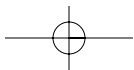
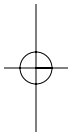
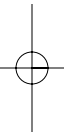
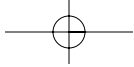


★ *Part One* ★

The Buffett CEO



★ chapter one ★

Introduction— The Warren Buffett CEO

Berkshire Hathaway's chief architect and CEO, Warren Buffett, receives most of the acclaim, but, to understand the company, you need to appreciate all the relatively unheralded operating managers who are part of this huge corporation. More than two dozen books have been written about the world's most famous investor, but, until now, none has thoroughly explored Buffett's management team and its unique culture. This book attempts to capture the essence of Berkshire Hathaway by profiling CEOs who are entrusted with management of its underlying wholly owned businesses.

Berkshire Hathaway (nyse:brka) is a conglomerate known most for its partly owned businesses like Coca-Cola (8 percent), Gillette (9 percent), and American Express (11 percent). Buffett's company is the largest owner of Coke stock.

Buffett made his name and wealth by growing Berkshire from \$40 million in sales in 1967 to over \$40 billion in sales today. Starting with shrewd common stock selections, Berkshire's has transformed itself by buying wholly owned businesses like Dairy Queen (ice cream), Benjamin Moore (paint), Shaw Industries (carpets), and Johns Manville (insulation; see Appendix Two for a complete list).

While this book profiles one partly owned CEO (Graham of *The Washington Post*), the main focus is on the CEOs and businesses that are owned in their entirety.

This perspective is significant for several reasons:

- ★ Berkshire Hathaway is an investment vehicle created by a financial and management genius, but it has now become larger than Warren Buffett. Its diversified units are run by financially independent managers within a flat organizational structure. Berkshire Hathaway has over \$140 billion in assets *without* a typical corporate infrastructure.

- ★ Although long known as Warren Buffett's holding company of publicly traded stocks, Berkshire Hathaway's present collection of wholly owned subsidiaries supersedes its image as a quasi-mutual fund. Not long ago, Buffett's holding company was composed of 90 percent equities and 10 percent operating companies, and everyone was eager to learn what stocks Buffett was buying. Today, Berkshire Hathaway is 70 percent operating companies and 30 percent equities and is striving to be 90 percent wholly owned and 10 percent marketable securities. When it was a much smaller insurance company (it now owns over 30 separate insurance firms), Buffett chose to own parts of large businesses via the stock market so that Berkshire's assets were liquid enough to pay insurance claims. As his company grew, Buffett acquired more wholly owned companies because there was less risk of having to sell them if claims were made.
- ★ Management can easily make a mistake in purchasing common stock. If the CEO has not acted in the best interests of the shareowners, the newly acquired business can be sold fairly quickly on the open market. On the other hand, buying a whole company that has incompatible management in place is difficult and expensive to reverse. Buffett has written: "[We] try to buy not only good businesses, but ones run by high-grade, talented and likeable managers. If we make a mistake about the manager we link up with, the controlled company offers a certain advantage because we have the power to effect change. In practice, however, this advantage is somewhat illusory: Management changes, like marital changes, are painful, time-consuming and chancy."¹ Over 35 years, some Buffett CEOs have chosen to retire, but none has left to join a competing enterprise. All Buffett CEOs are considered partners for life. This remarkable record alone is worth examining. How are the managers selected, managed, evaluated, compensated, and assigned within the corporate parent's structure to ensure such devotion and loyalty? Berkshire has a select group of managers. Primarily, they are centimillionaires who work hard for groups of billionaire board members and long-term millionaire shareholders.
- ★ Most CEOs allocate their own capital and expand their business whenever they can. Berkshire has centralized this function in the

hands of its most talented capital allocator. This unique management structure has led to superior investment and management successes and has proven to be Buffett's finest cultural and structural strategy. It may also account for the low CEO turnover. Most, if not all, of Berkshire Hathaway's underlying businesses have enjoyed steady and increasing employment. Except for its early textile ventures and the current competition from overseas shoe manufacturers, few, if any, divisions have suffered from major layoffs.

- ★ Technology—particularly the Internet and its impact on Berkshire—is worth exploring from the inside. Long a technophobe and bearish on anything that he can't value, including most “new economy” stocks, Buffett has carefully avoided technology-based businesses. FlightSafety is an exception. Recent market performance has shown how difficult it is for Internet companies to devise a successful business model. Still, like the invention of the wheel, the Internet has continued to lower the costs of doing business. Among Berkshire's businesses, it has helped GEICO and See's Candies and hurt World Book. Eventually, it may threaten the *Buffalo News* and the *Washington Post*. Indirectly, the Internet has created more customers for its NetJets fractional jet business. The Buffett CEOs discuss the impact of technology on their various businesses.

What will Berkshire look like after Warren Buffett? The chairman is not anywhere near “retirement,” which he defines as five years after his death, but most shareholders are curious about how the company will look when Buffett is no longer running the show. For clues, if not a definitive answer, this book spotlights the current Berkshire businesses and their managers, one of whom will someday become the CEO of the CEOs. You will learn who these managers are, what business and management principles they endorse, how they have handled the succession issue within their own businesses, and how their companies fit into the Berkshire mosaic.

One fact unearthed during the interviews may surprise you: The operating managers don't know much about the other wholly owned subsidiaries, beyond what is revealed in the chairman's annual letter to shareholders or in media reports. To some degree, you will learn, as did some of the Berkshire interviewees, what their counterparts are doing.

There is no “average” Buffett CEO, but the persons profiled here tended to be white males in their sixties, who were already managing third-generation businesses that are 100 years old. All but one of the managers were promoted from inside the business. Most Buffett CEOs manage “old economy” businesses: bricks, candy, furniture, jewelry, encyclopedias, vacuums, air compressors, newspapers, footwear, and insurance.

Each individual profiled exhibits traits that are uncompromising to Buffett: high ethical standards and integrity. When he put his reputation on the line to save Salomon Brothers, Buffett told a Senate subcommittee: “Make an honest mistake and I will be understanding, but lose the reputation of the enterprise and I will be ruthless.” He has often said, “Never do anything that can’t be printed on the front pages of your local newspaper.”

This book has exclusive interviews with Lou Simpson, the designated backup to Warren Buffett on the capital allocation side. No one at Berkshire will reveal who will succeed Buffett on the operational side of the business, but somewhere in this book is an interview with the person who may one day inherit that major responsibility. Berkshire hires its CEOs exclusively from within, so its future CEO of operations will be a long-term employee.

After Buffett “retires,” his job is to be split among three persons. One family member, most likely his son Howard, will become Chairman of the Board and continue the “Buffett family” atmosphere, influence, and culture. One manager will handle the capital allocation (buying pieces of publicly traded companies and buying wholly owned operating companies), and another manager will head the management team. Essentially, Berkshire will have a Chairman, a CEO/President in charge of capital operations, and a CEO/President in charge of operations.

According to Lou Simpson, the future management of Berkshire will be very similar to GEICO’s present management structure (Lou Simpson is GEICO’s CEO and President in charge of capital operations, and Tony Nicely is GEICO’s CEO and President in charge of operations). This projection describes only the proposed structure, not the individuals who will fill those posts.

Simpson sees himself as a backup to Buffett, not an actual successor. With just six years separating the two men in age, it is unlikely that Lou will succeed Warren. And nobody on the inside has suggested Tony Nicely as the successor on the operational side of Berkshire, but his profile gives shareholders a vision of how things will look in the future.

Berkshire has never sold an operating company or fired an original entrepreneur after buying his or her company. A few have chosen to retire, but most have a passion for the business that continues today and into the future.

Most publicly traded companies force out brilliant managers (like Jack Welch of GE) when they reach 65 years of age, but each one of Buffett's managers, like Mrs. B, can continue to run his or her business unit until age 104 and can then "retire." Like good soldiers, the Berkshire management team is permitted and encouraged—and may prefer—to die with their boots on. Maybe that's why all the Buffett CEOs are smiling.

In the case of FlightSafety's 80-something founder and president, Al Ueltschi, Warren won't split Berkshire's stock but does intend to split Al's age when he reaches his hundredth birthday.

Buffett CEOs do not deal with the responsibilities of typical chief executives. There are no meetings with analysts or with shareholders, no press interviews, no expansion requirements, no limitations on available capital, and no headquarter mandates. These CEOs instantly obtain the highest credit rating and the financial strength enjoyed by only seven other corporations in the world.

Buffett CEOs have the unique ability to focus completely on internal affairs and completely on the long-term success of their business, with no outside distractions. Berkshire managers can report into headquarters as often or as seldom as they choose. One manager never set foot in Omaha until 20 years after being purchased.

Berkshire's unique management compensation system has been led by its chief executive. With a salary of \$100,000 and no stock options, Buffett is the lowest paid of all the Fortune 500 CEOs. All of his managers have higher salaries, and all Buffett CEOs have a direct financial interest in their business. Their compensation plans are simple and are directly tied to the results of their own enterprise.

Don't expect outrageous stories or elaborate business strategies here. The business and management principles are simple:

- ★ Buy pieces of wonderful companies that you intend to keep forever.
- ★ Only consider managers that you admire and trust. Then slowly buy whole companies with phenomenal management in place.

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- ★ Manage your companies exactly as you would a small portfolio of stocks.
- ★ Let the managers continue to do what attracted you to them in the first place.

Even though Buffett CEOs do not know one another and are independently wealthy enough to speak their minds, each CEO, to a person, described Buffett and his influence on them almost identically. If their responses seem repetitive, its because 20 very independent CEOs came to the same conclusions on their own.

This is a fascinating story of outstanding individuals who are led by an extraordinary man. Of Berkshire Hathaway and the Warren Buffett CEOs, Buffett wrote in his 1987 letter to shareholders, “This divine assemblage . . . is a collection of businesses with economic characteristics that range from good to superb. Its managers range from superb to superb. Most of these managers have no need to work for a living; they show up at the ballpark because they like to hit home runs. And that’s exactly what they do. When I call off the names of our managers—the Blumkins, . . . Chuck Huggins, Stan Lipsey, . . . Ralph Schey—I feel the same glow that Miller Huggins must have experienced when he announced the lineup of his 1927 New York Yankees.”²