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From the Standards Blog

#20 Predictability and Standards Denial

What is it about human nature and standards, anyway? Consider two seemingly unrelated benchmarks, and the relationship of the typical American to each of these under-appreciated tools.

The first is what is referred to in common parlance as the “calorie” (in fact, the dietary calorie is a “kilocalorie,” properly so called, and is equal to 1,000 of the “small” calories used as a measurement in fuel research). A calorie (small or large) is an extremely precise measurement: the large, economy size, version used in dietary circles is the amount of energy required to raise the temperature of one kilogram of water, at one atmosphere of pressure (itself a precise standard), from 50 to 51 degrees Celsius.

When it comes to thermodynamics, the human body is a machine. It converts fuel into energy, and that energy can be measured in calories. The fuel itself, therefore, can be expressed in terms of the calories of energy it can release in the process of that conversion. Similarly, the body can be analyzed in terms of the amount of energy that is required to keep it running for a given time under stated conditions.

Dieting, therefore, is a pretty simple proposition: If the energy created by the conversion of the food ingested in a day is less than the energy requirements of the body on the same day, weight loss results. Invert the relationship, and weight gain occurs instead. As Ross Perot used to say, “Pretty simple.” Right?

Well, you'd never know that it was this simple today.

Not so long ago (say the 1960s), when you wanted to diet, you bought a little pamphlet that had two tables in it. In the first table, you could look up a given type of food, and find out how many calories were represented by a standard serving size. The second table told you how many calories, on average, a person of a given weight and height needed to ingest to meet 24 hours of energy demand. A deluxe version of the same type of pamphlet might also contain a third table, indicating how many calories a given type of activity (e.g., swimming or walking) might burn up.

All you needed to lose weight was this little pamphlet, based on the humble but precise standard known as the calorie, and a measuring cup. If you wanted to go really wild, you could buy a food scale as well. Oh yes – you also needed something called “will power.”

The second benchmark that we'll examine is the S&P 500 Stock Index. This familiar index aggregates the performance of a representative sample of 500 leading companies in a balanced variety of industries of importance to the U.S. economy. From time to time, companies are added and subtracted to maintain the representative nature of the mix.

The significance of the S&P 500 for current purposes is that it is the index that investment professionals most often reference as the reason that potential customers should come to them to invest their savings. Only by doing so, it is usually said, can an investor provide for adequate retirement savings. Over and over again we are reminded that the 50-year average annual return of the S&P is approximately 11%, and that there is not a single ten-year period in which the S&P did not beat the yield of conservative bond holdings.

So what we can learn from the above is that the only tools anyone really needs to retire in a state of svelte comfort are a simple diet table, a measuring cup, and a no-load S&P index fund. Guaranteed good looks and financial security, all made possible by two simple, well-respected, well-documented standards. Who could ask for more?

Similarly, we also learn that there is no need for either diet books or other types of mutual funds, right?

Let's take a look and see.

Type the word "diet" into the "books" search field at Amazon.com and you'll get 106,154 titles to choose from (as of this writing). That's quite a lot of authors anxious to tell you how to read a calorie chart and wield a measuring cup. But no, calories are passé. The offerings of today's diet gurus range from pure absurdity to more scientifically based diets that, at best, may make dieting marginally more effective.

How about mutual funds? Well, at the end of 2003, there were an impressive 8,126 mutual funds available to the investor trying to beat the S&P 500. In fact, the majority of these funds rarely beat the humble, mindless S&P, even before taking loads and fees into account.

So why is it that we don't stick to simple basics, but are always trying to beat the system? Why is it that we're convinced that if we try something new and different that we can eat more and still lose weight, or invest the same amount to make more?

Why isn't predictability enough?

The answer in part is that dieting and financial investments are huge industries, each of which is intent on pulling more dollars out of our pockets with new gimmickry. One day carbohydrates mean salvation; the next day they're damnation (while we all grow fatter by the day).

So also with investment vehicles: junk bonds, Internet stocks and hedge funds - each gets its season in the sun, each promising a superior road to riches. Perhaps it was only a matter of time before investment professionals and authors noticed the ability of the fashion industry to drive consumers through hemline hoops like trained poodles.

In fact, the example of diets and mutual funds is symptomatic of much behavior in the commercial standards market as well, albeit for more deliberate and calculating reasons.

Standard setting is rife with competing efforts to set standards that will uniquely advantage the proponents of those standards. Witness this week's news that a consortium of investors led by Sony has placed the winning offer - approaching US \$5 billion - to purchase the MGM film portfolio. It is believed that a leading goal behind Sony's bid is to gain the upper hand in a standards war. Once Sony takes control of the thousands of video titles now owned by MGM, it will be more likely that the Blu Ray next-generation DVD specification it backs will win out over the competing HD DVD specification being promoted by arch enemies NEC, Toshiba and Sanyo.

Sony lost a similar standards battle in the same market space in the late 1970s, when its proprietary Betamax video format fell victim to JVC's competing (and many believe inferior) VHS offering. Still smarting from that debacle, Sony appears willing to spend heavily this time around to avoid a similar defeat.

But not only Sony suffered in the Betamax/VHS wars. Video stores and consumers took a beating as well, since stores needed to stock both formats for years, and Betamax owners ultimately were forced to abandon their expensive, and now obsolete, video players. Due to the confusion, vendors and store owners as a group made less money, consumers spent more, and the market matured more slowly.

Wouldn't it be better for all if consumer electronic makers had learned a few lessons from the Betamax/VHS battle? The content owners have - they want a single standard. Which is why Sony is buying up the MGM catalog, so that it can offer that catalog (if it so chooses) only in its favored Blu Ray format, making it a safer bet for other content owners to tip in the same direction.

So what do DVD formats have to do with diets and mutual funds? Unfortunately, it seems to be human nature not to be satisfied with the predictability that standards can offer, whether we're a dieter, an investor, or a consumer electronics manufacturer. Instead of playing it safe and sure, we gamble on a more problematic, and sometimes illusory greater return.

Too many of us are fatter as a result. And too many vendors, as well as investors, are poorer for the same reason.

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Useful Links and Information:

Calorie information:

Typical User-Friendly Calorie Table:
<http://www.bodyfatguide.com/foodcalorie2.html>

The source of most commercial calorie and nutrition tables is the USDA Home and Garden publication Number 72, which includes not only calorie information, but data on fat, protein and vitamin content as well:
www.nal.usda.gov/fnic/foodcomp/Data/HG72/hg72_2002.pdf

Mutual Funds and the S&P 500:

Mutual Funds Fact Book summary of mutual fund facts and figures:
www.financialservicesfacts.org/financial2/securities/mutualfunds/

Standard and Poors' S&P 500 information page:
www2.standardandpoors.com/NASApp/cs/ContentServer?pagename=sp/Page/IndicesIndexPg&r=1&l=E&N&b=4&s=6&ig=48&i=56&si=138&xcd=500

50 year S&P 500 Performance Table:
www.mutualofamerica.com/articles/CapMan/October03/SandP500.htm

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