BERKSHIRE BEYOND BUFFETT: THE ENDURING VALUE OF VALUES BOOK TOUR

BY SUSAN CHRIST, CFA

On November 4, 2014, we attended the book tour for Larry Cunningham's latest book, *Berkshire Beyond Buffett—The Enduring Value of Values* at the George Washington University in Washington, DC. Below are tidbits and snippets from the evening led by Larry Cunningham; author, Henry St. George Tucker III Research Professor of Law and Director of C-Leaf; and Donald E. Graham, Chairman of Graham Holdings and former publisher of The Washington Post.

About Donald Graham

After graduating from Harvard in 1966 and serving a year military tour in Vietnam, Donald Graham was a patrolman with the Washington Metropolitan Police Department. He joined the Washington Post in 1971 as a reporter. He joined the Washington Post Board of Directors in 1976 and served for four decades alongside Warren Buffett as a fellow Board member. Donald Graham works tirelessly on behalf of residents of the city he loves as founder and chair of the District of Columbia College Access Program and co-founder of TheDream.US, a national scholarship fund for DREAMers, created to help immigrant youth get a college education.

On Buffett's Investment in the *Washington Post*

In 1973, his mother, Katherine Graham, appointed him to one of his best jobs--the sports editor of the *Washington Post*. That year, Kate Graham was the only woman CEO of a Fortune ***1,000*** company. It was an "all guys" world, which led to much self-doubt for Kate Graham. One day she entered Don Graham's office with a letter and asked Don, "Have you ever heard of this guy?" The letter was from Warren Buffett, a man Don Graham had never heard of even though Buffett graduated from Wilson High, a public high school in DC. [Buffett graduated from high school in 1946 and attended high school in DC while his father served as a four-term Republican Congressman. Don Graham was born in 1945.] The letter said, "Dear Mrs. Graham, I just bought 10% of your company…" Despite advice to distrust Wall Street types, Mrs. Graham flew out to L.A. to meet Warren Buffett and Charlie Munger. Don described his mother as a good listener, not carried away by conceit, but open to the possibility that someone knew more than she knew about the newspaper business. She returned from her first meeting with Buffett and Munger and told her son, "These men are the two smartest people I've met." Kate Graham obviously has a keen ability to assess intelligent investors. Indeed, the year Don's mother met Warren Buffett and Charlie Munger, Berkshire Hathaway Class A shares sold for $50 per share. The stock recently hit a new high at over $216,000 per share. Seed capital for the partnership that preceded Berkshire Hathaway included $1,000 Warren earned as a Washington Post newspaper carrier.

Buffett – Not only a great investor, but also a great CEO

Don Graham noted that while most recognize Warren Buffett as a great investor, the truth is that he is also the world's greatest CEO. He is extraordinary as a CEO. If you ask Warren, "What have you done?" he would point to Berkshire Hathaway. Warren Buffett and Charlie Munger think through every company policy carefully and personally. An independent thinker, Buffett is less influenced by others than anyone Don Graham has ever known. Warren Buffett never buys anything because someone else bought it. The companies Buffett buys is not what differentiates Berkshire Hathaway, but rather it is what Buffett does after he buys a business that differentiates Buffett from other CEOs. If Buffett likes a business and the people running it, "oversight borders on abdication."

A Sad Chapter for Corporate Philanthropy

Berkshire Hathaway once had a unique philanthropic policy flowing from his respect for Berkshire shareholders as partners. He and Charlie Munger thought through the question, "What is the right way to donate corporate funds?" In contrast to the prevailing corporate practice where company CEOs chose beneficiaries of corporate charitable donations (most often to their own favorite charities), in 1981, Berkshire announced their plan. This plan called for each shareholder to designate charities that would receive $2 for each Berkshire share the stockholder owned. The plan was a huge success, and over the years, the donation amount per share was steadily increased. Eventually, Berkshire shareholders were giving millions of dollars away each year, all to their own causes. A sad chapter in corporate philanthropy occurred when Berkshire Hathaway ended the program after associates at one of Berkshire's subsidiaries, The Pampered Chef, experienced discrimination because of the controversial pro-choice charities Buffett chose for his pro-rated portion of the charitable contribution pool.

On Berkshire Hathaway's stock price
Warren does not care that the stock hit a new high recently as he does not judge his success by price of the Berkshire shares. Indeed, Warren and Charlie would rather not see Berkshire Hathaway shares become overvalued because they want everyone who buys Berkshire Hathaway shares to enjoy success of the companies under the Berkshire umbrella.

About Larry Cunningham
Since 1977, Larry Cunningham has been the editor and publisher *of The Essays of Warren Buffett: Lessons for Corporate America*, the thematically arranged abridgement of Buffett's shareholder letters, which Buffett supports and endorses. Among Cunningham's dozen other books is *How to Think Like Benjamin Graham and Invest Like Warren Buffett*.

Berkshire Beyond Buffett – The Questions
Successors of leaders who excel face the greatest challenges. In the early years, Berkshire was essentially a mutual fund holding large positions in publicly traded companies. Now, most of Berkshire's value comes from wholly owned businesses and is the 5th largest corporation in the U.S. Given his central role and his age, what will happen to Berkshire when Warren Buffett is no longer at the helm? Does Warren Buffett provide the irreplaceable magic touch as described in a 2013 *Dealbook/New York Times* article? Is Warren Buffett playing out his last hand as described in a 2014 *Economist Magazine* article?

Uniqueness of Berkshire Hathaway and Its Shareholders
In his book, *Berkshire Beyond Buffett--The Enduring Value of Values*, Larry Cunningham contends there is something so special about Berkshire Hathaway that it can survive and thrive beyond Buffett's leadership. Berkshire Hathaway epitomizes Buffett's enduring values, which have been woven into the company's culture. This unique culture has attracted shareholders with unusually long-term outlooks. They trade little , pore through Berkshire annual reports and flock to annual meetings. Berkshire Hathaway stock represents a concentrated position in the portfolios of most Berkshire Hathaway shareholders.

Berkshire Hathaway is a conglomerate consisting of a wide range of totally unrelated companies. Berkshire companies vary by industry, size and annual revenues. Measured by revenues, eight Berkshire companies standing alone would be included among the Fortune 500. Company profit margins range from 1% to 24%. Acquisition costs vary from $44 billion for BNSF to less than $100 million. Princely premiums were paid for some Berkshire companies (MidAmerican), while others were bought at the bargain basement (Fruit of the Loom). Berkshire companies are located in 26 of 50 states. Berkshire is an accident built opportunistically. It is a collection of companies that met Buffett's criteria of a basic business selling at a fair price with cultures consistent with Berkshire Hathaway values.

Berkshire Hathaway Values
Always a teacher, Larry put all the Berkshire values into an acrostic spelling BERKSHIRE.

B-Budget Conscious

E- Earnest

R-Reputation

K-Kinship

S-Self-starters

H-Hands-off

I-Investor Savvy

R-Rudimentary

E-Eternal culture

On Thrift
Tom Murphy, the legendary businessperson whom Warren said he has tried to model himself after, epitomizes thrift. During his early days at Capital Cities, Tom Murphy saved money on building renovation by painting only the three sides of the building that could be seen from the road. GEICO – the low cost provider of auto insurance--sells directly to customers thereby avoiding the expense of sales commission. This shaves 10% to 15% off the cost of insurance, which GEICO gladly passes onto customers by capping underwriting profit at 4%. This is not an altruistic gesture. The policy has led to decades of profitable growth.

On Reputation
Warren Buffett often repeats that it takes 20 years to build a reputation and only five minutes to ruin it. To protect Berkshire's $700 million investment in Solomon Brothers, on 8/19/1991, Buffett stepped in as Chairman of the once venerable firm founded in 1910 after it was indicted in a scandal involving the firm's attempts to corner the Treasury bond market. Because of his reputation as a man with high ethics, Buffett was able to talk the U.S. Treasury secretary out of a ban on the firm's participation in the government bond market, thereby averting a potential worldwide financial calamity. Warren often quips, "Until then, the biggest thing I had to worry about was if the Cornhuskers would win this weekend's game." In one of his first actions as Chairman, Buffett gathered Solomon Brothers' employees and admonished them, "Lose money for the firm, I will be understanding; lose a shred of reputation for the firm, and I will be ruthless."

Integrity is not only a moral virtue, but also a business virtue that drives profits. For example, integrity has long been imbedded in Clayton Homes' culture. Clayton Homes' management was concerned about the ability of their customers to pay for their homes. Before the Clayton Home team began the manufactured home design process, they asked, "What can our customers afford?" They then worked to manufacture homes that customers could comfortably afford, which was in sharp contrast to competitors who loaded their customers up with unaffordable debt. As a result, in the wake of the financial crisis, Clayton Homes moved from number four in the industry to number one as competitors either went bankrupt or were acquired by Clayton Homes at fire sale prices.

On Hands-off

Berkshire Hathaway's hands-off approach borderlines unbridled desertion according to Larry Cunningham. Jim Weber, CEO of Brooks, said he has never had so much autonomy in his business career and never felt so accountable and responsible. Many Berkshire subsidiaries, most notably, Lubrizol and MiTek, have long been acquisitive making large acquisitions with little or no guidance from Omaha. These subsidiaries continue to grow profitably. Should managers seek input from Omaha, Warren Buffett is just a phone call away. According to Larry Cunningham, "The lesson: reposing trust and confidence in business managers can be the most effective way to promote desired results."

Berkshire's hands-off culture is in sharp contrast to the leadership of Steve Jobs who was at the center of every major decision at Apple. Hands-off leadership also contrasts with Harry Singleton's approach who set business strategy for Teledyne's subsidiaries thereby making him indispensible to the organization. [During the 1990s, Teldyne was dismantled with about 19 of 150 companies remaining in 1999.]

On Eternal Culture

Buffett is a long-term investor. His time horizon is forever. He has not sold a subsidiary in forty years and will not unless the business is doomed. Many "corporate orphans" are attracted to Buffett and the Berkshire Hathaway umbrella. Managers seeking a permanent home often assign value to that permanence thereby allowing Berkshire to acquire subsidiaries for less than fair value. Further, relative longevity runs throughout the organization. Rose Blumkin, founder of Nebraska Furniture Mart, worked "to avoid the grave" until she died at age 104.

Conclusion of Berkshire Beyond Buffett: The Enduring Value of Values

Creating Berkshire's corporate culture is perhaps Buffett's major achievement. As the new guard leads Berkshire Hathaway beyond Buffett, the core values that define the company will prove to offer unique, sustaining value. While it is hard to imagine Berkshire without Buffett, "it seems wiser to believe in Berkshire Beyond Buffett, an institution that transcends the man."

Tidbits from Q&A

Wired for business, Warren Buffett read every book on investing in the Omaha public library by age 11.

During an interview in May 1991, Buffett announced an off-the-cuff directive to Solomon Brothers' employees that has become embedded in Berkshire's DNA: do nothing that you would not be happy to have an unfriendly, but intelligent reporter write on the front page of your hometown newspaper.

One challenge for Berkshire going forward is what to do with the company's stock portfolio, which is concentrated in seven stocks with billions invested in each stock. While selling those large positions will be difficult, reinvesting billions from the sales proceeds may prove to be even more difficult for the next CEO.

According to Don Graham, Berkshire's compensation policy may change under new leadership. Buffett draws a salary of $100,000. The new CEO will likely be paid much more. Directors currently earn $1,000 per meeting, and they serve without Directors and Officers liability insurance. What will not change beyond Buffett is Berkshire's ability to attract and retain leaders who serve in their capacities promoting growth of their investment in the company. Selection of the new CEO is enormously important. That person will bear a burden like no other. There is zero chance that the next CEO will come from the outside. The next CEO will likely have had a close up view of how Warren makes decisions plus experience running a Berkshire business. One thing will change. Warren has 80 people reporting to him. It is doubtful that the next Berkshire CEO will have that bandwidth.

Both Larry and Don are pretty sure Warren owns businesses he has never visited.

Don Graham recommends that young people buy one share of Berkshire Hathaway stock and attend the annual meeting so they can hear Warren Buffett and Charlie Munger answer questions from 9 a.m. to 4:30 p.m. with only a brief lunch break. When asked about the sustainability of Berkshire's annual meetings beyond Buffett, Larry Cunningham predicted the meetings will be different as the new CEO will likely want to change the meeting format. Most people will still want to attend the meeting where they meet up with scores of friends annually. Many relationships have been developed and nurtured over the years during Berkshire Hathaway's annual meetings.

One questioner asked about the scarcity of women at the top of Berkshire Hathaway and about Tracy Cool, who was recently appointed CEO of Pampered Chef. Tracy, a 30-year-old "whippersnapper", was recruited by Warren Buffet five years ago as a troubleshooter to help companies work through hard times. Larry Cunningham stated that, while there are a handful of female leaders at Berkshire, the company would like to recruit more.

Bill Gates is very active as a board member. The Gates Foundation will have the biggest stake in the flourishing of Berkshire Beyond Buffett. Buffett's Berkshire shares will gradually be transferred to The Gates Foundation by the executor of Warren Buffett's estate in annual increments over ten years. In turn, the Gates Foundation must sell an equal amount of Berkshire shares. Through this mechanism, Berkshire shareholders will not go from having one known controlling shareholder to an unknown shareholder or to no controlling shareholder.

Even though she admittedly knows nothing about business, *Washington Post* editor Meg Greenfield deserves an asterisk in business history. She introduced Buffett and Gates on July 5, 1991.

Don Graham was asked about his thoughts regarding Buffett's advice on share buybacks given the apparent contradiction in Buffett's advice to his mother on share buybacks and that Berkshire does not buy back its shares. Graham said he thanks God Buffett encouraged his mom to buy back Washington Post shares, which was, at the time, a little known way to increase shareholder value. Graham thinks Buffett's view of his shareholders as business partners has driven his decision to refrain from buying back shares. He would not want to buy undervalued Berkshire shares from a fellow shareholder. To level the playing field, some years ago, Berkshire announced it would repurchase shares if they traded below 120% of book value.

One questioner noted that *Snowball* made it clear Buffett's personality was compelling, long before he was rich and famous. Something about Buffett's personality is compelling. What is it? Graham responded that upon meeting Buffett, one knows instantly they are in the presence of someone with a unique personality. Warren has deep relationships with people he is close to. In all the years since 1965, never has a Berkshire CEO left to work for a competitor. Very few even have left to work at another business.

Graham's advice to those who seek to emulate Buffett is to read Berkshire Hathaway's annual reports. The best summary of the letters are found in the *Essay of Warren Buffett.*

Serving on the Washington Post board with Buffett was a great piece of good fortune for Don Graham. If you had invested $10,000 in Exxon in the early 1970s, you would have hundreds of thousands of dollars today. In contrast, had you invested $10,000 in Berkshire Hathaway in the early 1970s, you would have millions today. Buffett's brilliance and his intense focus on business led to those returns. Larry pointed out that while no one can explain Buffett's genius, he has been exceptionally adept at sizing up people which has contributed to his success.