The "Positives" Section of a Due Diligence Report

Humans are generally more prone to believing, being affected by, and/or responding to negative than positive information. Case in point, many of us have been dissuaded from purchasing a predominantly positively rated item or service because of one (or a few) negative reviews that seemed more heartfelt. It is almost as though we are hardwired to trust negativity over positivity. Something evolutionary must be the cause of this disposition - perhaps a topic for another time. Nevertheless, this trait is even more amplified with investment analysts whose primary job description is to be some gnarly amalgamation of doomsayers, skeptics, and wet blankets. In my post a few months ago, I found it much easier to construct points around "The Concerns Section of a Due Diligence Report" because, once again, it is innately less difficult to conjure doomsday scenarios or follow the unceasing rabbit hole of what might have been overlooked.

In my own career, I have toyed with the idea of totally omitting the "Positives" section in due diligence reports because almost every time I wrote or read one, it seemed like a celebration of bias. In light of the tight time constraints that most investment analysts operate under, and the soul-aching and soul-searching ordeal of bringing forward an idea, why would anyone assume the sponsoring analyst does not favor the opportunity? In my view, the fact that the due diligence report even exists should emphatically count as the analyst's endorsement. This view can further be applied to GPs, deal sponsors, and to some extent, deal brokers or placement agents who have been confirmed to historically adhere to high standards. Like due diligence reports on the LP side, on the GP side, every created DDQ, pitch deck, deal memo, etc. is proof that there is belief that despite the negatives/concerns (that will undoubtedly be voiced by various parties), the sponsor believes the opportunity at hand is worth pursuing. So why do so many stakeholders want "Positives" to be spelled out? Do we really believe it (or assign true credence) when opportunity sponsors toot their own horn? Do we equally weigh the "Concerns" and "Positives" sections of reports? Are there ways to construct "Positives" that are (or appear to be) free from bias? The ever-alive consultant in me wants to answer these questions with the all-encompassing and very CYA-ish answer of "Perhaps", but I think a better approach is to list (below) specific thoughts on the "Positives" section.

- **Data helps**: Although inferences from data can be molded to advantageously or desirably suit conclusions, it is typically less malleable than sheer opinions. When the "Positives" section of a report is data-heavy, with clear cause-and-effect depictions, it creates a ballast that puts everything else into perspective. The goal is to convey impartiality, and there is no better way to do so than by presenting hard-to-refute numbers. Although qualitative views will inevitably appear throughout due diligence reports, I have found that the "Positives" section is the natural habitat for quantitative hard facts.

- **Assume a lay audience**: It is a good rule of thumb for all writing endeavors to assume that readers will likely fall into various categories of sophistication, knowledge, and specialization. Investment committees (those who make the final "yay" or "nay" decisions) tend to vary in different organizations. Not everyone reading the document will have the immersion, alignment, or background needed to bestow implicit knowledge of the psychological Kungfu being fought by the opportunity's sponsor. Laying out the pros of an idea allows all readers to make their own judgments regarding the objectivity of the whole analysis. Additionally, due diligence reports serve as time stamps of thinking at a particular point in time, so having "Concerns" and "Positives" independently laid out can give someone reading them in the future a well-rounded view of the degree of critical thinking that was applied.

- **Flowery language tends to miss the target**: The quickest way to diminish the integrity of a due diligence report, at least in the eyes of sophisticated investors, is to saturate the "Positives" section with overly flowery language. You don't want to sound like a hyperventilating fan who has never seen an interesting opportunity. There are ways to portray conviction without putting out foolproof "best-thing-since-sliced-bread" vibes. There is an art to highlighting positive attributes in an objectively convincing manner without sounding like you work for the fund (or deal) you are putting forth. I have seen some due diligence reports where the "Positives" section is so exaggerated that it irrevocably drains the integrity of the entire document. This is a surefire way to erode an analyst's built trust. I am not advocating for a total ban on the use of superlatives, but rather an awareness that audiences of due diligence reports are predominantly seeking proof of objectivity.

- **Thoroughness is key**: A campaign that aims to prohibit the use of "Positives" sections will likely be a fool's errand because this could render due diligence reports incomplete. If we expect analysts to honestly and painstakingly list what could go wrong with an idea, then it makes sense to equally delineate what could go right. Although it sometimes feels disingenuous for an opportunity's sponsor to rave about his/her idea, having a "Positives" and "Concerns" section in a completed report remains the most effective way to convey balance and thoroughness of analysis.

- **Sometimes it shows a relatively higher level of conviction**: Although I mentioned in a previous point that flowery language can erode an analyst's built trust, there is a caveat that must be highlighted. Analysts who have built long-term trust from historically exhibiting ultra-objective approaches and demeanors when assessing opportunities are usually given more leeway when they sporadically show superfan characteristics. People sit up and pay attention when a person known to be hard to please starts gushing over an opportunity. The prerequisites for this type of leeway are typically a "strong and long track record of good decisions", "an awareness that this overly positive stance can still erode trust if it turns out to be wrong", and "confirmation that the same level of historical thoroughness in assessment has been applied to the opportunity at hand".

I believe the way the "Positives" section of a due diligence report is crafted says more about the analyst than the opportunity he/she is bringing forward for consideration. Regardless, the "Positives" section can be a powerful tool in the investment process if the appropriate amount of care is taken to present hard data, if it is made consumable by all, if any perceived bias appears in moderation, and if thoroughness remains a priority.

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