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Investment Committees

How to Build a Team to Make Good Decisions

There's a lot of literature on group decision-making, but little or none on investment committees. We have a situation where there's this very important activity performed by investment committees and there seems to be almost no data on investment committee behavior.

John Payne and Arnold Wood
Individual Decision Making and Group Decision Processes [1]

Big Bucks but Poorly Pondered

"You're hired," are three of the sweetest words an executive of an investment management firm can hear. "You're fired," in contrast, are the three most dreaded. Those hire and fire decisions are often the product of an investment committee, a group with fiduciary responsibility to make financial decisions on behalf of beneficiaries. And those decisions are often poor. Committees, like individuals, are prone to all sorts of mistakes, including buying high and selling low.

Estimates suggest that investment committees oversee over $5 trillion in financial assets worldwide. [2] Yet there is no fully developed set of ideas on how to best create, manage, and evaluate an investment committee. Sure, there have been publications about how committees should define and stick to investment objectives, and how to avoid behavioral biases. [3] But a thorough discussion of the structure of an effective committee requires more depth and rigor than what we have today. Two heads may be better than one, as they say, but only if they operate effectively.

This essay is about how to create a productive investment committee. Topics include how to structure a committee, the importance of classifying problems, how to best gather options, the importance of leadership, methods to decide, and pitfalls to avoid. I have included a checklist at the end. Since most investment committees are already up and running, many of these topics will be helpful in improving results.

How to Build a Committee

One of the first challenges in creating a decision-making group is determining the right size. A group that is too small is likely to lack critical skills or information. But a group that's too large is unwieldy, reducing its effectiveness. A study of over 700 endowments found the average investment committee had 10 members, a number considered to be at the high end of an optimal range. However, committee sizes vary widely, with some having as few as 3 members and others topping 30. Some

members of larger investment committees are appointed not because of their essential skills, but rather for the purpose of recognition or political expediency. [4]

J. Richard Hackman, a professor of psychology at Harvard University, argues that smaller teams are generally more effective than larger ones. Hackman writes, "My rule of thumb is that no work team should have membership in the double digits (and my preferred size is six), since our research has shown that the number of performance problems a team encounters increases exponentially as team size increases." [5] Indeed, a majority of people on investment committees of six or more said they would prefer a smaller group. [6]

The cost of coordination aside, the size of the group does not matter as much as the group's cognitive diversity. The fact is most people prefer to work with others who are similar in age, gender, background, experience, and attitude. But this homogeneity can undermine a committee's ability to make quality decisions because it means that the committee is likely to fail to incorporate important information, perspectives, and experience. Brooke Harrington, a researcher at the Max Planck Institute for the Study of Societies, analyzed investment groups and found, "The larger the proportion of friendship and other socioeconomic ties within a group, the worse its portfolio performs; the larger the proportion of relationships based on professional, financial, or academic ties, the better the group performs." [7]

Many investment committees today are made up of birds of a feather. A survey by Arnold Wood, president and CEO of Martingale Asset Management, and John Payne, a professor of psychology at Duke University, found that 85 percent of investment committee members were white males over 50 years old. They found no members under the age of 30, and that only 15 percent were women. An even lower 5 percent of members were minorities. A bunch of older white guys sitting around a table might have thoughts different from one another, but it's not a given.

Research indicates that too much diversity can also present a barrier. Highly diverse groups have trouble socially integrating and communicating, and also have more conflict. [8] Nevertheless, most investment committees need to worry more about the lack of diversity than about too much diversity. Still, it's important to recognize that investment committees can clear most of the hurdles of diversity by implementing an effective decision-making process.

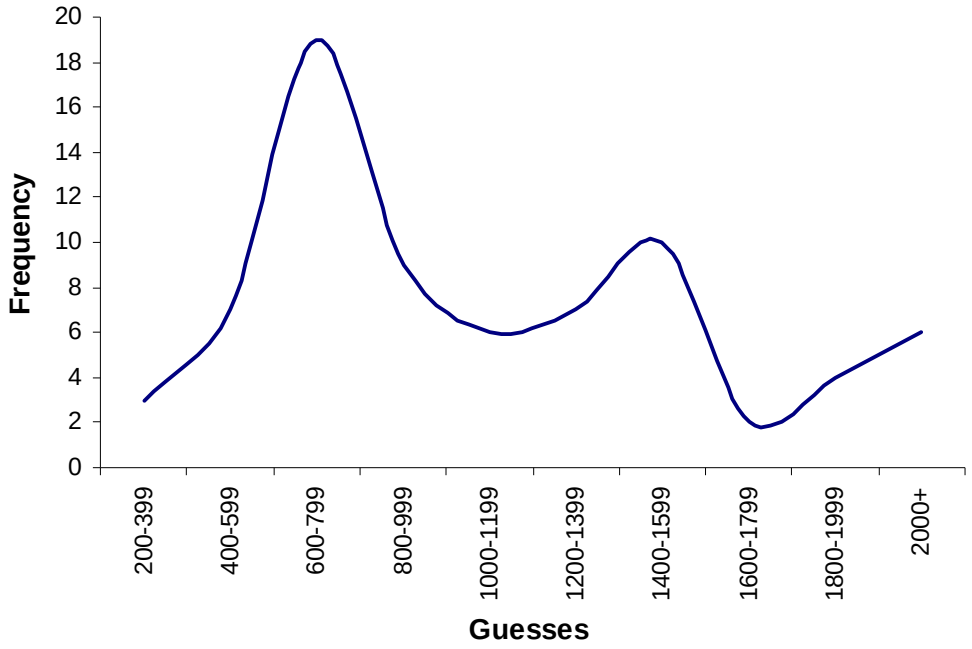
Why does diversity matter so much? Scott E. Page, a political scientist at the University of Michigan, offers a persuasive answer through what he calls the diversity prediction theorem. [9] The equation is as follows:

Collective error = Average Individual Error – Prediction Diversity

Average individual error represents the individual ability of the members within the group. If the error is low, you can say the people within the group are smart. Prediction diversity reflects the dispersion of guesses, or how different they are. The collective error reflects how well the group predicts. You might think you are all set if you have really smart committee members. But given the inherent difficulty of the problems investment committees face, relying solely on smarts is a bad bet.

Let me give you a simple example of the diversity prediction theorem in action. [10] A couple of years ago, I passed a jar of jelly beans around to the students in my class at Columbia Business School. I then asked them to guess how many beans were in the jar (with a reward for the best guess). Exhibit 1 shows the distribution of the actual guesses. You can see it looks nothing like the textbook bell-shaped distribution.

Exhibit 1: Distribution of Jelly Bean Guesses



Source: LMCM analysis.

The average of the group was within 3 percent of the correct answer of 1,116, and only 2 of the 73 participants did better. These are impressive results and support the argument for the wisdom of crowds.

Now let's see how the diversity prediction theorem sheds light on this outcome. The average individual error is the average of each student's difference from the right answer. If all of the students were spot on, the error would be zero. The average error in this case was under 701 beans, which means the students missed the mark by over 60 percent, on average. Statisticians square the error to make sure that the errors above and below the answer don't cancel out. So the average individual error was 490,949.

Next, we consider how far the average guess was from the average guess. This measures the dispersion of guesses. If all the students gave the same answer (whether accurate or not), diversity would be zero. In this experiment, the average difference from the average guess was just under 700 beans. Again, we square that result, arriving at prediction diversity of 489,692.

Now we can solve the whole equation:

1,258 = 490,949 – 489,692

The square root of 1,258 is approximately 35 beans, the difference between the group's average guess of 1,151 and the actual 1,116 in the jar. According to Page, the core insight of the diversity prediction theorem is that "individual ability (the first term of the right-hand side) and collective diversity (the second term) contribute equally to collective predictive ability. Being different is as important as being good." [11]

So a large committee made up of people whose judgments are highly correlated will underperform a smaller committee of individuals with diverse judgments. Based on endowment survey data, most investment committees reflect the worst of both worlds: they are large and they lack diversity.

While monitoring size is easy, measuring diversity is not. What matters is cognitive diversity, which takes into account factors including experience, training, background, and education. Most organizations rely on social identity diversity—considerations including gender, age, race, religion. (See Exhibit 2.) Social identity diversity may correlate with cognitive diversity, but they are certainly not the same thing.

Exhibit 2: Measures of Diversity

Differences in social categories	Differences in cognitive categories
• Race	• Education
• Ethnicity	• Training
• Gender	• Experience
• Age	• Information or expertise
• Religion	• Personality
• Sexual orientation	• Cultural background
• Physical abilities	• Motivation

Source: Adapted from Elizabeth Mannix and Margaret A. Neale, "What Differences Make a Difference? The Promise of Reality of Diverse Teams in Organizations," *Psychological Science in the Public Interest*, Vol. 6, No. 2, October 2005, 36.

Investment committees that function well also have excellent leadership. How size and diversity shape the committee's performance is largely a function of how the chair manages the committee. This issue is significant enough to warrant a separate discussion below.

Classify the Problems

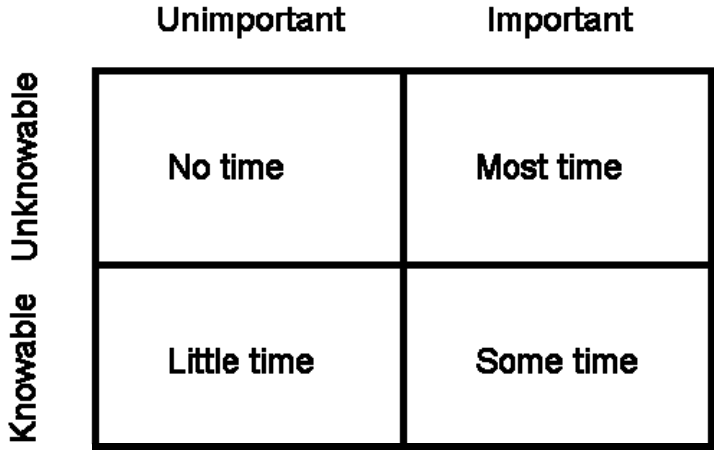
Problems come in different types, and one of the first tasks of a committee is to determine what type of problem it faces and how to best solve it. Problem classification is an important and frequently overlooked step in group decision making. Understanding problem types leads to better time allocation and crisper decision making.

Let's consider two categories of problems. The first are problems with clear and correct answers. These are factual questions, and may include items like investments costs, spending levels, and maybe even investment policy. Someone (and it may be a staff member or consultant) may know the answer to the question and the rest of the committee can quickly and reliably defer to that individual's knowledge. These issues are also within the committee's control for the most part. While the answers to these problems can be important, this category is relatively easy for a committee to address.

Second are complex problems, which often include a prediction of the future. These are generally the most consequential questions committees face, and there is no simple answer. Examples include asset allocation, investment manager changes, and anticipating market returns. Committees have the potential to answer these questions more accurately than an individual if the correct process is in place. This process requires the group to be diverse, information to be properly surfaced and aggregated, and the committee members to have well-structured incentives. Still, the outcomes for these problems—forecasting markets, manager performance—are generally outside the control of the committee.

Addressing complex problems not only requires an appropriate approach, it demands thoughtful time allocation. Exhibit 3 is a simple two-by-two matrix that considers issues based on how knowable and how important they are. Committees should spend the vast majority of their time on important topics, and in particular those topics that are unknowable. Dealing with important issues with unknowable outcomes requires a probabilistic mindset and discipline. Issues that are known and unimportant should receive little time.

Exhibit 3: Committees Should Focus on What's Important



Source: LMCM analysis.

But the time allocation of investment committees is far from this ideal. A recent survey of defined contribution committees found that they spent over one-half of their time, more than that on any other issue, discussing past investment performance—an unimportant knowable. [12] (Unimportant in the sense that there is nothing the committee can do about it.) In fact, committees report spending the bulk of their time (40-50 percent on average) on topics like "market dynamics" and "managing the managers" even though committee members themselves do not rank those topics as the most important. In contrast, a topic of high importance, investment policy, used only 5-15 percent of committee time.

Wood argues this time misallocation happens because, "tasks, like discussing stocks with managers, not only provide some immediate sense of completion but also are familiar and fun—unlike developing written objectives, which requires discussion of less-definable issues, situational analysis, and defining how decisions will be measured. Receiving easy gratification now or waiting for an uncertain outcome later also defines how time is spent." [13]

In putting together committees, leaders sometimes seek to find experts to match the problems they perceive the committee will face. So if the committee needs to decide about an allocation into alternative investments, they may seek a member with experience in alternatives. However, research shows that experts fare no better than informed people when making predictions about complex systems (including politics, economics, and markets). Philip Tetlock, a psychologist at the University of California, Berkeley, writes, "People who devoted years of arduous study to a topic were as hard-pressed as colleagues casually dropping in from other fields to affix realistic probabilities to possible futures." Tetlock suggests these "colleagues casually dropping in" need a degree of sophistication "pegged in the vicinity of savvy readers of high-quality news sources such as the *Economist*, the *Wall Street Journal*, and the *New York Times*." [14]

Problem categorization and time allocation are among the responsibilities of the committee chair. The chair also needs to repeatedly remind members of the group's objectives, keep them on track, and reiterate the processes to best meet those objectives.

Gathering Options

To make a quality decision, a committee must properly evaluate all relevant information. But groups frequently do a poor job of properly unearthing, pooling, and weighing information. As a result, the quality of the group's decisions suffers. Think of it this way: if committee members have a point of view that they don't reveal, there's a good chance that they will reduce prediction

diversity. And because the collective accuracy depends both on individual accuracy and diversity, unused information leads to inferior decisions.

One well-documented example is the study of shared versus unshared information. Shared information is knowledge that every group member has, while unshared information is knowledge held by one individual within the group. Ideally, the committee would like to consider all available and relevant information, whether shared or unshared. But research consistently shows that group discussion tends to dwell on shared information and that groups generally fail to incorporate unshared information.

In a classic study, psychologists Garold Stasser and William Titus wanted to see how groups aggregated information. [15] The task was to select between three candidates for student body president, but it is easy to imagine the group selecting a consultant or investment manager. Stasser and Titus set up the experiment so that candidate A was the most attractive.

The psychologists then created two conditions. In the first condition, groups of four members all received the same pieces of information about each of the candidates, and were asked as a group to select the best one. In this case, 83 percent of the groups selected candidate A, as you would expect.

In the second condition, each member received eight pieces of information in common as well as two pieces of unshared information. The researchers designated the unshared information so that, if shared, it would represent a full view and would naturally lead to the selection of candidate A. But based solely on the shared information, candidate B appeared better. In fact, when the groups were asked to select, 71 percent of the time they chose candidate B.

So while in the second condition the group members had between them all of the information necessary to make an optimal decision, they consistently failed to pool their unshared information. Additional research has supported the findings of Stasser and Titus. [16] In open discussion, groups tend to talk much more about their shared information than their unshared information, and members tend to overweight shared information. As a consequence, group decisions generally reflect shared information, even when pooling unshared information leads to a better choice. Failing to reveal and use unshared information means there is a substantial slippage in the group's diversity, and hence, accuracy. Making sure that unshared information is revealed is ultimately the committee chair's responsibility.

One of the great challenges in making investment decisions is that the outcomes—both past and prospective—combine skill and luck. Almost everyone recognizes the role of skill and luck in outcomes, but most people find it difficult to understand the contributions of each. For example, many committee members would struggle to properly place investing within a spectrum that runs from pure skill games like chess to pure luck games like roulette. Investment results, especially those in the short-term, reflect lots of good or bad luck. The lack of clarity in assessing skill makes decision making hard.

When the outcomes of an activity combine skill and luck, you will have reversion to the mean. This means that exceptionally good or bad performance is likely to be followed by performance that is closer to average. Think of it this way: a really good outcome combines skill and a lot of luck. Even if the skill is the same in the next outcome, the luck isn't likely to persist and the outcome will be closer to average.

In markets, this means that really extreme performance—either for an individual manager or an asset class—is likely to be followed by results that are closer to average. The classic mistake in dealing with markets is the failure to recognize this reversion to the mean. Specifically, investors tend to buy when an investor or asset class is doing well, and sell when they are doing poorly. Studies show that investors earn a return that is a fraction of that of the market because of this behavior. [17]

"Buy high, sell low" goes well beyond individuals. Presumably sophisticated institutions, many guided by investment committees, fall into the same trap as well. Amit Goyal and Sunil Wahal, professors of finance, studied how 3,400 plan sponsors hired and fired investment managers over a decade. [18] They found that they tended to hire managers who had performed well in the recent past, and that the number one reason to fire a manager was poor performance. This is the institutional equivalent of buy high and sell low.

As you would expect, reversion to the mean shaped the results. As Exhibit 4 shows, on average the hired managers generated substantial excess returns in the 24 months prior to being hired, and the fired managers were behind their benchmarks. But in the 24 months following the change, the fired managers outperformed the hired managers. This is as reversion to the mean predicts. Investment committees, like individuals, have a hard time avoiding poor timing.

Exhibit 4: Even the Institutions Can't Avoid Reversion to the Mean

Source: Amit Goyal and Sunil Wahal, "The Selection and Termination of Investment Management Firms by Plan Sponsors, *The Journal of Finance*, 63, no. 4 (2008): 1805-1847.

An essential issue in evaluating investment managers is time horizon. Timely and accurate feedback is crucial for learning and performance monitoring. The challenge in investing is to match the evaluation period with the time horizon of the manager or strategy. For instance, managers who run portfolios with high turnover can be evaluated frequently because the feedback on their strategy is timely and accurate. But for managers who have low portfolio turnover, the feedback is too noisy for frequent assessments. Given that the evaluation period tends to be one and three years for almost all managers, there can be mismatches on both ends of the spectrum.

Another challenge for investment committees is avoiding the "accepted obvious." The accepted obvious is a set of "arguments or rationales that seem attractive or convincing as stand-alone propositions." [19] The accepted obvious almost always starts as a useful idea, but ends up being stretched to the point where it is a poor choice.

The clear example in recent years is the move to mimic the Yale model, based on the strategies implemented by David Swensen, the chief investment officer of the Yale University endowment. [20]

Swensen was early in allocating assets into hedge funds and illiquid investments, with excellent long-term results. Other early adopters of this approach also did well, lending even more credence to the approach.

Over a dozen years or so, the Yale model migrated from a fringe investment strategy to the accepted obvious. Many endowments "slavishly imitated" the model without fully considering the higher costs of alternative managers and that the best funds might be unavailable. For example, endowment funds nearly doubled their allocation to alternative investments, from 23 to 42 percent, in the seven years ended fiscal 2007. Perhaps more troublesome, followers also failed to anticipate how illiquidity would affect the relationship between their funds and the institutions they served. As a result, for example, a number of high profile universities were forced to sell their illiquid investments at distressed levels. [21]

In gathering options, it is essential that committees think in terms of probabilities and outcomes because both the future needs of the beneficiaries and the results of the fund are unknown. Committees must explicitly consider a range of possible outcomes and associated probabilities for each investment or asset class, and combine those distributions in a way that captures the interactivity between them. Importantly, a mean-variance approach can be very misleading, in large part because it tends to rely on historical results. Expectations for future asset returns should consider valuation, as high returns usually follow low valuations, and vice versa. Simulations can be a valuable analytical tool in this process. [22]

One substantial challenge to this approach is that correlations between asset classes are not stable. In times of stress, correlations typically rise and offset the benefit of diversification. So committees need to weigh carefully the needs of the beneficiaries, the portfolio construction to serve those needs, and the downside risks.

How to Decide

A number of years ago, I was on a committee that was voting on whether to bring a person into the organization. After hearing the balance of the evidence on the candidate, I was in favor of bringing him in. The committee chair then started going around the conference table, asking for a verbal "yea" or "nay" on whether we approved of the candidate.

It so happened that the man sitting next to me was a physicist who had won the Nobel Prize and is probably the smartest person I have ever met. He was to vote right before me, and offered a nay when the chair called on him. So here I was, set to say yea, but faced with the world's smartest man saying nay only seconds before. Feeling seriously conflicted, I said nay and slumped in my chair.

Diversity is one of the key ingredients in group decision making. But by going around the room as he did, the chair invited social conformity and reduced independence. To get the best possible results from the committee, the chair must ask for independent votes. Submitting and tallying ballots is a quick and easy way to do this. Even if the chair skillfully surfaces the group's knowledge, a faulty aggregation process will undermine the effort. The chair should not ask for opinions sequentially, and should not reveal his preference until after the process is over, if at all.

An investment committee must also consider what constitutes a successful vote. One approach is to consider three thresholds: a quorum, a majority, or a consensus. Quorums, a number of members (often but not necessarily a majority) in the group, are often sufficient for relatively quick decisions, especially when there are lots of options. For example, honey bees use a quorum-sensing technique to find new homes. When roughly fifteen bees sense each other at an attractive nest site, they return to the swarm and signal it to move. [23]

A majority vote is the next threshold. We can extend this to include the modal selection when a group faces multiple options. Research shows that groups can make very good decisions using

this approach. One simple illustration is predicting the winners of the Academy Awards. Every year I ask my students at Columbia Business School to predict the prize recipients in twelve categories. Over the years, the most popular predictions have yielded 10 to 12 correct forecasts, while the average individual has been right only about 5 out of 12 times. [24] Majority (or modal) votes are appropriate for deciding most issues.

The greatest threshold is a consensus. A consensus may be reasonable for certain decisions, like determining the mission of the committee or for simple questions of fact. But in dealing with future unknowns, it is probably too high a bar to clear. A committee that reaches consensus on how to deal with the future is failing to register the true views of the committee members. Frequently, dissenting views are sublimated in order to "move forward," which may appear to increase group harmony but ultimately undermines decision-making effectiveness.

One underutilized technique in group decision making is the premortem. Everyone knows about a postmortem, a review of the facts after something has gone wrong in order to draw lessons for future decisions. Postmortems can be a very effective learning tool. Premortems, in contrast, consider what might go wrong before the committee makes the decision. Specifically, once the committee has narrowed its choices to one or a few, it allows its members to pretend they are in the future with the knowledge that the decision went bad. The members then write down what went wrong. Gary Klein, a psychologist who studies decision making, found that premortems help members identify a greater number of potential problems than they would otherwise. And because no one is yet wedded to the decision, those possible sources of failure can be incorporated into the decision-making process. [25]

One final aspect of deciding is documenting decisions. Once the committee has come to a decision, an independent committee or staff member should document how the committee arrived at that decision. The decision-making method, concerns or objections, and views from dissenters should all be included in the documentation. This effort allows for honest post-decision audits. When decisions work out well for the right reasons, that's great. But because investing is probabilistic, a good process can lead to a bad outcome or (what's more difficult) a bad process can lead to a good outcome. Thoughtful committees spend time reviewing past decisions and give themselves honest scores for the process they followed. A decision journal promises steady and good feedback.

A decision log also provides the committee with a memory, which is necessary for a couple of reasons. First, humans suffer from hindsight bias, which says that once an event has occurred we tend to think we knew what was going to happen before it did. A decision log helps offset this bias. Second, since the composition of investment committees can change frequently, the log gives new committee members a sense of the group's decision-making history.

Leading a Committee

A committee's effectiveness reflects, to a large degree, the skill of its leader. Good leaders are generally process-oriented, maintain focus, unearth information and options, and implement proper methods to decide.

Research shows that the best group leaders are firm. But it matters a great deal what they are firm about. Leaders who tend to advocate for one position or alternative get low marks from the other group members, and groups with such leaders tend to make poor decisions. In contrast, leaders who make sure that all information and alternatives are exposed tend to be better appreciated, and those groups generate better decisions. In short, good leaders focus intently on the process rather than the outcome. [26]

This process orientation leads directly to the next point: effective leaders maintain focus. Focus in this sense means prioritizing the issues the committee must deal with and allocating the committee's time accordingly, properly defining the types of problems the committee faces and

how to best solve them, and finally, ensuring the committee members with dominant personalities are kept in check. If you've ever been on a committee you know the type of person who tends to get off topic quickly and easily. A skillful leader reigns in the wanderers and keeps to the agenda.

To the degree that decision making relies largely on revealing and selecting among alternatives, a leader's most important job may be to make sure all relevant information is exposed. This requires making sure that all committee members have had the chance to voice their opinions, and that all views are welcome and respected. This by no means suggests that all ideas have equal validity, but as we know from our study of diversity, unusual points of view can sometimes add enormous value to solving a problem.

To extract information, a committee leader must first suppress his own view. He must then ask other committee members to offer their point of view. And he also must make sure to watch the group members. For example, introverts often don't speak unless asked to, while extroverts frequently think aloud, taking up air time. Neither is right or wrong, but both represent management challenges for the committee chair.

Finally, the leader should determine the best way to decide. Votes should be independent, to avoid the temptation of social conformity. Generally, establishing a majority is sufficient to ensure a good decision.

Pitfalls to Avoid

Properly structured and well-led committees that effectively classify problems, surface options, and decide stand an above-average chance of success. But it is worth reviewing some committee pitfalls, which generally reflect a breakdown in some part of the decision making process.

The first pitfall is the "Ringelmann effect," an observation on social loafing. Maximilien Ringelmann, a French agricultural engineer, asked individuals to pull on a rope attached to a strain gauge, which measures effort. He then asked multiple people to pull on the rope at the same time to see if the aggregate force would equal the sum of the individual averages. Instead, he found that people pulled less hard when in groups. As Arnold Wood summarizes, the Ringelmann effect "describes the inverse relationship between the size of a team and the magnitude of each group member's contribution." [27]

This is relevant for committees because it suggests that adding more people to a committee may lead to a diminution in individual effort. Committees can offset this effect by having the chair assign tasks to specific members, and by making sure that each committee member articulates her point of view or information. But for very large committees, the Ringelmann effect is very difficult to avoid.

A second major pitfall, groupthink, is a famous one. [28] A term popularized by Irving Janis, a psychologist, groupthink occurs when a collection of people minimize conflict and seek to reach a consensus view. Groupthink is associated with a number of decision-making disasters, including the failed Bay of Pigs Invasion (1961) and the explosion of the space shuttle Challenger (1986).

Janis observed three broad symptoms of groupthink. The first is overestimation of the group, including its power and morality. Second is close mindedness. Here, groups ignore or dismiss information that might sway the collective opinion. The final symptom is pressure to conform. Here, members employ self-censorship or pressure nonconforming individuals to adopt the group's view.

The methods to offset groupthink come down to surfacing all options and using an effective decision-making process. To state the obvious, groupthink is more likely to take hold with members who are homogenous. Research by Cass Sunstein, currently the head of the White House Office of Information and Regulatory Affairs, and his colleagues affirms this point. The

scientists separated liberals and conservatives into like-minded groups and asked them to deliberate on controversial social issues. In most cases, the groups settled on more extreme views than those expressed by most individuals in interviews conducted before the deliberations. The views of individuals became more homogenous, and more extreme, after they spent time with their groups. [29]

Committees that are able to surface unshared information are in a position to make better decisions. But, as we saw, the evidence suggests that most groups are not good at incorporating unshared information into their decisions. Studies by Chip Heath and Rich Gonzalez, psychologists who study decision making, add an additional twist: even though interaction is relatively ineffective for information collection, it does produce "robust and consistent increases in people's confidence in their decisions." As relevant, the psychologists found that the boost in confidence wasn't because the individuals had better information, but rather because of the social environment. The group creates a positive illusion that fuels individual confidence, even if that confidence is unwarranted. [30]

A final pitfall is too much reliance on outside advice, especially when advisors have incentive-based bias. For example, some pension consultants are also registered investment advisors, which present a possible conflict of interest. A recent study by the U.S. Government Accountability Office found "lower annual rates of return for those ongoing plans associated with consultants that failed to disclose significant conflicts of interest." Committees that rely extensively on outside advice must take the time to carefully and thoroughly assess the incentives and potential conflicts of their advisors. [31]

Conclusion

Investment committees make decisions that affect trillions of dollars and millions of beneficiaries. Yet surveys suggest that very few committees are structured to make the best possible choices. Key ingredients to good committee decisions include a small but diverse set of members, proper decision-making methods, and a leader who effectively defines the problem, unearths relevant information, and remains steadfastly focused on process.

Of all the issues surrounding group decision making, capturing the benefit of diversity is probably the most important. Almost all of the process loss in group decision making boils down to some form of diversity deficit. Balancing the potentially conflicting goals of maintaining a congenial work environment and tapping the power of diversity is the biggest challenge in making an investment committee effective.

Summary

General Findings

- Small committees tend to be more effective than large ones
- Cognitively diverse committees make better decisions than homogenous ones
- Diversity can create a performance drag
- Committees frequently allocate time poorly
- Committee members don't always reveal the information they have
- Committees often fail to properly consider reversion to the mean
- Large committees encourage social loafing

Advice for Committee Members

- Prepare your thoughts ahead of time and make sure to share what you know
- Embrace diversity of thought
- Analyze situations using probabilities and employ simulations when appropriate
- Challenge the accepted obvious
- Be mindful of matching evaluation periods with investment time horizons
- Maintain a decision-making log and review it periodically
- Do premortems

Advice for Committee Chairs

- Be process, not outcome, oriented
- Identify the type of problem the committee faces
- Maintain the committee's focus—nip at the bud discussions that are off topic
- Consider the proper voting threshold: quorum, majority, or consensus
- Make sure committee members vote independently
- Put measures in place to offset groupthink
- Assess whether advisors have conflicts of interest

Endnotes

[1] John Payne and Arnold Wood, "Individual Decision Making and Group Decision Processes," *The Journal of Psychology and Financial Markets*, Vol. 3, No. 2, 2002, 94-101.
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[8] Elizabeth Mannix and Margaret A. Neale, "What Differences Make a Difference? The Promise of Reality of Diverse Teams in Organizations," *Psychological Science in the Public Interest*, Vol. 6, No. 2, October 2005, 31-55.
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