Checklists Gone Wrong

September 23, 2022

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Checklists are simple yet powerful tools. A wide array of industries have succeeded with checklists. Pilots use them to improve flight safety. Hospitals use them to improve patient care. Nuclear power plants use them to ensure safe operations.

Atul Gawande, famed surgeon and New York Times best-selling author, wrote the book on checklists – *The Checklist Manifesto*. It's an insightful, practical look at how organizations use checklists to succeed in pressure-filled environments.

Checklist implementation is very popular. Organizations enthusiastically publicize how checklists have counteracted human and organizational flaws.

But like most good things, checklists have been misconstrued and distorted to become a headache, not a help, to an organization.

Organizations require mindless checklist completion instead of using them as a tool to improve understanding. It's not the finishing of a checklist that drives value. It's the thinking that occurs along the way that otherwise would not have happened. Checklists have become another mandated task to get out of the way. After all, bureaucratic organizations love nothing more than adding additional documentation and compliance tasks.

But that's not how checklists help. The value of checklists is not checking off every box. It's meant to complement our thinking by prompting issues that are often neglected.

The investment process is a natural place to use checklists.

Investing is complex and complicated. There are many moving pieces and few investors can keep track of it all. Therefore, checklists make a lot of sense.

But investment firms have lost track of why checklists are valuable.

They are not a task list.

They are not a to-do list.

They are not a compliance or documentation exercise.

They are not to satisfy audit or reporting requirements.

Checklists enhance thinking and direct our attention to what is often missed. They augment what investors may forget given volatile environments and overloaded schedules.

For example, many private markets investors have big due diligence questionnaires/checklists that need to be completed before moving a recommendation forward. But these checklists are no longer checklists. They are burdensome, boilerplate exercises that appear like meaningful work but force teams to regurgitate basic, unhelpful information.

Checklists are not for data gathering. They are for thinking.

Below are several items I've seen from various DDQs/checklists that in no way help the investor identify and think about meaningful issues:

- "Provide an overview of the firm"
  - An overview does nothing to identify core issues and doesn't belong on a checklist. Yes, some overview may be need at some point in the recommendation process, but it's not relevant for a checklist. It's items like these that cause analysts to roll their eyes when they must fill it out.
- "Does the firm have defined values"
  - What exactly do defined values mean? And even if the firm claims certain values, are they actually implemented? Or is it marketing fluff? 99 out of 100 times it's vague nonsense, so get it off the checklist. Firm values are never controversial, meaningful, or insightful. Just insignificant ambiguous language. So stop wasting time on it.
- "Provide background on the firm's Principals"
  - Of course people are critical to every investment strategy so it's rarely overlooked. Checklists are not for obvious items, only for those overlooked. Also, get very specific about the background concerns so an actual issue is addressed. Don't ask for generalities.
- "Provide a list of the firm's competitors"
  - The relevant question is not who the competitors are, it's what the firm is doing to outcompete them. So the checklist needs to address the specific, underlying concern. Just listing competitors does nothing to improve understanding about what the company is doing vs. their competitors.

This list could go on and on. There's a couple key points.

- First, checklists are for items that tend to be overlooked, not for the obvious. If something is obvious, get it off the list.
- Second, the value of checklists is not listing generic/background information that can be found elsewhere. Stop listing the firm's principals, the number of employees, or it's office locations as part of the checklist.
- Third, as items on a checklist grow, the process rapidly loses effectiveness. Checklists are for meaningful risks. Creating 100-item checklists is missing the point if analysts neglect the 5-10 core items because they are occupied with 90 irrelevant items. So narrow the focus. Anything more is overwhelming and too broad to be useful. A good checklist is concise. It's specific. It's actionable. It's not to list every possible random issue.

There's a renewed focused by the investment industry on process vs. outcome. Because any given outcome may be due to chance or luck, it's more productive to focus on how you get to a decision rather than how it worked out. And that makes a lot of sense. It's a legitimate concept that is very valuable to the investment process. Checklists are supposed to help by emphasizing the "process" part of investment analysis.

However, organizations distort the meaning of "process". They load their teams up with endless checklist busy work, under the guise of "process vs outcome". But that's not what process vs outcome means. Process doesn't mean mindless task repetition but instead deliberate, focused thinking on the critical issues.

If your checklists are prompting a greater focus on substantial issues, then you are doing it right. Checklists should be directing discussion and work on a smaller number of meaningful topics.

But, if your checklists are an endless documentation exercise, then something is wrong. Go back and rethink the entire purpose of the checklists.