Skin in the Game

Wes McComb, MBA, CIM, PFP

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The term skin in the game was initially used regarding investments, by Warren Buffet when referring to executives of corporations owning shares in the companies that they run. Nassim Nicholas Taleb wrote a book called Skin In The Game: Asymmetries in Daily Life in which he expands the term to encompass bureaucracies, religion, public intellectuals, ethics and other fields but the underlying idea is the same as Buffet's: a decision maker needs to suffer a loss from a bad decision, not just reap rewards for good outcomes.

Without this counterbalance of risk/reward a decision maker's motives may be suspect. A politician may vote in favour of an issue that will personally benefit them, not for what is in the best interest of their constituents. Or bureaucrats may be so far removed from any personal risk that any decision that they make may have more to do with pleasing their bosses than fulfilling their mandate.

For investors 'skin in the game' is a very important concept to understand. If your money manager has none of their own money in any of their recommended investments their motivations need to be carefully analyzed. There could be incentives to take on too much risk so they can receive bonuses or there may be commissions or other rewards involved. This may not necessarily be the case, but by investing alongside their clients, by having 'skin in the game', they provide a sense of fairness and comfort that we are all in this together.