

Gladwell, Malcolm – The Tipping Point

Little, Brown and Company, 2000, [Surrounding knowledge] Grade ★★★★★

At an early stage, it's often hard to know if a new idea or product will transform into something big or not. This is why value investors typically stay away from businesses without a track record. They are well aware that some of these ventures will turn into great successes but argue wisely that they are too hard to evaluate and prosper from. Still, some upstart businesses do reach a point of accelerating growth, why it would be great to be able to recognize patterns and signals for when it's about to happen. The author of this book describes a tipping point as an event when something reaches critical mass and begins to accelerate at a much higher rate.

The Tipping Point was the first book by the now famous author Malcolm Gladwell. He has today written five bestsellers - all with a focus on sociology and psychology. He became interested in the subject of tipping points and critical mass after having witnessed the sudden drop in crime rates in New York in the 1990s. After having analyzed the reasons for the escalation of crimes in the 1980s and the subsequent drop, he then shifted focus to other situations that showed similar characteristics. One of these is the story about the Airwalk shoes that had an exponential increase in demand - which then quickly disappeared. Indeed, retail and especially fashion is a sector that value investors often shun due to its unstable characteristics.

Gladwell starts with introducing the reader to how something can turn into an epidemic by describing situations covering the spread of viruses, trends and criminal acts. He describes the ingredients that he finds have led to tipping points with three features. A few special individuals are needed, *the power of the few*. It needs to be difficult to switch from, *stickiness*, and the environment or situation needs to be right, *power of the context*. Thereafter he presents in-depth case studies of different kind of epidemics where he uses the concepts earlier introduced to the reader.

As an example of the power of the context, it has been found that the number of 150 is a “magic number”. The company Gore along with the Hutterites and various military organizations have

experienced first-hand that the efficiency suddenly drops drastically when groups surpass a size of 150 persons. The rule of 150 is explained by the fact that in a smaller group the members know each other's strengths and weaknesses and this increases efficiency. It's vital to know who the best person is for a specific task but when the group becomes larger than 150 people a tipping point is reached and beyond that size this becomes exponentially harder. Gore has solved this by opening a new plant when an old plant reaches 150 workers and it has worked fantastically well for them.

Many of the author's ideas are very easy to grasp and therefore it's important to stay critical. Gladwell has been critiqued for over-emphasizing the broken window theory when explaining the change in NY crime rates. The theory explains how a broken window or graffiti in the subway leads to more criminal acts if it's not removed. Gladwell has since admitted that he overstated its importance. The concept of tipping points is however an essential mental model with parallels to other powerful concepts. Gladwell for example mentions that it's difficult to grasp how a paper folded over 50 times could reach the sun and that it doesn't make intuitive sense that a 15% compounded return leads to more than 16 times the money after 20 years. But it does and this is also one of the most important insights for an investor.

I chose to read *The Tipping Point* to try to understand why ideas and businesses take off in order to be able to look for patterns as to when this is in the process of happening. After reading it, I don't think the book gave all the answers but it definitely delivered some. In the end, the greatest takeaway for me is the reinforcement that it's possible to create change with small means. The small details that differentiate one business from another may well be why one survives and thrives while the other goes away which is important to think about when evaluating moats. The book will hopefully also help the reader be even more conscious of the limitations in being a human as well as an investor.

Niklas Sävås, January 18, 2018