mission is to strengthen the franchise, promoter's interests and mine are perfectly aligned. I may not agree with every decision, but I never doubt intent.

(I am deliberately not repeating my spiel around competitive position, ROCE, moat etc. Those are a necessary condition for even considering a business as investable. This discussion exclusively focuses on the person I am backing in an investment decision.)

Each boldfaced word in previous para is worth delving into. **Promoter is in singular form**. In my experience, there's one individual who the buck stops at, even when other family members seem involved. In every instance, my answer to "who am I backing here" is an individual's name, not a family name. Committees or amorphous groups of people aren't backable. Singular form is important as a clear hierarchy is essential to prevent family dynamics from derailing business. At any point of time, this person feels indispensable. However, over time, generational transitions have been smooth, usually to next-in-line after decadal apprenticeship.

Longstanding is a necessary condition
I have a confession to make. While I can tell whether a business is good, I have no idea why it is so. Neither do I know why one business is good and another isn't, often in same industry. Establishing causality in messy world is impossible. How much of a company's success to attribute to promoter is unknowable. All I know is that business performance was exceptional over a long timeframe when a certain set of input variables stayed constant. One key variable was the person in charge (others include managers, approach, brand etc). Others aren't independent variables, as they flow out of promoter's mindset. That's why seemingly impressive managers often fail when transplanted under a different promoter. When I judge a business to be sustainably good, I am implicitly assuming persistence of input variables that made it good to begin with. So, a longstanding, continuing promoter is central to my conviction around a business staying good.

Trustworthy matters but is to be correctly defined
Investors loosely use the phrase 'clean' in a setting where any of us who ever registered a Leave & License agreement is perforce unclean. This isn't about inevitable 'costs' of doing business. I view trustworthy as comprising two aspects. First, a business that has been built in a fair manner, whose advantages stem from capabilities, not cronyism. Second, a history of behaving well with other stakeholders, especially minority shareholders.

Focus is an underrated variable
In general, someone with a track record of sound judgment should continue to demonstrate the same. However, while people don't change, context can. The contextual change that has done maximum damage is distractions. Promoters need an uncluttered mind to fully engage on each of the big decisions. Other business interests, large acquisitions or any misadventure that entails constant fire-fighting interfere with clear thinking. With distracted decision-making, a crisis can become a calamity. Even outside of crises, being proactive about strategic priorities requires

undiluted focus. My business is entirely about getting a few big decisions right. I can only achieve this by sticking to a narrow domain and constantly obsessing about “what am I missing”. Whether investor or promoter, sharp focus is essential for sustained excellence.

These are some of the tenets of my utopian construct. Ideally, I would want a focused, trustworthy, longstanding promoter with a strong track record, across actions and outcomes, 100% of the time. My actual hit-rate is short of 100%, but not by much. This, more than anything else, has led to good things happening, including sound sleep.

Part 3: What I DON’T want to back

Certain ownership constructs are inherently disadvantageous to minority shareholders. This third part of the series cover all that is bad about them.

I previously discussed my ideal construct, one of a longstanding, focused, trustworthy promoter. This edition covers sub-optimal ownership constructs that are generally avoidable. I’ll start by dumping on entire categories of businesses. Once I have offended enough people, I’ll get to exceptions to all the nasty things I say below. Let’s start this airing of grievances.

Avoidable constructs
These usually come in two flavors: bad people and bad context.

Bad promoters
When it comes to judging people, it’s best to go purely by track record. Just as some promoters have history of doing the right things, others are history sheeters. Evidence comes in many forms: serial acquirers; chronically high debt; iffy accounting; shafting minority shareholders; treating company funds as personal piggybank; preference for dodgy clients; indefensible diversification; ‘cash’ transactions galore. Here, answer is easy: avoid. Since people don’t change, avoid forever. It’s best to even avoid meetings, so as to not fall for improbable redemption stories. Dodgy promoters can do convincing mother-promise on not screwing minority shareholders again. Remember the famous tale of Munger declining a meeting with Pearson (of bacchanalian Valeant fame) despite Ackman’s pleading. This risk is highest when underlying business is decent, as it’s tempting to ignore the promoter question. I wouldn’t take a chance on bad promoters.

Bad context
Bad context is one where there’s innate misalignment between primary owners and minority shareholders. In bad ownership constructs, even good people can end up doing bad things, in the sense of acting against my interests. I can think of a few buckets: PSUs, MNC subsidiaries, conglomerates, private equity owned, no-owner.

Government-owner:

I don’t think government is all bad and am far from anarchist. However, government as promoter isn’t good for minority shareholders, anywhere in the world. First, there’s no one individual I am backing. People overseeing a PSU keep changing, along with business priorities. There is no one to back. Second, irrespective of how decent people are, creating shareholder value isn’t high on any government’s priority list. PSUs will keep getting drafted into public service, irrespective of risk or cost to shareholders. I still don’t know what the true economic objective is for PSUs, despite having observed many for decades. Maybe they’re improving and some will eventually get privatized, but that’s a punt for thematic or event-driven investors. I’d stay well clear of this category.

True owner is at a different level:
Cummins India is an outstanding business run by fine people. So is Cummins Inc. Despite good people and a solid franchise, disproportionate part of every conference call over the past decade has been devoted to whether Cummins Inc is being fair to minority shareholders of Cummins India. Is new engine made in listed entity or private entity? What’s transfer price for exports? Will you shift production from Eastern Europe to India? Then, will it come to listed entity? Why is your expensive building being shared with Cummins Inc? What royalty do you pay? Root cause of analyst angst is that what’s best for Cummins Inc need not be best for minority shareholders of Cummins India. Cummins India is a division of Cummins Inc, not an independent company.

Conflict of interest is inherent to being a shareholder in any subsidiary or division, because the topmost promoter (i.e. owners of parent entity) wants to maximize value at his level, not mine. This not a problem unique to MNCs. You’ll find the same conflict with a captive finance subsidiary of an auto OEM, trying to push vehicle sales rather than lend prudently. Many MNCs (including Cummins) have behaved responsibly towards minority shareholders, but many haven’t. Even in the good ones, there’s no assurance good behavior will persist, as conflict always lurks beneath the surface. Sudden changes to royalty or transferring an outstanding manager to a global role (good for him, bad for me) keep happening. Spending a decade as shareholder, while doubting intent the whole time, isn’t my idea of fun. While many MNC subsidiaries are stellar businesses (e.g. engineering, pharma, FMCG, auto), there’s no good answer to “who am I backing here”.

Conglomerates:
Conglomerates are what happen when feudal promoters misinterpret Berkshire Hathaway for convenience and ego. It’s absurd to believe that one can achieve excellence across eighteen industries or that access to capital is still a competitive advantage. In most cases, mess has worsened over time, negating legacy as an excuse. Rant done, there are sober problems with conglomerates. This setting is also fraught with misaligned interests. Focus is lacking. When company #8 in the group is going through covid, it’s unlikely to get promoter’s undiluted attention (whereas it’s #1 for me, if I am not a shareholder in numbers 1 through 7). Many conglomerates shuffle senior managers from one company to another. As a shareholder in one company, I feel cheated. Managers are (generally) not owner-like. Some of the more egregious international acquisitions happened in conglomerates, as managers were happy to

build empires and promoters were too scattered to think through risks. It's hard for a promoter who owns eighteen businesses to deny a manager the joy of owning two or three. While a few stray examples of decent businesses get touted, norm is that of diffused mediocrity and misallocated capital. Unwieldy agglomerations getting valued way below 'sum of the parts' is one of the rare examples of an efficient market.

No owner:
While a promoter-less, board-governed structure is the norm in the West, India is a long way from there. Even in the West, this arrangement provides ample fodder for B-school case studies on agency problems. However, there are counter-balancing forces such as threat of lawsuits, activism, buy-out or hostile takeover should managers grossly mismanage a business. In India, most of these are untenable in any meaningful sense. With an untested model and without checks and balances, this is not a good construct for Indian minority shareholders. Posterchildren of this model have demonstrated egregious capital misallocation under zamindari CEOs, to create unwieldy hotchpotch businesses with deservedly high hold-co discounts. Overrated boards have been spectators if not cheerleaders. Similarly, a few businesses set up consortium-style (e.g. credit rating, stock exchange), with no clear owner, have seen managers stray to the point of criminality. Lack of a permanent owner is a huge problem.

Private equity owned:
Typo. That should read: private equity rented. Around the world, private equity firms claim high IRRs but return unusually low multiples on capital invested (1.5x on a fund is rare). While some of this is due to high fees, a lot is due to short holding periods. Effective holding period across a fund is hardly 2-3 years. In most cases, we have owned businesses for over a decade (and counting). It is therefore imperative for us to back people with an even longer time horizon. Private equity fails this test. Even if individuals are well intentioned, I cannot count on a short-termist system to do what is right for the long run. Like with conglomerates, owner is also defocused as my business of interest is only one of many in a portfolio. There's also a skill issue, as financial investor and business promoter are very different roles. Much as I like my well-tailored friends in private equity, former consultants or bankers, with more confidence than real experience, aren't my idea of a backable promoter.

Default settings are integral to sound judgment
I can picture you going "But what about TCS, Titan, HUL & Nestle, you foul fiend" (sorry, too much time with 7-year-old). I deliberately chose an extreme route, only highlighting negatives in each construct. Intent is to emphasize **appropriate default settings for each construct**, given inherent misalignment of interests between controlling and minority shareholders. Intent is not to tar every business under these categories with same brush.

Given how overwhelming markets are, sound judgment is impossible without default settings. We have to categorize whatever we encounter, understand patterns of behavior within each category and have a predefined framework for approaching each category. Investment decisions cannot start from a blank slate, just as morning routine cannot start afresh with "So, which toothpaste is optimal risk-reward". I cannot get excited about one PSU without framing it more generally against category risks. I cannot get carried away by some PE-backed white-knight story, without remembering what happened the last time they bestowed a new logo & CEO to a shitty bank. In old English, this is called stereotyping. In new jargon, AI/ML. This is not a bad thing. This is essential for limited brains to process an unlimited world. These are the mental shortcuts and heuristics that let buggy humans emerge as our planet's dominant species.

Default settings efficiently incorporate historical odds into a decision-making process. They're neither 100% right nor the final answer for each instance. But they're certainly more right than wrong and do more good than harm. They ensure that we don't miss category risks and ask appropriate questions. Since sub-optimal ownership constructs are fraught with conflicts of interest, it is important to approach them with the right default setting. Bad behavior isn't inevitable, but good behavior cannot be taken for granted. I'd rather distrust and then verify.

Therefore, my default setting for aforementioned six constructs is 'avoid'. I am not advising others to adopt the same (separately, ignoring all advice, especially on the internet, is a good default setting). It's perfectly fine to end up with a less extreme default setting than mine. However, I believe that the risks that I outlined are a material input into whatever default setting works for you. **Even if you aren't at 'avoid', hopefully you're at 'eyes wide open'.**

Exceptions are possible, but should be part of an established process
Having offended as many people as possible, let me undo some of the damage. It is possible to find acceptable businesses within sub-optimal constructs. If lack of an appropriate owner is the problem, others can step into an owner's shoes in certain situations. Empirically, this happens infrequently and needs to be carefully tested against preponderance of evidence. I'll cover the criteria and approach for making exceptions in my next essay. Partly since this essay is already too long, but mainly because I don't want to dilute my main message.
Certain constructs are inherently risky for minority shareholders. They are best approached with a default setting of skepticism. Since this is a big deal for my professional wellbeing, I chose to be blunt about how I think through such situations. I'd rather be offensive than wrong.

Part 4: Not Ideal, but backable

This part discusses how to think about exceptions within the constructs discussed in Part 3.

I was intentionally harsh in my prior essay. It is only fair for a permanent owner investing in structurally flawed constructs to have a high bar for whom to back. Of the categories mentioned in last essay, I am loathe to make exceptions in the case of bad promoter or government as promoter. However, there are occasional exceptions in the case of conglomerate, MNC subsidiary, private equity owned or no-owner situations.

I cannot ignore a long history of owner-like behaviour just because it doesn't fit preconceived constructs. Unit of analysis in investing is 'company'. While categories and base rates can help, they aren't a substitute for company-specific assessment factoring in idiosyncratic considerations. I'll cover backable businesses, within sub-optimal constructs, in two parts.

Focus within conglomerate

Conglomerates have an owner, just not one exclusively focused on the business I am interested in. Certain conglomerate constructs automatically fix this problem, with clear demarcations on which individuals (or branches, from an extended family) are in charge of which businesses. Economic interests are also appropriately aligned. For a specific business, I can pinpoint the individual who functions as its focused, longstanding promoter. I can see decadal evidence of how that business has performed under this individual's stewardship. This situation is no different from a standalone promoter-led business, except for a loose family affiliation in the background. A few well regarded South Indian conglomerates are illustrations of this model.

A second construct is where a promoter has multiple business interests, but my company of interest is, by a wide margin, the largest among them. While I'd ideally like 100% focus, it is never 100% even with a standalone business. There may be unlisted business interests, next generation floating new businesses, distractions within the listed company or philanthropic ventures that take a life of their own. If I get the sense that my business of interest is, say, 90% of promoter's 'portfolio', I have reasonable assurance that big decisions will get adequate mindshare. 100% focus is figurative, not literal.

That said, I still believe conglomerates are a sub-optimal structure, requiring extra caution. When studying history, I explicitly check that focus has been getting better over time, not worse. Measures like divestitures to make portfolio less unwieldy, clear family settlements or disentangling cross-holdings are a positive. Periodically adding new forays or shuffling managers across group companies are negatives. After investing, I would be extra watchful for distractions or new interests creeping in. In summary, I can live with certain constructs within conglomerates, but with eyes wide open.

Owner-like managers

Philosophically, 'owner' is a mindset, not a shareholding percentage. While agency problem is real in owner-less businesses, there are noble exceptions. Longstanding senior managers have run businesses with more of an owner mindset than most promoters. In a no-owner construct, HDFC group has multiple businesses where 'lifer' managers have built best-in-class businesses. That they did it in financial services, a cesspool of agency problems, makes it extra creditable. Each company has done way better than peers that had actual promoters. In conglomerate construct, Titan and TCS come to mind as exceptional businesses built by owner-like managers over decades. In MNC-subsidiary construct, it's hard to even think of HUL as an MNC, given decades of homegrown leaders. In other situations where private equity renters rotated in and out, there are examples of owner-like managers building industry-leading businesses over decades.

Exceptional, owner-like managers with decadal track records are clearly backable. The key is to ensure that they seem like 'lifers' in their mindset towards the company. A culture that produces an entire cadre of similar leaders ensures that this mindset survives succession. While there is some risk that managers can leave or be fired (unlike promoters), it is adequately low and manageable in cases like the ones I mentioned. This is a case-specific call, where I cannot generalize principles for spotting owner-like managers. This falls under a holistic I-know-it-when-I-see-it approach to decision making.

I have belaboured on this ownership issue over four essays. While an important question merits thorough discussion, there's the risk of getting lost in detail. Why expend so much effort on ensuring a sound ownership construct? Because world is highly risky, making it inevitable that even good businesses run into trouble. Since we cannot anticipate trouble, we need a construct that can handle any trouble. There's no better way to achieve this than through a business owner who has everything at stake and an obsessive focus on strengthening the franchise. True margin of safety arises from aligning my interests to those of such an owner. Unlike cash on balance sheet or disciplined entry price, this isn't a 'static' margin of safety. It is dynamic in that the right owner can proactively respond to any shock, including those never-before encountered. Right ownership construct bestows a degree of anti-fragility to my investments. This has been invaluable, especially in ensuring decent outcomes even when I erred on some other part of my thesis.

(If you have stuck with this series so far, there's light soon. My next essay will be the last. I'll cover special case of ownership change and wrap it all up.)

Part 5: Abrupt ownership change

A few concluding remarks to summarize the 6000 words on this topic, but before that what sudden ownership change can mean.

Here's the fifth essay of this series, trying to answer my most important question: Who am I backing here? What kind of controlling owner would be best for interests of a (long-term) minority shareholder such as myself? I started off with my ideal construct, one of a longstanding, focused, trustworthy promoter. I followed it up with sub-optimal ownership constructs that are generally avoidable. I got to backable exceptions within sub-optimal constructs. Current essay is the last leg of my framework, which deals with an abrupt change in owner, either before or after I invest in a business.

Sudden owner change
This is a special case, although I can no longer call it a rare case. This can be tricky, since the new owner is usually credible in a different setting but new to the one I am concerned about. So, it's best to go back to first principles. My thinking on ownership constructs has to be internally consistent with my thinking on investing, in general.

So, what's my investing approach? More-of-the-same. I invest in proven slow-changing understandable businesses, in established industries, with a long track record of excellence, achieved under stewardship of people who continue to run it. Any step change is anathema to me, whether or not it's linked to promoter. I hate big-bang M&A, especially overseas. Ditto with unrelated diversification. Even an external hire as CEO is bothersome, as is sudden uptick in aggression under a next-gen promoter. While intent isn't to flee right away, any step change is a big deal. I have to revisit my investment thesis to check if situation still fits. An abrupt change in promoter has to be seen in this light.

I clarify that I refer to change involving an external, new promoter, usually due to take-over. Sometimes an abrupt internal promoter change happens, due to ill-health or a squabble within a promoter group. In 'internal' changes, there is usually a sense of continuity. While this situation isn't ideal, new promoter has already been part of the same system and imbibed the same values, culture, risk-appetite etc. As a first order of approximation, I don't treat these as abrupt or significant changes, although I'll be more watchful.

When there's a sudden, 'external' change in promoter, short-term impact is usually negligible in established businesses. However, long-term impact could be significant since big judgment calls will be handled differently by a new person from a different system. Mindset around business direction, propensity for M&A, aggression, margin of safety, risk, capital allocation, values, culture can be very different. Ownership construct and focus could differ if acquirer has other business interests. My business can end up in one of the sub-optimal constructs that I discussed earlier (e.g. part of conglomerate).

Different owner doesn't automatically mean worse owner. It could turn out better too. However, **central question for me is "Can I reliably assess business risk and prospects, when it's not more-of-the-same?"**. Given the fuddy-duddy way in which I think about investing, my answer is NO. It's not that I don't know the answer. I don't know what questions to ask or what evidence to study. Any situation where key input variables have materially changed, compared to long history, is outside my circle of competence. I act on the basis that it's imprudent to risk others' money behind my cluelessness. Naturally, I don't suggest that others act similarly. I do suggest that others remain alert to the possibility that it is a different business under different hands, and that analyzing its prospects just became harder.

Lest it sounds like I am casting aspersions on all acquirers and business prospects under acquirers, I clarify that this isn't about them at all. This is about certain situations falling into my 'too tough' bucket, due to my inability to reliably assess them. To quote George Costanza "It's not you, it's me".

Conclusion

Since even Douglas Adams didn't stretch his trilogy beyond five parts, let me append a few concluding remarks here, to summarize this essay-series.

For a permanent owner or long-term investor, “who am I backing here” is the most important question. The person in charge of any business has disproportionate long-term impact, since all consequential decisions bubble up to the very top. Consistently making the right calls isn’t merely a function of personal abilities. It is linked to the context in which the person operates. Whether business is standalone, part of conglomerate, subsidiary, government-owned or board-managed matters. Similarly, whether the person is part of an MNC system or private equity firm matters. **Ownership construct, a combination of individuals and context, disproportionately influences business compounding and investment returns over the long run.**

My ideal ownership construct is to back a focused, trustworthy, longstanding promoter with a track record of prudence and competence. Any other construct is less than ideal. I view bad promoters and PSUs as a strict no. Due to inherent misalignment of interests, my default setting for conglomerates, private equity owned, MNC subsidiary and no-owner constructs is ‘avoid’. However, there can be exceptions. ‘Lifer’ managers with a long history of owner-like behavior are backable. Another backable construct is a business within a decentralized conglomerate, where each group company has earmarked individuals as owners.

A special case is when business owners change abruptly, due to takeover. For a more-of-the-same investor who uses track record as primary input into decisions, central problem is that there’s no basis to figure out how long-run trajectory will differ under new owner. My decision on what to do is a function of my limitations rather than judgment on new owner.

(More generally, this is a robust way to handle complex systems, which are mostly unknowable. Stick to the few pockets that seem relatively steady and insist on continuity of input variables that have been associated with favorable outcomes over a long timeframe. I’ll dive into this in a separate essay, at some point.)

While developments over past few years prompted this essay-series, this is how I have always thought about the most important question for a permanent business owner. While other investors have different timeframes, constraints and preferences, we all have something in common. **We are passengers with no control over our journey, hoping to God that the driver knows what he’s doing.** To that extent, for any long-term fundamental investor, issues to consider are common. I have tried to share my thinking on these issues, along with implications for investors. As always, this is about a way of thinking on an important aspect of investing. Even if my answer isn’t relevant to your context, I hope that some of the thinking is.

Happy owning!

PS. The above philosophy is based on what I learnt and practice at Nalanda Capital. So, credit for anything sensible goes to my colleagues. That said, views expressed are personal, and blame for any nonsense is solely mine. Anand

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