

Practicing the Scuttlebutt Method

[SB scuttlebuttinvestor.com/blog/2018/11/19/the-scuttlebutt-method](https://scuttlebuttinvestor.com/blog/2018/11/19/the-scuttlebutt-method)

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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 an 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

— Phil Fisher, "Common Stocks and Uncommon Profits"

The first question I usually get when I tell someone the name of my blog is: where did you come up with such a dumb name? And I get it – "Scuttlebutt" isn't the sexiest name for a website or blog but it is an idea that has resonated with me over the years and to which I am forever indebted. Scuttlebutt Investor is an homage to the great Phil Fisher – an early GARP (Growth At a Reasonable Price) investor before GARP was even a thing.

You might have thought that this would have been my first post ever - explaining the Scuttlebutt Method but alas so much to write about and so little time. However, I thought it was due time to dig a bit into what scuttlebutt investing involves and why I am so passionate about it.

What is Scuttlebutt?

Scuttlebutt is a term that generally refers to rumors or gossip. The origin of the term is related to sailing. Water for consumption on sailing ships was typically stored in a scuttled butt - a butt (cask) which had been scuttled by making a hole in it so the water could be withdrawn. Since sailors exchanged gossip when they gathered at the scuttled butt for a drink of water, scuttlebutt became slang for gossip or rumors. It's not that far off from the more modern office equivalent – "watercooler talk".

As it relates to investing, the Scuttlebutt Method was coined by Phil Fisher in his seminal book "Common Stocks and Uncommon Profits" (See [Recommended Reading](#)). It refers to a method of conducting due diligence about a company and its investment merits by talking to all kinds of people related to it like customers, vendors, trade associations, competitors and employees (former and current). It is true feet on the street research. This is, of course, above and beyond all the financial statement reading and standard due diligence that a prospective investor is expected to do.

There is an advantage to gathering your own information and making decisions based on facts that you have gathered yourself. Investing is more of an emotional than intellectual exercise, and it becomes very hard to stay on an even keel and to make rational, unbiased judgments if you're making them based on someone else's information.

— John Harris, Ruane, Cunniff & Goldfarb (Graham & Doddsville Winter 2018)

Why is Scuttlebutt research important?

In my opinion, scuttlebutt research is important for two key reasons:

1) It provides deeper insights into a company that can't often be had through just reading. Former employees and current employees can provide valuable insights about employee morale and sentiment. Current and former customers can also be an extremely valuable source for assessing a company's moat and potential switching costs. Why do they continue to use the company's products/services? What would motivate them to switch to a competitor? How difficult would it be for them to switch to the competition.

2) It is a form of primary research as compared to secondary research like reading financial statements and other company materials. Primary research is important because doing the legwork and kicking the tires yourself provides a higher level of confidence and conviction. When the market is selling off indiscriminately, that extra layer of research and due diligence provides conviction in a position that can't be had from secondary research alone.

Practicing Scuttlebutt

I'm probably going out on a limb here but practicing the scuttlebutt method well is like method acting. It involves completely immersing yourself in a subject or industry or company for some length of time to play out every scenario and run down every question until you become a master on it. Eventually, practicing scuttlebutt becomes a natural part of you and it becomes tough to segregate research from life. And you become a researcher or anthropologist no matter what you're doing. Here is my six point plan for effectively practicing scuttlebutt:

Anecdotal + Empirical

The common criticism of the scuttlebutt method is that it's highly anecdotal and this is partially true but anyone that is merely talking to some people and then buying the stock is guilty of scuttlebutt malpractice. Practicing the method well requires a marriage of both the anecdotal and the empirical. It requires reading the 10-K, financial statements, presentations and doing a high level of due diligence and then and only then talking to people with an educated mindset on the topic. It's only by first doing this level of more

empirical fact finding, can one decide if the company is worth digging into more, the right people to talk to, formulate the right questions to ask and how to interpret and analyze that information.

Look for disproving information

The other trouble with conducting a bunch of research (scuttlebutt and otherwise) upfront is that this vested time can often lead to some level of confirmation bias. In other words, we do a bunch of research, form a hypothesis and then look for people and things to confirm that hypothesis. However, it's important to also do the opposite – look for and analyze information that disproves your hypothesis. Talk to people on the other side of the issue and try to understand why what they are saying makes sense or doesn't make sense. Talk to the biggest cheerleaders of the company but also talk to those that don't view the company as favorably. And don't take a side - make a rational, impartial judgement of the company based on all the facts - good and bad.

Talk to everyone – get out of the echo chamber

We humans have a tendency to find our tribe and stick to our tribe. We self-select our friends and make friends that think like us, share our opinions and act like us. Our families also come from similar walks of life. It's a fallacy to think that you and your friends and family and other people you regularly interact with are representative of the population. So how do we solve for this? Well – talking to friends and family is ok but we need to supplement this with people that aren't necessarily in our direct circles. This requires getting out of your comfort zone and talking to a diversity of people before landing on a POV. In my case:

- I often end up in long conversations with Uber, Lyft, taxi drivers and often pepper sales associates at stores and other places with lots of questions. They aren't people I know (which is the point), but they're often willing to engage in a long conversation and often provide a varying perspective on different topics, products, services.
- I read reviews online as they often represent a broad cross section of the population. This can be reviews for a restaurant on yelp, critic reviews for a movie on Rotten Tomatoes or even reviews for a product on Amazon. For example, when I wanted to understand how Starbucks' (SBUX) new Roasteries were being received by customers, I went online and started reading Yelp reviews. Yes - there are often fake reviews online but you're trying to develop a general picture of something you may have not had the chance to experience in the flesh, so it is often still helpful.
- I resist the temptation to talk to one person and form a view on the company as it tends to provide a biased view. Talking to numerous people is necessary as only then does a realistic picture of the company emerge by combining the differing perspectives of various people.

Empathize with the end customer or consumer

I try to find users of the product/service and understand why they use it and what they like about it. How do I do this? Sometimes I'll just post on facebook and ask if someone uses/has used a particular product and often get a few responses from folks where I can dig further. Sometimes these are friends (where the response might suffer a bit from the echo chamber issue above) but other times – they are just acquaintances and so not as much of an issue. I did this when I wanted to learn more about Shopify. I asked my facebook universe if anyone had ever started an e-commerce store and what platform they used and why. Also – I often will sign up and use the product or service in question myself so I can understand what makes it good or bad. I'll often do this with competitive products/services as well to understand the entire industry landscape

Think broadly about the people that can be helpful and engage them

Often a company or topic seems so obscure or different from what we know that it's difficult to know who to talk to or you feel awkward talking to someone about it. 1) you'll be surprised by the power of the network that you have. Check out linkedin and you'll find you have only one degree of separation from someone that can help you figure out a topic/industry/company; 2) you'll be surprised how much someone in a given industry loves talking about their work or industry. For example, I was interested in Henry Schein (HSIC), a purveyor of dental supplies so I scheduled an appointment with the dentist and while I was getting my dental work done, peppered my dentist with questions. Similarly, I was doing research on CDK Global (CDK) – a company that provides software to auto dealerships so I went to the dealership and showed some interest in a car and got to talking to the salesperson about how they use the software and what they like about it. I also managed to find a consultant online that advises dealerships on dealership software and he was more than happy to give me his perspective.

Keep a vow of confidentiality

The goal of scuttlebutt isn't to get inside information. Far from it. It's to get context and color that you wouldn't otherwise get from reading. But people are a lot more willing to open up and provide that color if they are confident that their conversations will be kept confidential. Fisher was keenly aware of the benefit of confidentiality. He said, "The inquiring investor must be able to make clear beyond any doubt that his source of information will never be revealed. Then he must scrupulously live up to the policy. Otherwise, the danger of getting an informant into trouble is obviously so great that unfavorable opinions just do not get passed along."

You know who else avidly practices the scuttlebutt method? I leave you with these videos:

1998 Meeting: <https://buffett.cnbc.com/video/1998/05/04/phil-fishers-scuttlebutt->

[method.html](#)

2017 Meeting: <https://buffett.cnbc.com/video/2017/05/06/afternoon-session---2017-berkshire-hathaway-annual-meeting.html?&start=5088.04>

2018 Meeting: <https://buffett.cnbc.com/video/2018/05/05/afternoon-session--2018-berkshire-hathaway-annual-meeting.html?&start=5684.21>
