

The Sweet Music of the Gritty

Nicolò Paganini (1782-1840) is considered to be one of the greatest violinists in history – a true master. His reputation has grown to epic proportions with the retelling of a story that supposedly demonstrated his immense talent. According to the story, Paganini had almost finished performing a piece when one of his violin's four strings snapped, which would surely end the performance and disappoint the crowd. Undaunted however, Paganini kept playing. Even more impressive was the fact that the piece sounded just as beautiful as when he was playing with four strings. If this impressed the crowd, one can only imagine how they felt when the virtuoso continued even after a second and third string snapped. Paganini completed the song with just one string – his hands were a blur, but the sounds remained angelic.

We've probably all had a similar experience in our lives, although it may not have involved a world-class violinist. There seem to be some people who possess such an incredible ability at something that they simply must have been born with it; like the fellow student who studies for ten minutes before an exam and aces it, the athlete that excels in three different sports or the child chess prodigy. Any way that you slice it, these people seem to be extraordinary.

These types of people are a fascination of ours at Sionna, because we are always looking for a management team that has the ability to play the corporate violin with just one string, if necessary. Returning to the story of Paganini may help us discover what we should be looking for to help identify extraordinary business executives. It turns out that Paganini had previously written and practiced a piece to be played on two strings. Later, a member of Napoleon's family requested a song played with just one string. As a result, Paganini had developed the ability to play beautiful music with fewer than the four strings of a violin. When combined with his showmanship, he created and prepared a piece that was written specifically with a section to include four strings, another for three, and so on. Before the age of recorded music, no one knew how the song was "supposed" to sound. They naively assumed that the broken strings were an accident, when in fact they were intentionally designed for dramatic effect.

It turns out that a story that supposedly demonstrates the innate ability possessed by some, is actually a prime example of the hard work put in by a passionate student devoted to his art. If it isn't natural ability that differentiates the great violinists, athletes or corporate executives from the rest, then what could it be? And where can we look for it? We believe the answer may come from Angela Duckworth, a researcher at the University of Pennsylvania who has dedicated her career to studying "grit." Duckworth defines grit as, "perseverance and passion for long-term goals." One of the defining features of those high in grit is the ability to maintain their determination and motivation over long periods, despite experiences with failure and adversity. That sounds a lot like successful entrepreneurs. Entrepreneurs like Sam Walton, the founder of Walmart, or Phil Knight, the founder of Nike.

Sam Walton was able to play the corporate violin with just one string because of his immense passion for what he was building – a passion that is difficult for a hired manager to replicate. In fact, he was so passionate about the retail business that he was once arrested in Brazil. Walton had gone into a local store and wanted to measure the width of the aisles. Without a tape measure, he improvised and began to measure the width by lying down on the ground, which the local police didn't appreciate. This charming anecdote is merely one demonstration of a man who was truly passionate about the work that he did.

Phil Knight's building of Nike had to endure some incredible adversity. In fact, Nike wasn't even the name of the company at first. The business began as a company called Blue Ribbon Sports, and it was merely an importer for a Japanese shoe company. That was until the Japanese company tried to force Knight to sell his successful business to them, by threatening to go to another distributor. This was around the time that Knight's bank also cut him off and put the entire company on the brink of disaster. Somehow, Knight managed his way through these existential challenges. He was able to build on this grit and determination, and turn Nike into a business that today is worth US\$86 billion. Could it be that the passion required to invest the time and effort to start a business combined with overcoming the inevitable adversity that the capitalist system throws at aspiring entrepreneurs, creates a perfect environment for incubating gritty leaders better suited to succeed? We believe it does. It is not an easy thesis to support with hard numbers, but as Albert Einstein said, "not everything that counts can be counted, and not everything that can be counted counts." One way to test this theory is to look to a group of businesses that exemplify this entrepreneurial dynamic – owner operators. These are businesses that are typically still run by the founder of the company, who keeps the vast majority of their wealth invested in the business.

There is a growing body of research that supports the belief that owner-operated businesses outperform the market over the long run. One piece of research that demonstrates the tremendous results created by owner operators was a paper published in May 2014 in the Journal of Finance. The research examined the relationship between CEO ownership and stock market performance and found that a strategy of investing based on high managerial ownership delivers strong annual returns, outperforming low managerial ownership investments by between four and ten percent. Most of the reasons cited for this outperformance have centered on the alignment of interests created by managers of the business owning a significant amount of stock themselves. An alternate theory suggests that it is the longer time horizon of an owner operator that leads to outperformance; they often think about the next two decades, not the next two quarters. These are all advantages of owner operators, and likely do contribute to the outperformance over time. However, we propose that it may be the passion that these entrepreneurs have for their businesses and the perseverance required to take an idea and turn it into a thriving public company that really makes the difference.

If it is indeed the case that grittier managers are likely to be more successful, and the entrepreneurial process develops grit, then outperforming the market over the long term may be as simple as investing in a diversified collection of owner-operated businesses. This is a theory that we decided to test nearly five years ago. We built a portfolio of approximately 30 owner-operated businesses in Canada and the U.S. and created Sionna's Owner Operator Fund. So far, the results are encouraging. Since its inception on October 31, 2012 the fund has meaningfully outperformed its benchmark.

Although we often attribute exceptional performance to innate talent, it is likely that passion, perseverance and just plain hard work is the true differentiator of exceptional performers. In our experience, these important attributes are commonly found when partnering with owner-operated businesses. We continually scour the investment universe for the next manager with the passion and perseverance of Paganini to benefit you, our valued clients.

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