Warren Buffett

an investography

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It was the year 2006.

Invariably everyone who watched the news flashed on American television channels could not believe what they saw. Others who ran through the same news in the morning newspapers next day were in similar state as well.

After all, they were exclaiming how a person could be so generous, that too in the land that takes materialism seriously. Had they been there in his shoes they would not have done anything similar to what he had just done. It not only needed heart, but bones too. He was the man!

Everybody talked about it in astonishment. People discussed over their dining tables, bedrooms, supermarkets, sports clubs, bars, offices, schools and colleges. The media, for its part, was having its day out.

The news struck millions of people across the globe - not just those in the Unites States. It struck even those stereotyped people who had never bothered to know anything outside their day-to-day affairs. They were struck with a sensation, a sense of disbelief.

Even housewives whose world was within kitchen walls were impressed. They were surprised that a man from a hardcore materialistic and capitalist country like the US dared to do such a thing.

This was the news.

"Most successful investor on the globe and undisputed superstar of stock markets, Warren Buffett, has announced that he would give away some $37 billion to charity. It was not the wealth he inherited from his parents, it was rather a fortune he made from the scratch."

Well, the fortune that was $37 billion at the time he made the announcement rose to $52 billion a year later. That is the specialty of the man we are talking about. After all he had turned a million into billions.

Way back in 1956 Buffett's possession was a mere 100 dollars. That was the foundation, and he got it multiplied into millions and billions. Of course the number of people who held $100 or more at that time in the United States of America could have been in millions. But none of them, not even a single person, had been able to reproduce the success that Buffett was able to accomplish. He was, and still is, one in a million, a kind of folk hero celebrated not only between Atlantic and Pacific oceans, but across the globe.

He neither inherited a fortune nor married for money. His fortune was amassed almost singlehandedly. Interestingly, most of it would go to the underprivileged section of the society through benevolence. A rare species he belongs to that had a heart and guts.

By the way, who is this man Warren Buffett?

Is he an industrialist?

"No"

Owned big software companies?

"No"

Scientist who invented the next BIG thing?

"No"

Glamorous movie star?

"No way"

Politician by any chance?

"A resounding no"

Underworld don?

"Certainly not"

Then, who else is this much celebrated, rather revered Warren Buffett?

He has been the most prominent and successful investor in stocks, and the second richest man on the planet. In business circles and the stock market Warren Buffett is close to god. Small or big, black or white, male or female, homosexual or heterosexual, he has been the role model for almost every investor who ventures into the world of capital market. He is a kind of a divine power that directs many investors like spiritual gurus mesmerize depressed souls.

People who came to know about him, read literatures on him, studied his success and the seemingly effortless path he paved and travelled towards that success eventually wanted replicate him. However he was never a man of any sensation and magnetism like silver screen heroes. He was not a captivating orator either. Yet, he was much celebrated.

Microsoft's chief Bill Gates was the wealthiest man in the world when Buffett announced his decision of philanthropy. Gates foundation was carrying out considerable amount of development programs and welfare schemes. HIV awareness campaigns, aid in the areas of education, agriculture and microcredit are to name a few. It also aimed to eradicate some of the deadliest diseases. It is a big ticket charity business - really big. Foundation's money was mostly spent in African countries, India and many other third world countries. Though there is no denying about the criticism on Bill Gates' hidden and ulterior business motives, there is no second opinion that the money spent through his foundation had produced social improvement on some parameter or the other.

Warren Buffett had been observing the functioning of *Bill and Melinda Gates Foundation* for quite some time announcing his donation, which was going to be the largest charitable gift ever in the US, would be given to the foundation. We have heard about great ancient emperors who generously gave away to the poor and weaker sections of the society from the sovereign fund. Buffett did not have people's (or state) money like any of those great rulers. Everything he decided to gift was made by him, on his own efforts, in his life time, from the word go.

At what has been an unprecedented act of generosity, a magazine came out with a report depicting how big the gift was.

- It could have easily bought 289 most sophisticated luxury hotels in the world.
- The money would have met one full year defense budget of one of the most advanced nations in the world, Germany.
- It was more than enough to meet healthcare needs of Namibia for 50 years.

- India’s largest private sector company Reliance Industries could have been completely bought with that money. Even then few billion dollars would have remained. (this estimate is according to the market capitalization of Reliance at that time)

"This has been coming for 50 years," he mentioned about the decision at the time of announcing it. He also added, "There's never really been any other plan in terms of where the money should go."

If he decided to share is wealth with the people, he could have done it himself. He could have taken the money directly to the people in need instead of handing it over to Bill Gates, and asking his foundation to manage it. Such doubts might surface in one’s mind.

Shortly before the news on donation was out Gates had announced he was to step down from his day-to-day tasks at software giant Microsoft. He commented that he had been working part-time for the Bill & Melinda Gates Foundation and full-time for a company that had made him the richest man in the world, and he wished to reverse those priorities.

This was perhaps the primary reason for Buffett in his decision to distribute it through the foundation. After having thought about charity for many years, Buffett was looking for someone or some organization reliable. The man who was already the richest on the earth would have the least intensions to mishandle the money meant for charity, Buffett might have thought.

One of the terms attached to his donation that either Bill or Melinda Gates, if not both, continued to be involved with the foundation precisely described what he had in his mind. Moreover, the donation was not going to happen overnight. It will be awarded yearly, with 5% passed on each year, it was announced.

Like everyone else, Bill Gates was also taken by surprise with the announcement of Buffett’s decision. It was not the first time Warren Buffett was making a contribution, but the difference was the size that surprised everyone. In fact, it was his support for philanthropy that had persuaded Gates to set up the foundation in the first place.

Gates was obliviously thrilled. Keeping in mind the volume of wealth at stake, he commented, “There is no reason why we can't cure the top 20 diseases.” He, however, was cautious with the remark: "It is a big challenge to make sure this money gets used in the right way."

United Nations spent around $12 billion for this cause annually. Warren Buffett's donation was at least three times larger than this. It was larger than the corpus of Bill and Melinda Gates foundation that it already managed.

Rest of his wealth, after the donation, would go to Buffett's three children and the charitable trust running in the name of his late wife Susan Thompson Buffett. Not a bad dad, of course!

Generally people leave behind substantial part of their wealth to their children. Remaining part, normally very tiny portion, would go to charity. But Buffett did exact opposite.

Why did he do that?

And more importantly, how did he turn his $100 into multibillion dollars?

What was the magic behind this otherwise impossible success?

2. Millionaire Dream

Year 1930 was like every other year in history between the two world wars.

Many children were born that year. The history of twentieth century reserved very important places for two of them.

One was Neil Armstrong. He was born on 5th August in 1930. Rare opportunity in the history of mankind, to be the first human being to land on the moon and herald a new chapter of technological development and improvement in the way civilization functioned, was waiting for that child. An irrevocable and undeniable position in the history of human race awaited him. As they say, rest is history. But that is not our point of discussion here.

Twenty five days after Armstrong was born, another child arrived on the earth in the same country, United States. His name was Warren Buffett.

On that August 30, no one would have envisaged even in their wildest fantasies that the little one was going to amass unprecedented wealth and fame, not only in the U.S, but around the globe. He was born and destined to make a name in the history for himself.

Forefathers of Warren Buffett originated from France. Many generations ago they had migrated and landed on American soil. After having indulged in vocations such as weaving and cultivation, they were finally into trading and business.

Earnest Buffett was the name of Warren Buffett's grandfather. He developed misunderstanding and conflict with his brother when he was young. It was so serious a conflict that he named his grocery store 'Buffett & son', instead of 'Buffett & sons', and thus ignoring his brother.

Warren's father Howard Homan Buffett did not find his father's grocery business interesting. He chose different career options. For some time he was working as the editor of *Nebraska Daily*. Later he found a job at a bank.

Leila Stahl was Warren Buffett's mother. She hailed from Nebraska's rural area and grew up there. While working at *Nebraska Daily* she got acquainted with Howard Buffett. They were attracted towards each other and eventually got married. Leila delivered a girl baby in 1928 and named her Doris Buffett.

Unites States witnessed an unprecedented economic turmoil in 1929. Its worst effects are still recounted in one way or the other. Historians and economists still refer to it as ‘Great Depression’ since it represented a period of contraction in American economy. Many people lost their jobs, for none of their mistakes. Majority of industries and businesses were shut down. People even struggled for three square meals and had little means to provide for their families. Stock mark fell sharply. For three years it continued to slide with so signs of bottoming out, let alone recovery. This period also saw increasing number of suicides.

It was during this phase of turbulent economic condition Warren Buffett was born in the year 1930. Two weeks before he turned one year, the bank in which his father worked was closed down. Howard Buffett found it hard to get another job. People looking out for work outnumbered the vacancies available. There was no question of finding a job of one’s choice and ability. Warren’s father found it hard to run the family and provide for it. Even food seemed to be a problem. Fortunately for them Earnest Buffett, Warren’s grandfather extended help by supplying grocery from his store. That did not last long, while recession lasted.

The grandfather was a strict businessman. After having waited for some time he insisted that his son paid him the dues he owed. Howard was forced to do something. He made a bold, rather strange, decision at the time. The decision was to become a stockbroker. The building where his bankrupt bank operated remained empty. So he established his office in the same building.

But he had a risky proposition. After all the stock market was having the worst time in the history of US economy. People shied away from investing in stock market and owning shares. Trade volume was not encouraging at all. Most of the days, he would get into his office and hung his hat and coat. There was virtually no business. The trouble did not end there for Warren’s father.

Earnest Buffett, Howard’s father was a big merchant and influential person in town. He was Omaha Rotary President and advised members of the club that his son did not know much about stocks. He suggested them not invest with him. Even if Howard could get one or two clients, they decided to backtrack thanks to his father.

There have always been fathers in this world who never accepted any new and unconventional initiatives that their sons take. Few unfortunate people are born to such fathers. Warren’s grandfather was one such a father. That was good enough reason for Howard to resolve himself that he should be a role model for his children, unlike how his father was to him.

The economy slowly started picking up. By the time Warren started attending school his father’s stock broking business improved considerably. It improved so good that he even shifted his office to a larger building.

Howard neither had the habit of drinking nor smoking. He was matured man with right values, high ideals and humanity. Investment made by one of his customer did not do well once. The customer lost his investment value that resulted is loss. Howard paid off that loss from his pocket despite the fact that there was no obligation to do so. He was very different kind of businessman, very different from his father.

Bad economic position and subsequent humiliation in his childhood years deeply affected young Warren. The seed that he would amass huge wealth when he grew up got planted in his tender mind. That thought and resolve never deviated, never declined. It only increased as he grew up. His desire was to become very very rich.

His first business attempt began when he put up a gum stand on the family’s side walk where he sold chicklets. He was only 5 years old then. At that time he had a friend by the name Bob Russell. Bob’s house was so situated that the traffic by it was more than that of Warren’s house. He opened a lemonade store in front of Bob’s house. He even told Russel’s mom “*what a shame you aren’t making money from the people going by?*” She eventually revealed it to the media some good fifty years later.

When he turned six, Warren entered into a business agreement with his grandfather. It was a business that suited his age. He purchased 6-pack coca cola from the grocery store Buffett & Son, owned by his grandfather. He went door to door and resold each bottle for a nickel (5 cents). When he was done with the pack, he had 30 cents at his hand which included a cool profit of 5 cents. As he was born in a mercantile family, Warren thought and behaved like a businessman right from his early years.

At the age of seven he was hospitalized. He had to undergo appendix surgery. Everyone feared that he would die. His father bought him all the food items Warren loved. East or west, people and love remain the same. People make a genuine attempt to ensure that their loved ones don't die with unfulfilled desires. But Warren's desire was not in food items.

He told nurse, "*I don't have much money now, but some day I will and I'll have my picture in the paper*" Amount of conviction he had at seven simply separated him from rest of the crowd.

He took a sheet of paper and articulated how fast his wealth would grow and how soon he was going to be a millionaire. The sheet was full of numbers.

Warren read a book on stock market investment when he was eight years old boy. Author of the book was none other than his own father - Howard Buffett. At Howard's broker office Warren did errands. He helped in writing share prices on the board. He drew price charts. Introduction to stocks happened very naturally for little Warren Buffett. There was another stock broking firm in the same street by the name Harris Upham Brokerage. By seeing the enthusiasm Warren had they also let him write stock prices and draw charts.

Howard took his son to New York City when Warren was about ten years old. They travelled by train and roamed around the city. It was a new experience for the boy. He saw the New York Stock Exchange building for the first time and stuck by amazement. The symbol of American capitalism where businesses were gauged for their financial performance left a durable image in his mind.

Like everyone else's curiosity while investing in stocks for the first time, Buffett was thrilled too when he purchased 6 shares of Cities Service preferred stock. He held three of them and remaining three was for his elder sister Doris. When he made this maiden investment in shares in the year 1941, he was just eleven.

"*I made my first investment at 11. I was wasting my time before that*," he told in an interview later. We may be wrong if we completely disregard that statement as a joke. He meant it.

For each share in Cities Service he paid a price of $38 when he bought it. The price dropped to $27. Buffett became desperate. Luckily it improved and came back to $40. Warren and Doris wasted no time in selling it off. They felt relieved. Warren made a profit of 5 dollars after broker commission.

True, he earned something in that transaction. But it was his learning, rather than his earning, that helped him most. Almost immediately after he and his sister unloaded their holding, the stock shot up over $200 a share. He learned his first lesson in the share market. If the investment is made in a sound business, it pays off to hold on for a long term instead of booking quick profits. This lesson also formed the fundamental principle upon on which his resounding success as an investor was based.

Failure or lesser than anticipated degree of success in the first attempt should not demoralize a person. Nor should a person quit trying. Each incident is an experience and each failure is a lesson learnt. Mistakes are not wrong at the outset, but repeating the same mistake second time without making any attempt to learn from the first certainly is.

The lesson Warren Buffett leant with three shares helped him develop the kind of maturity and ability to remain cool and rational even when his investments ran into $3 million and $30 million in size later on.

This event also emphasizes another important aspect of life. In any walk of life, if a person starts getting himself involved at a very early age he will get lot of time to correct from his mistakes. He will have the time for *trial and error* based learning. He can afford to learn from his mistakes because the time and age will be on his side. Pure academic knowledge is no substitute for practical experience. Warren got this wisdom at as early as 11 years of age.

On a Sunday morning in December 1941 Japan attacked Pearl Harbor. That was more than enough for the United States to jump into the Second World War - directly. Whole nation was behind President Franklin Roosevelt who enjoyed an unmatched popularity as war hero. Republican Party was looking for a good candidate in Nebraska State to file against Roosevelt’s party. Warren’s father Howard was identified as the candidate for the Republicans.

Howard Buffett spent minimum amount of money in 1942 election campaign. He was not expecting to win the election. The day before the results was to be announced; he prepared a speech congratulating his opposition candidate, but the result was otherwise. Quite unexpectedly, even for himself, Howard Buffet won the election from Nebraska district to the U.S. House of Representatives.

Entire family celebrated this news. They rejoiced. For Warren Buffett this was not a good news. Having won the election, Howard should shift to Washington to attend the House of Representatives to represent the people that elected him. That meant that his family had to shift along with Howard. Going to a new place leaving all the friends and the home where he grew up was something that failed to impress twelve years old Warren. The poor guy, however, had no choices. (*It is a rarest opportunity to quote Warren 'poor'*) He looked uncomfortable in the photo taken after his dad won the election.

Howard could not find a house in Washington. So he rented a house in a remote Virginian town, some fifty miles away from the capital. The house stood on a hill, something like movie setting. That is what Warren's younger sister Roberta felt. She remarked, "*like something out of the movies,*" years later.

When the family lived at this beautiful house, Howard stayed at a hotel in Washington discharging his government duties. Warren and others had to be away from him for the whole week. Howard visited them during weekends. Missing his father most of the time and loneliness were boring Warren. He started hating that place and felt terribly homesick. He was dying to go back to Omaha, exploring ways and means to get approval.

Warren Buffett complained that he could not sleep in nights and also he had problem in breathing. He kept standing in the nights without sleeping. While continuing such tricks in one direction, he also moved coins in another direction as well. He wrote a letter to his grandfather in Omaha, Nebraska, saying he was unhappy. Earnest decided to grant his grandson's wish. He wrote back asking him to come back until his 8th grade in Omaha.

That was good enough for Warren Buffett.

He shifted back to Omaha and stayed away from other members of his family. He spent most of the time with his grandfather Earnest Buffett and aunt Alice. She was an economics teacher at a local school. Alice showed unbounded love and care towards her nephew. Warren himself liked her pretty much and her effect on him was quite obvious. Few years later, when Warren decided to honor selected preliminary school teachers in Omaha, he named the award after Alice in her memory.

During this period when Warren shifted back to Omaha, his grandfather was writing a book. After coming back from his grocery shop he would dictate the content during evening hours and the grandson inscribed it as Earnest dictated. In his 1985 annual letter to his shareholders, Warren recalled this as: "*A grocer by trade, he was also working on a book and each night he dictated a few pages to me. The title - brace yourself - was 'How to Run a Grocery Store and a Few Things I Have Learned About Fishing'*".

About Earnest's effort warren continued, "*My grandfather was sure that interest in these two subjects was universal and that the world awaited his views*". But none of the grocer's books came in print. Nonetheless, his efforts and narrating style greatly influenced young Warren.

It was not only his grandfather, but also his father Howard Buffett, who wrote books. His subject was stock market. No wonder, Warren had the exposure about stocks and stock market at a very early age. More so was the ability to effortlessly articulate his ideas in simple language with conviction, which he inherited from his father and grandfather.

Buffett had great love for number, statistics and mathematics even when he was young. Population details of major American cities were at his fingertips. This invariably wowed his friends. He was a master especially when it came to matters such as the correlation between annual rates of return of one's investment, number of years invested and the future value.

The son of first time congressman had a good time Omaha with his old friends and other familiar people. He did not stop visiting his own friends alone. Warren also frequented to the homes of his father's friends at their hometown. Around that time he had just crossed thirteen years. Howard's partner in his erstwhile stock broking business had invited Warren for lunch one day. During casual talk he declared them, rather decisively.

"*I will be a millionaire by the time I turn thirty, or (I will) jump off the tallest building in Omaha.*"

This was the bet, but he knew exactly what he was talking about. Right from his childhood years he hadn't had the habits of making pledges out of emotion and ego. He had that unique gift to detach emotions and get directed by rational thinking. Of course he was not unaware of the fact that he was not going to be alive if he jumped off the tallest building in town. If that be the case, how silly was it to pledge his life for his goal? What encouraged him to make such a risky proposition?

Simple! The question of probability of success comes only when someone does things beyond his control, in other words things over which he has little knowledge. When one is committing himself into matters that he is fully aware of, then there is no room for doubts. Outcome is positively certain. Warren Buffett firmly believed that he was going to be a millionaire at his thirtieth birthday.

He did not have the habit of making empty promises for the sake of it. It was difficult to indulge him into things he did not know fully and matters in which results were uncertain. Many years later, he was on an outing with some of his golfing buddies at Pebble beach, where the group offered him a bet. He couldn't score a hole. The men agreed to pay him $ 20,000 if he could do that. On the contrary, if he failed, it was enough if Buffett paid them just $10. On top of this highly skewed wager, they also offered him three days to practice.

Warren Buffett did not need three days. All he needed was few minutes which were enough for him to decide. He turned down the offer. As one of his buddies recalled the event, "*he thought it over and decided it wasn't a good bet for him. He said if you let yourself be undisciplined on the small things, you'd probably be undisciplined on the larger things too*"

By 1943 Warren's father spotted a house in Washington. In the same neighborhood lived Richard Nixon, future vice president and president of the country. Howard moved his family from the remote Virginia town to

Washington. Warren ran out of ideas he had developed to stay away from his parents back in Omaha. By fall that year he had no other choice, but to move to Washington unwillingly. Thirteen years old boy did not know then that his stay at the capital was going to be a turning point in his life.

In Washington Warren Buffett did not waste his time in amusements. He decided to deliver newspapers door to door. His bicycle carrier had both *Washington post* as well as *Times Herald*. Both the dailies were competing with each other. If his customers did not like one of them, he offered them the alternate choice.

All these might sound strange and weird for the people in this era where the bragging of little known local politicians and their sons are notoriously infamous. The news that the son of a representative in the US congress was delivering newspapers is somehow inconceivable, but that is what Warren did.

Along with daily newspapers, he also sold weekly magazines. He earned $175 a month. That was sizable money in the US those days. Not many working adults made so much money. Buffett was just a school going kid.

During this period in his life, the teenager fared badly in his studies. This could be attributed to his complete concentration in newspaper delivery. School principal summoned his mother Leila and warned to regularize her son. It had a telling effect at home which irritated Warren. He and another boy, son of another congressman, ran away to Hershey in Pennsylvania State.

The house Howard had arranged for his family before they joined him in Washington was in Virginia, which was south of the capital, whereas this place in Pennsylvania was on the opposite direction. Hershey is some 130 miles north of Washington. When they both were roaming around as strangers, policemen arrested them. However they were let go due to their innocent looks. Then they returned back to Washington.

His father was obviously upset and angry with Warren.

Howard was a good father. He wanted his son come up well in life. Warren was warned. He had to get good grades in school or he should forget his newspaper distribution business. Warren took it as a challenge and paid attention to his studies. Nonetheless that did not deter his business as paper delivery boy. In fact it thrived. He delivered newspaper at 500 houses through his bicycle, and did it seriously and sincerely. For instance, he would recite the subscription renewal details even if was waken up from deep sleep. He reminded his customers in advance so that they renewed their subscription without fail.

On those days it was very common for people to shift houses quite frequently. That was a potential risk in his business. He would incur loss when someone moved midmonth. To overcome this risk, he befriended with security men and lift operators, and delivered them complementary copies. In return, they kept Warren informed when someone was about to shift their houses. This business tactics worked well in his favor.

Real purpose of him earning money this way, toiling in the chill, at the threshold of his teenage years was not to spend it as he desired. He rather wanted to use it as the foundation for his future financial success.

Warren Buffett filed his income tax returns at the age of thirteen. He deducted $35 for bicycle as business expense. His returns document ran into three pages. He sent a check for seven dollars and posted it to United States Treasury. Children of his age were playing hide and seek in their backyards. Warren Buffett, however, was taking shape as a businessman, slowly but firmly.

When he turned seventeen years, Warren did something unique for his age. With $1,200 he had accumulated by distributing newspaper he purchased 40 acres of agricultural land in his home state Nebraska. He rented it to farmers, but he was not convinced to be complacent with the rent he earned this way. His quest did not diminish.

Warren and a friend of his, a judge’s son, bought a pinball machine and installed it at a barbershop. It was like how videogames are today. The primary objective of the game is to score as many points as possible. In the coin-operated pinball machine, a player attempts to score points by controlling one or more metal balls on a playfield inside a glass-covered case.

For buying and installing this machine, Buffett and his friend spent twenty five dollars in total. They entered into a 50:50 agreement with the barber. Our little businessmen earned $50 every week from this machine. They also called this business initiative as '*Wilson Coin Operated Machine Company*'. Warren was just fifteen then. Within no time, he installed three more pinball machines at various other barbershops. Sometime later in the year they sold the business to a war veteran for $1200, a cool deal that turned $25 into $1200.

The boys did not stop there. They developed a formula in spotting the winner at the racetrack by preparing a horse-racing handicapping sheet and sold it under the name Stable-Boy Selections. It was a huge success amongst gamblers. But the law needed them to obtain license for such businesses, so they gave it up without continuing any further.

3. Where to work?

For a kind of boy Buffett was, there was too much inclination towards indulging in business even at that age. Studies had never been a big interest for him. Of course, it was not about his ability to be a smart kid at school. Rather it had to do with his interest and application in studies. Due to his excessive curiosity in the world of business he thought it would suffice to be an ordinary student, by just attending school and tiding along.

At a time while his fellow classmates were busy with exotic news on the sport page in daily newspapers, Warren Buffett scanned through business page to get him updated with the happenings in business world. He also paid great attention to the share prices of various companies listed on the exchange. Some of his teachers, who taught him at school, also sought suggestion and clarification from him about share market. Most of the times he helped them by answering their queries, but on few occasions he scared them by saying that the companies they invested would go bankrupt soon.

By 1947 Buffett was a youthful seventeen years old teenager. He had completed his high school. Thanks to his newspaper distribution service and other business initiatives he had accumulated nearly $5,000 then. He further wished to indulge in some business as he was not too keen attending college and earn an academic degree after his name. Instead of sitting idle in the classroom he could do something constructive, he thought.

His wishful thought, however, did not materialize. Due to the pressure from his parents he had to sell out his otherwise successful business of operating pinball machines. His father persuaded him to attend the famous University of Pennsylvania at Wharton business school, which he had to agree. But he believed that it was a waste of time. As long as Buffett studied there he kept complaining that he knew more than the professors who taught in the classroom.

On the day before the exam, he would sip a coke bottle and scan through the book open for few hours. That was enough for him to effortlessly score A+ grade in the exams.

On few occasions, Buffett dated female classmates on few occasions at Wharton. He was anything but interesting for girls though. Nothing went serious. So he came to a conclusion soon that he could spend his time usefully and constructively, instead of wasting it on dating.

He attended that business school only for two years. This could be attributed to 1948 elections in which his father was defeated. Whole family started moving back from Washington to Omaha in Nebraska. It was an opportunity which Warren capitalized as he also wanted to go back along with his family. After two years at Wharton, Buffett transferred to his parents' alma mater, the University of Nebraska in Lincoln, for his final year of college.

His urge to do something outside his academic chores did not subside while at the University of Nebraska. He took a job the Lincoln Journal and his job responsibility was to ensure the delivery of the journal in six rural counties. Buffett supervised fifty paperboys who did the actual delivery. Despite spending most of his time at his part time job, he successfully completed his studies. As a matter of fact, Warren Buffett graduated well ahead of the stipulated time.

Now, Buffett was a holder of a Bachelor degree. On the other hand, his personal wealth stood at $9800. Going forward he only attempted to explore various options in business that he could pursue. Elders in the family thought otherwise. They insisted that he should study further. For their satisfaction he applied for masters degree at Harvard University. The famous university with its three hundred years legacy refused to admit Warren Buffett stating that he was under-aged. At that time he was nineteen years old. He was advised to come back after one or two years when the university could decide again.

Every challenge opens up an opportunity. This bad news resulted in good things for Buffett. It can be said that the Harvard University’s decision was an important event and turning point in his life. Had Harvard not declined his application, he would not have applied for Columbia Business School in New York City.

Strangely, Columbia Business School had something special that was missing at Harvard. Benjamin Graham, widely acknowledged as the father stock market and security analysis, worked there. He was teaching what he was known for. The business school kind of served as a launch pad for Buffett that he would develop key principles on which his success and life as one of the most talked about investors.

Even before joining Columbia Business School, he knew about Benjamin Graham. Only a few days before his admission he had read an everlasting book titled *Intelligent Investor* authored by Graham. In Buffett's opinion it was the best book written in the subject of share market. It's a bible. One can be an atheist, but when it came to stock market 'Intelligent Investor' is the bible.

One of Buffett's classmates who later managed Sequoia fund recalled that there was an instantaneous mental chemistry between Graham and Buffett. The Bonding between them only strengthened over the years. If there was anyone who interrupted Graham during this lectures and asked questions, it was only Buffett. Rest of the class primarily remained as audience.

There were almost twenty students in Graham's class. Most of them were elder than Buffett by many years. Some of them already worked in Wall Street. As everyone knows, Wall Street is synonym of America's capital market and nucleus of its capitalist economy. It is a street in Lower Manhattan, New York City, where the New York Stock Exchange is located.

Before anybody in the class could recall Graham's question and think about answering it in the class, Buffett would raise his hands. Graham was anything but an academic person. He always respected the idea that more than one 'right' answer to every question could exist. He never branded the answers as 'right' or 'wrong'. Every time Buffett answered his questions, he probed the reasons behind such answers. He also enquired about his student's thought process of approaching problems. Graham was so atypical that he encouraged bringing the universe inside the class. Perhaps it was only Warren Buffett who fully appreciated his views and benefited from them immensely.

Other teachers confined their preaching with the principles and phenomenal theories from textbook. Benjamin Graham was different as he quoted real time examples with the securities trading in the market. He was never concerned about revealing secrets. It was immaterial for him even if some shrew students leveraged on his idea and made money. He taught every technique he knew and committed to develop his pupils. More than accumulating wealth, the intellectual challenge that the investment world produced and the exhilarating fun in dealing them seemed more important for Graham.

Highly intelligent people are sometimes careless on trivial matter and quite obviously too. Graham was no exception to this rule. He was absentminded and generally careless on matter outside his circle of competence. Once he came to work in shoes of different colors. Graham, who was with his wife number three when he taught Warren Buffett at Columbia, would sleep with a notepad by his pillow so that he could note down the ideas occurred to him before he forgot them. He discussed themin the classroom next day.

Warren Buffett was very popular in the class at Columbia Business School. Understandably, he was the only student who got A+ grade in Graham's class. In his twenty first year of existence, Buffett graduated with his master degree in economics from the university.

He firmly believed that real and purposeful education did not stop with schools, colleges and universities. Also, he did not prefer working for anyone else. Simply speaking, he did not prefer to be a slave, at least economically, to some unknown master. Still, he reached out 'Graham-Newman' company run by none other than his mentor Benjamin Graham. He offered to work freely since he only needed the practical experience of working with Graham. The mentor, however, turned down his pupil's offer.

He had his own reasons and the reason had nothing to do with Buffett and his abilities as assessed by Graham.

Benjamin Graham was a Jew. (He was born in London and subsequently migrated to the U.S.) Jews were generally hated during that period in America. Not many employers offered Jews any positions. For example, Morgan Stanley did not hire any Jew till 1963. It was good enough reason for Graham to hire only Jews in his firm. Warren Buffett had to listen to what his mentor said.

At home, Howard Buffett strictly told Warren not to turn in the direction of Wall Street. Howards himself had struggled during 'Great Depression' when Warren was born. He was fully aware of the uncertainties associated with the market. So it was understandable that he suggested his son to go after some other job that ensured stable income instead of stocks that were subject to fluctuation.

But, do you think Warren Buffett paid heed to this advice?

4. New Avatar

Even though Benjamin Graham refused to take Warren Buffett in, he offered his student some valuable suggestion. His first advice was not to work in the Wall Street in New York City. Second advice was all the more important. Stock market had risen sharply then and hence it was not prudent to invest until it came down reasonably, according to Graham.

The Dow Jones Industrial Average (DJIA) is the index that reflects the prices of 30 largest companies by market capitalization that traded on New York Stock Exchange (NYSE). Ever since its inception, DJIA had never gone past 200 points. But in 1951 it touched 250 points making its all time high and also making Graham cautioning Warren Buffett.

Buffett carefully considered the warning. Of course he did not blindly accept what his teacher told him. He rather weighed the advice and assessed the prevailing market situation rationally. Then, he decided to take his own course.

He was sure about one thing though. After Graham declined to hire him, Buffett found it hard to accept anybody as his boss. He severed his stay in New York and left for Omaha. Upon landing there, Nebraska National Bank offered him a job, which he declined. Instead he chose to work for his father. In Howard's stock brokerage firm Warren took up the role of salesman.

When Warren started working there, a friend asked him if the firm would be called 'Buffett & son'. Reply was instant. "No, it would be called Buffett & father," said Warren. His sense of humor was apparent on so many occasions.

Apart from his role as a stockbroker, the twenty year old also started investing the money he had accumulated so far. During this initial period, his investment was mostly limited to Texaco gas station. He also put his money in real estate. Neither of them was successful.

Warren was good at face to face debate. It was like a cakewalk for him. But to address a crowd his limbs would start shaking. He badly wanted to get rid of this fear and joined Dale Carnegie public speaking course. It cost him

$100.

It is very hard to find a person like Warren Buffett when it comes to frugality. He believed thrifty as a great virtue and he practiced what believed strongly. Such a hardcore thrift spent 100 dollars! You got to believe this. Rather than seeing it as an expense Warren viewed it as an investment.

Years later he recounted it, "*I did not take the course to prevent my knees from shaking when public speaking..but to do public speaking while my knees were knocking*"

But why would a twenty one year old stockbroker need to develop his public speaking skills? Public speaking, as an art, was not that necessary to be a good broker or successful investor. On the contrary, Buffett had some unique goals set in his mind. Perhaps he envisioned that the whole world would one day listen to what had to say.

That day was not going to be soon. But he did not wait for long time to practice his public speaking skills. So he started conducting evening classes at the Nebraska University in Omaha. Wide range of knowledge he had acquired from Benjamin Graham and the self-confidence he attained from the recent public speaking course came in handy. Buffett taught the subject '*Investment Principle*' in the evening classes.

Interestingly, most of the students who attended the class were in their thirties and forties, whereas the teacher himself was in his early twenties. The average age of the students he taught was twice his age. Many of them were doctors. Students, who first underestimated Buffett forhis looks and age, realized soon that he was a man of substance. His lectures were simply captivating.

He explained about the share market in simpler and interesting language that the people whose world was filled with disease, medicine and treatment soon began involving. He delivered lectures and explained the principles based on the book 'The Intelligent Investor'. He spiced it up with stories and words of wisdom, and the crowd was as mesmerized in his lectures as the devotees of spiritual gurus.

He was unlike Graham when it came to teaching method. Buffett did not give any stock tips like his teacher did in the classroom. Not only did Buffett not give tips, he also advised the class not to take tips from anyone else. He warned them not to invest based on the recommendations they received. In particular, he cautioned them to be careful with stockbrokers. Interestingly, he himself was a stock broker – working for his father. That was Warren Buffett.

He worked at his father brokerage firm during daytime and in the evening he was busy conducting classes. On top of these, he was also busy with something else. It was something that keeps every twenty one years old youth busy.

Buffett saw a girl, Susan Thompson, in his neighborhood. He was attracted to her the moment he saw her. But he was not an expert in talking to girls, leave alone talking in a manner that impressed them. Despite multiples attempts, Susan did not develop any interest in Warren.

Their families lived adjacent. Susan's father was a psychology professor and held important position at Omaha municipal council. Families were so close that Susan's father campaigned for Howard Buffett when ran for the House of Representatives. Moreover, Warren's younger sister Roberta and Susan were roommates in college. These were not sufficient enough to get into the heart of a girl at Susan's age.

She did not enjoy Warren's seemingly intelligent talks and silly jokes. On many occasions she slipped away silently through the backdoor at the indication of him entering her house through front door. She was so desperate to void him.

There was another understandable reason for her to avoid Buffett. She went out with a guy by name Milton Brown, son of a Union Pacific mail handler. Susan was crazy about him. He dated her during high school which continued at Northwestern University.

As there is no substitute for mad love, it did not make sense for Buffett to compete with Milton. According to his theory, problems ought to be handled through unconventional approach. It was rather easier to gain her father's approval instead of getting approval from the girl. The psychology professor was found of mandolin, he played it since he was twenty. Buffett knew about it and learnt to play the instrument. He would visit Thompson's house and play with his would be father in-law, who was thrilled to have someone who could play the instrument with him. Buffett did that almost every evening, while Susan went out with her boyfriend Milton Brown.

Buffett waited for an appropriate moment. That paid off well. Very soon he won the confidence of Mr. Thompson, who held him high. Susan was asked by her father to go out with Buffett. Susie looked up to her father and respected his judgment.

At some stage, differences surfaced between Milton and Susan. Their relationship eventually broke up. Father had successfully changed daughter's perception about Buffett and made her realize what mattered most in life. As she got acquainted with Buffett, she came to realize that he was a sweet person. They liked each other, almost without any external influence.

Warren had carried his childhood memories - mostly that of his upsetting mother - with him, which were partially responsible for him keeping distance from girls. He was a changed man now. In return, she fully understood him and his emotional needs. In return Warren fully surrendered himself to her.

In the year 1952, Warren and Susan Thompson got married, and she became Susan Buffett. He rented out a three bedroom apartment for $65 a month. Though he was telling that he would be one of the wealthiest men in America, the house was in bad condition. Along with Buffetts, it also served as home for several mice. They crawled into the shoes at night.

In that house, the couple had a daughter. Warren named his daughter Susan, same as his wife. He adored the little one as 'little Susie' and the mother as 'Susie'. Around this time, he was very particular about money. In an effort to save money and as mark of his frugality, he made a bed for his daughter in a cupboard drawer.

All these days, Warren was still working for his father. In his role as salesman, the talent to analyze stock was getting wasted. Even when he identified great investments, he got little commission. Some customers patiently listened to his ideas and suggestions, but bought them through other brokers.

While his life was running like this in Omaha, lady luck unexpectedly knocked his door one fine day. Buffett's mentor Benjamin Graham sent a message to him conveying that he has relaxed his earlier decision to hire only Jewish people. The message also said that Warren could work for Graham in New York if he preferred. That made 1954 a special year for the newly married Warren Buffett.

Even before Warren asked about salary, Graham offered to pay $12,000 an year. The student could not have asked for anything better than this. Filled with unexplainable excitement, Warren Buffett flew to the New York City with his wife and infant daughter.

5. Handholding – Ben Graham

Benjamin Graham was Warren’s teacher, who refined Warren’s investment principles. It was him who channelized his raw energy. It was him who gave direction, purpose and methodological approach in his journey as an investor. In short, there is no Buffett without Graham. That makes it imminent to know about the teacher himself before continuing with the pupil.

Graham was born in 1894 in London. When he turned one, his family moved to the United States. His father was running a business selling imported goods from China. Unfortunately he passed away when Benjamin was nine.

Benjamin was not born as Benjamin Graham. His name at birth was Benjamin Grossbaum. During the first World War(1914-1917) Grossbaums became Grahams as Grossbaum sounded obviously Jewish. General hatred towards Jews was very high then.

Graham’s childhood was full of struggle. He had lost his father at a very early age. Her mother had put all her money she had saved in stock market, which got wiped out in 1907 crash.

Young Graham took odd jobs to support his living. It did not deter him or his education though. He excelled at Boys High School in Brooklyn and also entered Columbia University. When he graduated in 1914, the University offered him positions in three departments, English, mathematics, and philosophy. He thought otherwise, declined those offers and walked towards Wall Street.

Benjamin Graham’s unique approach differentiated him from rest of the crowd. He had a safe approach that was based on solid principles. Still, the Great Depression that began in 1929 tested his principles. He was devastated, like everyone else in the street. Market moved in one direction - downwards. The worst continued to worsen. The story goes like this.

He lost 20 percent of his investment value in 1929. Next year (the year Warren Buffett was born) he thought the market had bottomed out and invested with borrowed funds. But the decline continued.

Stock market continued to fall till 1932 without any real support. As far as Graham was concerned, 70 percent of his wealth was wiped out. The father of capital market investment was almost bankrupt. His wife went back to work as dance teacher.

At the time Graham decided to quit, his partner Jerome Newman was helpless too. It was then one of Newman's relatives put up $75,000 capital that allowed the firm to survive. During this time Benjamin worked for five year without a salary. Despite these inconveniences, he authored a book, titled *Security Analysis*, with David Dodd. The book laid a foundation to what would later be referred as value investing.

Warren Buffett joined this Graham-Newman company in 1954. The father of newborn daughter who wasn't comfortable working under others accepted Benjamin Graham's offer. What did he find special in Graham? What was special with the strong bonding between the two?

Graham attracted Buffett because of the techniques and methods he taught at the Columbia Business School. Buffett strongly believed that the foundation of his life and its success was going to be those principles.

You may be wondering what those principles are.

One of the most important principles that Graham preached was 'Margin of Safety' – a simple one to understand.

Imagine this. You have a reserved ticket for 8 o'clock train. Your house is not far away from the railway station. It is a matter of 10 minute drive. Nonetheless, you leave your house at 7 0'clock. Why? Because there may be unexpected traffic jam on the way or he may not get a cab on time or the vehicle may breakdown halfway. It is not that you want these things to occur, but you are just cautious so that you catch the train even after these eventualities.

A man takes his wife to a garment shop. Before they started from home, he strictly instructed her that the budget was only X. Still he carries with him 1.5 times X cash.

Your son, who is in high school, carries four pens with him to write three hour exam.

All these examples represent margin of safety, a principle Benjamin Graham prescribed for investing in share market.

In short, paying 50 cents to buy a stock that is worth a dollar is margin of safety. But how do we do that?

Firstly, you should fully analyze the balance sheet of the company you are planning to buy, irrespective of the industry it belonged to and the volume of business it carried out. Based on the net worth calculated from the balance sheet, you can determine the value of one share. Then the market price of the share has to be compared against its value we calculated above. Run a test if the stock is available at a price 25 or 30 percent below its value. Only when the security passes this test, the company has to be considered for investment.

This procedure was the central point around which Graham's margin of safety principle revolved.

In addition to Margin of Safety, Graham also taught a simple, yet beautiful, approach towards share market. It is widely acclaimed, even today, as Mr. Market analogy.

Warren Buffett wrote about this analogy to his shareholder in 1987 annual letter.

"*Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.*

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains.

At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low *price, since he is terrified that you will unload your interest on him.*

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic - depressive his behavior, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him
or to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the
patsy is, you're the patsy.""

How true! Also read Warren's conclusion on this analogy below.

"*Ben's Mr. Market allegory may seem out-of-date in today's investment world, in which most professionals and academicians talk of efficient markets, dynamic hedging and betas. Their interest in such matters is understandable, since techniques shrouded in mystery clearly have value to the purveyor of investment advice. After all, what witch doctor has ever achieved fame and fortune by simply advising "Take two aspirins"?*

The value of market esoterica to the consumer of investment advice is a different story. In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets.

Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind."

Another simple investment principle Benjamin Graham prescribed was '*cigarette butt*' technique.

In this approach, the focus was on stocks that one could pick up almost for free, like consumed cigars, and that might have a couple of valuable "puffs" left in them. In fact, while Graham taught Warren Buffett at Columbia Business School, one of the assignments was to research the performance of shares trading below $5.

Graham suggested that Wall Street is filled with cigar butts. All we need are the methods and the frame of mind to spot them. Buffett recounted it in his 1989 letter to shareholders.

"*If you buy a stock at a sufficiently low price, there will usually be some hiccup in the fortunes of the business that gives you a chance to unload at a decent profit, even though the long-term performance of the business may be terrible. I call this the "cigar butt" approach to investing. A cigar butt found on the street that has only one puff left in it may not offer much of a smoke, but the "bargain purchase" will make that puff all profit.*"

For Warren this 'cigar butt' approach was one of the many methods he could deploy. Walter Schloss, Warren's friend and fellow student in Graham's class, religiously followed this principle, only this principle. In the process he produced better than market returns in the long run quietly.

Graham prescribed simple methods that everyone could follow. He did not encourage getting insider information and investing based on such information. Doing so amounted to betraying innocent investor in the market, he argued.

Buffett remembered all the principles taught by his mentor. One that had profound impact on him was: "You *are neither right nor wrong because the crowd disagrees with you".* This wisdom perfected him further. His convictions were based on facts and his judgment instead of going with popular opinion. It was the cornerstone of his success as an investor.

Warren Buffett was obviously thrilled with Graham's offer to work with him. That period denoted an important phase in the American economy. People from older generation still lived through the memories from Great Depression and anticipated prolonged duration of economic contraction. Younger generation was yet to actively take part in the world of investment. Only three percent of management graduates from reputed institutions came to work in Wall Street.

Upon arriving, Warren settled down at a house in suburban New York City with his wife. At that time, his father Howard Buffett came forward to assist him economically. Warren refused it; he did not even take money from his father as a loan. He had the right mix of confidence and attitude - he could start from zero on his own.

Moreover, he never thought about making money through illegal means. He wished that the income he earned and the wealth accumulated should be through honest means. Some of his colleagues had suggested him not to account all his income, some of which will not be known to taxman unless he declared. He disregarded such suggestions and paid tax.

In the same year they arrived in New York City, Warren-Susan couple added another member to the family. He had already named his first daughter after his wife. He also wanted to name this second baby, male child, remarkably. He took Howard from his father's name and Graham from his teacher's name. Newborn child was called Howard Graham Buffett.

In Graham-Newman six people worked, including Buffett. Walter Schloss and Warren Buffett shared a small office room. Schloss was older than Buffett. (We mentioned about him in cigar butt section) He did not have regular college education. Schloss was, however, a devotee of Benjamin Graham. After having read his book and mesmerized by his evening talk somewhere, he came behind him. Schloss ended up working with Graham.

The 'Graham-Newman' firm worked like a mutual fund. It managed the funds of investors and partners. There were certain predetermined procedures in stock selection. Of course, it was Graham himself who had defined those procedures. It was like a handbook. He recommended to look for companies that were available at two third of their movable/liquid assets, which comprised of raw material, semi finished goods, finished goods, cash and cash convertibles. By purchasing the liquid assets at 33 percent discount, rest comes free. All fixed assets, futures profits, brand image etc.

The firm functioned around this core principle. Warren Buffett would scan through Standard & Poor stock guide. Other employees at the firm also did the same – searching for stocks that fit into Graham formula. They went to Graham and briefed him if they spotted any. They kept distance from the other partner, Jerry Newman. Compared with him, Graham was easy to approach. He listened patiently and did not get irritated easily. Graham scrutinized the companies they brought to his attention and decided further, go or no-go.

In fact, people working at 'Graham-Newman' did not have to be anxious about whether Graham would endorse their selection. The master had a template for himself. If the company identified and its balance sheet matches with that template, he would okay it.

Benjamin Graham rarely compromised on this rigid investment principles. He never paid attention to others qualitative factors such as the type of industry the company operated in, honesty and growth oriented business drive from the management and customer loyalty and its products etc. All he was interested in were quantitative factors, derived into easy to understand simple numbers, which were available to everyone.

This was a point to which Buffett had a different perspective. Apart from looking into the profit & loss statement and balance sheet of a company, Buffett also made an attempt to figure out the factors that enabled it operate better than its competitors. They differed on few dimensions from their perspective point of views when it came to stock selection. However, both Graham and Warren had high regards and undiminished love towards each other.

As against complex methodologies and formulae that split one's hair, Graham preferred a simpler approach towards investment selection. He categorically rejected intricate technical analysis. He defined, rather designed, a durable principles - unlike fashion and consumer preference that changed quite often.

A person who is prepared to wait for long term would eventually generate remarkable wealth by investing in shares. More importantly, it would not make him poorer than his current status. Both the student and the mentor did not care about short term fluctuations. When it came to choosing investment with long term perspective, they believed in durable principles. The difference, however, was in deciding what ought to be those time-tested approaches.

Graham was disinterested when the stock pickers, including Warren, explained him about the products a company manufactured. As far as he was concerned, those were needless information without any relevance. Employees sometimes got too excited about the market potential and leadership position of companies, but Graham would look through the window once they switched to such topics.

On many occasions Buffett had argued with Graham about the potential drawbacks in going ahead with rigid mathematical formula all the time without really worrying about the quality of the company, its products and management. They seriously differed on this front. However, there was no Warren Buffett without Benjamin Graham. It was Graham who laid a clear roadmap for Buffett to effortlessly explore the dangerous and mysterious jungle, the stock market.

While Benjamin Graham was the father of value investing, Philip Fisher is regarded as the pioneer in the field of growth investment. They represented different school of thoughts. Buffett was prepared to learn alternate approaches and thought processes. From what he read from Fisher's writings he also believed that there could be some potential problem in a company if it was available at prices below its tangible asset. The problem could be in any form, like pathetic management, declining business, changing customer choice etc. Moreover, by strictly going by the balance sheet numbers some great businesses could be missed out as they may not fall inside that selection criteria.

Graham had been severely affected in the great depression. So he adhered to safe investment approaches. But Buffett thought otherwise. He thought it was perhaps okay to go beyond those safest rigid rules. It was not blindly putting money in everything that came across, but taking calculated risk by considering potential opportunities and risks.

While working at Graham-Newman, Warren Buffett came across a Philadelphia based insurance company named Home Protective. He came to know about it through a stockbroker who offered to sell it at $11 a share. There was no published material about the company. Therefore there was no way to analyze and check if fits to the template designed by Graham. Yet, Buffett did not give up. He went to the state insurance office in Harrisburg where he got the details and jumped in. The details and numbers were sufficient for him to conclude that Home Protective was indeed a kill.

The firm, however, was not interested in it. Jerry Newman did not agree to the proposal. Buffett's suggestion was rejected. (Nor would Graham have agreed to it, knowing the kind of man he was.) So Buffett and his colleague Tom Knapp bought it for their own accounts. Shares that they bought at $11 soon surged to an astonishing $70.

There were instances where Buffett made huge profits by making investment on his name after his suggestions to buy for the firm were rejected by his boss. But Graham, a man of his stature, neither regretted nor envied. One such investment was in the company 'Union Street Railway' of New Bedford, Massachusetts. It was trading at $40 a share, but had $120 per share in cash alone – leaving aside all other moveable and immovable assets. Grahams was not interested when exhilarated Buffett briefed him. Buffett bought it himself and profited immensely from the investment.

One more example was Xerox Company which was making a revolution through its copying machines. The company had huge potential that interested Buffett. Graham did not approve that as well.

In 1954, another opportunity came in the form of Rockwood & Co., a Brooklyn chocolate company. The firm held a huge inventory of cocoa beans. Rockwood & Co was also planning to buy back its shares from the public. Interestingly, the buyback was not carried through cash. Instead, it offered to redeem equity shared with cocoa beans which it had in huge quantity. Market price of the beans far exceeded the market value of the stock trading on the exchange.

This scenario enticed Warren Buffett. He decided to buy the shares from the public and exchange it with the beans. He would take it to commodities market and ended up with huge profit.

The scenario was better described by Buffett himself years later:

"*For several weeks I busily bought shares, sold beans, and made periodic stops at Schroeder Trust to exchange stock certificates for warehouse receipts. The profits were good and my only expense was subway tokens.*"

These kind of transactions, taking advantage of price discrepancy in two different markets is widely known as 'Arbitrage' in the world of finance. This art of arbitraging was highly encouraged at Graham-Newman investment firm, but it was Buffett who was ahead of his colleagues and boss when it came to putting this principle into practice.

He was a student who thought ahead of his teacher. However, Benjamin Graham continued to be a mentor, caring employer and a guide when he needed some advice. Above all, he continued to be a great friend in Buffett's life throughout. The student always remembered his master despite his popularity.

In fact, plenty of people made huge money by following the principles laid down by Graham who is still regarded as the father of value investing. He served as a ladder for many people to reach higher altitudes in life and investment career.

On the contrary, when Benjamin Graham passed away in 1976, his asset value was a mere $3 million. By that time Buffett's net asset was many times higher than what the master had accumulated. That, of course, could have been a matter of debate and interest for rest of world. Graham and Buffett, on the other hand, did not attach high importance to money in their relationship which was based more on spiritual and emotional grounds.

Graham was very popular in his heydays. People were willing to pay premium to get the share of Graham-Newman investment firm. When the net asset value of the firm was around $1000 a share, it traded in the market at around $1200. Many people bought a single share just to include it in their portfolio. Had Graham intended to, he could have expanded his operations into a grand scale business empire and made huge money by just managing others' money. But making money was not his primary motive. It was about avoiding losses. Moreover he wanted to live as an example living his principles and conviction.

One day he told Buffett while going out to lunch at a local restaurant near their office, "*Money won't make any difference to you and me, Warren. We'll be the same. Our wives will just live better.*"

Despite surge in income and asset value, Warren continued to be frugal. He never spent carelessly. Numbers spoke this fact better than anything else. His investment value that stood at $9,800 in 1950 surged to $140,000 by the year 1956. Average annual growth was around a phenomenal 56 percent. As opposed to this breathtaking growth in Buffett's investments, Graham-Newman firm's investment grew at an average annual rate of 17.4 percent from 1945 to 1956. Standard & Poor's 500 index had also grown at around same rate. Though Graham's achievement was good on a standalone basis, it could not be called outstanding against benchmark index and more so against the personal achievement of Warren Buffett.

Benjamin Graham was sixty one in 1956. He wanted to spent the rest of his life alone. Subsequently, Graham-Newman was disbanded. Everyone worked for him travelled in their own directions. That was an important point in Warren Buffett's life. It was like getting out of the nest and exploring new horizons of investment world. It was the period when Buffett got ready to herald a history for himself. As the next and immediate step, he boarded the train back to Omaha.

Graham went back to his teaching profession which he enjoyed the most. California University absorbed him. He started living at Beverly Hills with his wife and with the occasional company of his French lover, Marie Louise Amingues. Apart from the teaching profession in Los Angeles, he also spent his leisure time in financial writing and skiing.

6. Private Partnerships

Warren Buffett had completed twenty five years and eight months on 1st May, 1956. He had $140,000 at his hand. According to the standards of that era, an average American citizen would have to spend at least three generations to accumulate so much wealth. At an age when normal people start working after graduation and struggle to stabilize their positions at workplace tiding along office politics and competition, Warren Buffett had accumulated wealth more than one needed to lead a comfortable life.

Had it been someone else, he would have become complacent and begun basking other luxuries in life. He would have driven the most expensive cars around the country. He could have spent most of his time at Hawaii beach sipping Margarita with South American girls in bikinis.

Warren Buffett, however, belonged to a difference category. He never had such illusions about 'enjoying', because his purpose in life was different. According to his own yardsticks, his life as an investor had just begun. He explored the options in front of him. Of course, he worked for his father at his brokers' office. He also worked for this mentor Graham for some time. That was good enough. Warren was not prepared to work for anyone anymore. He decided to get into money management business independently.

Before getting into details about what Warren did after deciding to get into money management, lets have a high level idea about money management business and how it functions etc. In particular, it is imperative to know how mutual funds operate in order to appreciate the unique nature of Warren Buffett.

Money is collected from investors and the corpus is invested into shares and other investment instruments. This is the basic concept of mutual funds. People who run mutual funds are the self-proclaimed experts of the stock market. Mutual fund companies have fund managers who manage investors' money and invest on their behalf. They charge a particular percentage of the investment corpus as fund management fee every year. Well, investors benefit when the investment appreciates. Their fingers are burnt when reverse happens. Fund managers, on the other hand, are always assured of fixed compensation irrespective of fund performance.

An asset management company that manages, for instance, $ 10,000 million with an investment team of ten experts can end up making $ 200 million in the form of fund management charges at 2 percent annual fee. This percentage is fixed irrespective of whether the fund grows in value or declines. Almost all mutual fund companies operate this way. Mutual fund, as an investment vehicle, is an American invention. Perhaps more money is made in mutual fund industry than the profits made in liquor business. This explains why new mutual fund companies and schemes mushroom every other day around the world.

Warren Buffett defined his own path, which was way different from rest of the crowd, when he decided to get into money management business. Unlike conventional mutual fund managers, he promised a minimum annual return of 4 percent. It did not matter even if the stocks he bought lost all their value and the corpus became zero. For a person who handed over 100 dollars at the beginning of the year would be given 104 dollars. On the other hand, if the investment grew more than 4 percent, one fourth of the profit over and above 4 percent would be taken by Warren as money management charge. Remaining three fourth was for the investors.

Consider this. We have $100 at hand and wish to have somebody manage it on our behalf. Let us first take a mutual fund manager whose fee is 2 percent of the fund value. If the investment becomes half in value, he would deduct $2 as his fund management fee and return us $ 48. Irrespective of the performance, he is assured of $2.

Now, think about this scenario in which the investment neither grows nor declines in value. It stays at the same level for one year. Even then the fund manager takes $2 as his fees shrinking our investment value to $ 98.

As opposed to this, consider another scenario in which the investment value doubles. Despite the phenomenal growth, fund manager would still get only $2 dollar. We would end up with $ 198.

Now, imagine what would have happened if we had let Warren Buffett manage our funds. In the first two scenarios, one that becomes half in value and another that stays at the same level, Bufffett would give us $ 104. In the third scenario, even though the investment value doubled, he would only give us $176. In the first two situations, he would have to spare $54 and $ 4 respectively from his pocket whereas in the third case he would earn $ 24 as his fund management fee.

In a way, Buffett acted like an investment insurance through which he absorbed others' loss. Higher share of 25 percent in the profit that he demanded was the premium towards that insurance protection.

Warren Buffett's proposal was very lucrative to the people who chose to invest with him. The list included his elder sister Doris, her husband and Alice – the school teacher aunt who took care of him when he ran away from his family back to Omaha as a teenager during his father's tenure as senator. Other investors were also friends and relatives of Buffett. The corpus amounted to $105,000. Along with this, he also put $100 from his savings and started an investment partnership fund on 5th May, 1956 evening and named it *Buffett Associates Limited*.

He was a man who valued professional freedom to the core. So he laid down two conditions to his partners/investors. Firstly, no partner should interfere in his stock selection exercise. Nor should they force him. Secondly, partners should not seek too much information about the investments and the rationale behind making such investments.

Buffett preferred to keep the details about his investments secretly. If it got leaked out, others might also buy those stocks which would increase the market price of the underlying share, limiting his options to accumulate more at lower prices. He explained this genuine reason for maintaining confidentiality in his operations.

Before completing one full year in his new venture as investment manager, his popularity as a prudent investor was so much that more investors approached to him. Those made him start two more partnerships. The value of the assets managed by him crossed $ 300,000. Unlike conventional fund management firms with an army of experts, this entire corpus was managed by one person - Warren Buffett.

Buffett was a gifted man. His shrewdness helped him process data and news swiftly. He could process even small information and envisage the potential effects of the information at hand.

Not long after Warren Buffett returned from New York to Omaha, Tom Knapp, Graham-Newman colleague of Warren, flew to Omaha to visit him. They then drove to Beloit, Wisconsin, where Benjamin Graham was to give a speech. On the way, something that Knapp mentioned in his casual conversation really excited Buffett.

Blue Eagle stamps from The United States Postal Service were popular those days. Warren heard his friend telling him that the US PS was going to take the Blue Eagle stamps out of circulation. He could clearly see that the beautiful four cent stamp would become a rare thing very soon.

Successful person does not do different things. He just does things differently, they say. That’s exactly what Buffett decided to do.

He and Knapp decided to stop at every post office on the way and bought as much Blue Eagles as possible. Totally they bought $12,000 worth of stamps. As expected, it soon went out of circulation. After that, it was a history that the stamp collectors came to them and paid unimaginable high price.

Likewise, National American Fire Insurance is worth mentioning here. The company was managed by two people, Howard F. Ahmanson, a banker, and his brother Hayden. Its stocks were sold to rural Nebraska farmers in late 1920s which remained largely forgotten by the purchasers. During the initial years of Buffett Partnership, Ahmanson brothers announced a buyback proposal at $50 a share.

Buffett calculated the profits earned by the company and its net worth. It did not take him long to conclude that $50 a share was very cheap. The insurance company was not publicly traded on any exchange and hence the farmers had no clue about the real value or the market price the company can demand. They were prepared to surrender their holding for whatever Ahmansons offered.

Spotting a value in the deal, Buffett decided to buy the stocks from the public. But he did not know whom to approach. At least if he possessed the shareholders list and address, he could meet them to negotiate a buy. Keeping that in mind, he took his lawyer friend Dan Monen to the company and met Hayden Ahmanson. But Hayden, who was not a naïve, was aiming to buy the stocks back from farmers too cheap. He curtly refused to let them see the stockholders list.

Buffett was not deteriorated. He switched to his next step by offering $100 for every share that Ahmansons were willing to buy for $50. Monen came in handy. Buffett requested him to drive around Nebraska state hunting for the stock. The lawyer took Buffett in his red-and-white Chevrolet to every nook and corner of state.

Waving '$100 a share' placard at everyone they came across at every street, marketplace, courthouse, country side and the link roads, Monen and Buffett travelled through the state. They were able to garner 10 percent stake in National American Fire Insurance Company. This investment fetched Buffett a huge profit of $100,000. Being the first investment transaction that enabled Warren Buffett taste six digit profit, this was an important rug in the investment ladder he ascended.

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Warren Buffett's popularity spread like wildfire in Omaha. At the same pace, his wife Susan delivered their third child. Buffetts named their newborn son 'Peter'.

While the count in the family increased by one, count in the number of partnerships he managed increased by two. In total, he was looking after five partnerships and his wife three children. It was a risky proposition for Buffett as there was very little room for error. He would have to pay from his pocket if the investments failed to generate positive returns. So, he began working with an extra sense care and concentration.

Family size just got bigger. It did not make sense for them to continue living in a rented house any longer. He purchased a five bedroom stucco house on Farnam Street in central Omaha for $31,500. Being hardcode thrift, the house was the biggest expense he ever made in his entire life. He even nicknamed it "*Buffett's Folly*"

Profits he made and the rate at which his investments grew were simply amazing. Nonetheless, he never indulged in blind gambling. Year 1958 alone saw his investments grow by 41 percent. His initial investment doubled within a span of three years.

Next year, that is 1959, number of partnerships that he handled increased to six. It was an unforgettable year for him from another angle as well. He happened to meet Charles T. Munger, a lawyer by profession, through a common friend. Though born in Omaha, Munger was practicing his law in California. His grandfather was a judge and father was a lawyer. Charles Munger was so special that he managed to graduate from Harvard law school without having attained an undergraduate degree. Interestingly, like Buffett himself, Munger also worked at Earnest Buffett's grocery shop during his childhood. He and Buffett had met a couple of times during those tender years, which they hardly remembered.

Despite his comical look on the surface, Charles Munger was a brilliant man with sharp ideas. He was very rational by weighing both positives and negatives in his approach towards all his actions. He and Buffett were mutually attracted in their very first meeting. Their frequencies matched. Moreover, they both had good degree of sense of humor. In short, there established a bond of unique kind.

Having understood the shrewdness of Charlie, as Charles Munger became known as, Warren suggested him not to waste his talents in law profession. Instead, he argued, that Charlie would do better in the field of money management and investment. They talked for hours in the first meeting itself. That night at Dick Holland's house, Munger was holding the same beverage the entire evening. He was so busy chatting.

Warren was independent and did not need any advice or suggestion most of the times. Over the years, it was Charlie who stood with Warren and guided him by offering alternate view points. Graham had implanted the principle that one should look for stocks that offered irresistible mouthwatering value. It was through Charlie's association and influence that Warren relaxed this otherwise steadfast selection criterion. The lawyer helped Buffett look through the alternate viewpoint that it was prudent to pay moderate price to a good business than buying an ailing business at cheap valuation.

Charlie went back to California, but they continued to talk over the phone almost every day without fail. Warren even skipped dinner times as he was sprawled on the floor with the phone talking to Munger. Little Susie would express her displeasure, "*Oh-oh, Dad's talking to Charlie.*"

At the beginning of 1960s Warren Buffett was looking after seven partnerships singlehandedly. They were Buffett Associates, Buffett Fund, Dacee, Emdee, Glenoff, Mo-Buff, and Underwood.

Having increased in size, Buffett graduated from hundred thousand to million. In 1961 he made his first million dollar investment in a windmill manufacturing company. On those days, it was indeed as a 'breaking-news'.

Usually Warren Buffett did not reveal the information about his investment portfolio mixture. But in 1961 he communicated to his partners that 35 percent of the total investment remained in a single company, Sanborn Maps. He had started accumulating that stock three years earlier.

Sanborn was a popular company in map business. It's once lucrative map business had declined considerably. However, during its peak years when it was making huge profits, it had successfully invested in other companies. Its investment portfolio, built over the years, was worth around $65 a share, which Buffett did not fail to notice.

But the stock market did not discount this factor. Since the company was into a business that was declining and out of flavor, it was available at $45 a share in the market. Sanborn perfectly fit in the template defined and preached by Benjamin Graham.

Warren Buffett followed the footsteps of his guru. He continued to accumulate the shares of Sanborn Maps throughout 1958 and 1959. He kept up his hope on Graham's mantra that the stock price would catch up its underlying value one day. That day, however, did not seem to dawn.

Ironically, directors of the company only held mere four hundred shares, whereas total outstanding shares stood over one hundred thousand. Buffett also noticed the management discontinuing the dividend distribution in recent times. At the same time, salary and other benefits of the director surged. Other investments of the company also did very well. Yet, management did not prefer to distribute any of that with shareholders.

This produced anger and anxiety in Warren Buffett, for the major portion of his partnerships' investment remained in Sanborn Maps. Being the largest shareholder, Warren became part of its board and insisted that the management liquidated company's investment portfolio and distributed the proceedings with shareholders. This request was not accepted by the management.

Buffett was already the single largest shareholder, on behalf of his partnerships, in the company. Some other dissident minority shareholders also teamed up with him. Sanborn did not have any other option than paying heed to the combined voice. It finally gave up and agreed to use its portfolio to buy out stockholders. The man who made it happen ended up making nearly 50 percent profit.

Only after the tide settled down, he wrote to his partners pointing Sanborn as an example for the 'necessity for secrecy regarding (our) portfolio operations as well as the futility of measuring (our) results over a short span of time'.

Five years after setting up investment partnership, his investment grew 251 percent. During the same period of time, Dow Jones Industrial Average appreciated only by 74.3 percent. By 1962, he was controlling investment wealth of around 7,200,000 dollars. His personal net worth had already crossed a million.

You may recall Warren Buffett's offer to jump off the tallest building in Omaha if he did not become a millionaire by the time he turned thirty. He achieved that feat in thirty years and a few months.

One might argue for the sake of arguing that Warren did not manage to achieve his wager in his thirtieth year, but only in thirty first. Taking into account the money spent in buying the home and rest of his wealth other than $100 he put in at the time of setting up the partnership etc, he would have attained his target by 30.

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In investment circles Buffett was already a popular man. More than ninety investors from all over the United States had invested with him. He was managing seven partnerships in total. It was getting bigger and wider. So, he merged them into a single entity named 'Buffett Partnerships Limited.' He also increased the minimum value to be admitted into it from twenty thousand dollars to hundred thousand dollars.

He also made another move. As the size and responsibility were getting bigger, he shifted his office to Kiewit plaza (Until his death Kiewit was Omaha's wealthiest person) on Farnam Street. Thereafter he remained in the same building for the rest of his life. By the way, if you are wondering where he was operating from before moving to Kiewit Plaza, you may not believe the answer. It was his bedroom that remained as his office. It was from that bedroom he scanned through annual statements and balance sheets of many companies in America, devised his investments approaches, did his stock picking etc. In between, whenever time permitted, he ate and slept.

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A massive textile company, called Berkshire Hathaway, based in New Bedford was struggling. Its stock was trading below $ 8 per share. Buffett smelled that it was a typical cigar butt that had more than a few puffs left in it. He made his first purchase in Berkshire in the year 1962. His partnership bought 2000 shares at $7.5 each. (It closed at an all-time high of $150,000 on December 13, 2007)

His investment grew by 39 percent in 1963 and by 28 percent in 1964. Asset under management expanded to $ 28 million. Warren Buffett's personal wealth crossed 4 million. It was a HUGE money those days.

In mid sixties a scam, now recalled as Salad Oil Scandal, shook entire America. Allied Crude Vegetable Oil Refining was the company that made it possible. Soybean oil, which was used to make salad dressings, was transported in ships between continents, say between US and Europe. The oil also served as collateral to obtain loan from banks. Oil tanks were inspected on ships' arrival at the harbor and subsequently credit was sanctioned.

A good arrangement indeed! But the company devised a trick by filling the tanks with water and topping them up with oil that floated on the surface. Inspecting authority trusted it and assumed that the entire tank was full of oil. Even worse, they sucked the oil from the top and poured in the subsequent tanks before the inspection resumed there. Innocent bank official approved them as well.

One day it dawned that the oil company had cheated over $ 175 million.

Things came to light. Media christened it '*Salad Oil Scandal*'. As Allied Crude Vegetable Oil Refining filed for bankruptcy, many financial institutions that had lent money were helpless. They had to write off the loss. American Express bank alone lost $58 million for no fault of its. Share price of American Express halved. From $65 a share, it nose dove to $35 in the year 1964. Warren Buffett keenly observed these developments.

So called self-proclaimed experts in stock market advised to sell the stocks of American Express. They certainly believed that the bank, which declared dividend to its shareholders for 94 years in a row, was to get worse and face the risk of insolvency.

But Warren Buffett thought otherwise and he had reasons to back his thought. Before coming to that conclusion, he performed analysis in his own unique style. First, he visited his favorite restaurant Ross's Steak House in Omaha. He placed himself near the cashier and chatted with the owner. Simultaneously, he kept on watching the customers. He was neither interested in how much they ate nor with whom the men dated that evening. His primary motive was to find out how the customer paid their bills.

Like before, they continued to make the payment through American Express cards. He could not find them paying cash or through other banks' cards. Even though Salad Oil Scandal put a dent in American Express's coffers, it did not make any change in the behavioral pattern of its customers. From his experience at the steak house in Omaha, he assumed that the same must be true at other restaurant across the country.

Still Buffett did not stop wit this first round of test. He also visited few travel agencies in Omaha and observed that they were doing their normal business with American Express traveler's checks. Likewise, he also went to supermarkets and drug stores that used to sell American Express money orders and noticed no change.

So, the operations of American Express as a bank and financial institution were normal and its business was as usual. He even visited few competitors of the bank to reconfirm his conclusion and reinforce the conviction.

Wall Street on the other hand was lamenting in single voice to sell. It was directly opposite to Warren Buffett's conviction. He kept reminding himself the basic lesson once again and swiftly got into action. The lesson he had inherited from Graham was:

"*Buy when others sell and sell when others buy.*"

His action was not only swift, but also bold that he channeled 40 percent of his partnership's wealth in American Express shares. It amounted to $13 million with which he could garner 5 percent stake in American Express.

Around this time, bank administration allocated $60 million to offer its creditors whose money was washed away in the scandal. Shareholders opposed this logical step taken by Clark, the American Express president, to pay back the depositors. Some of them took it to the court and sued him claiming that he was "wasting" their wealth on an imaginary moral obligation.

The situation was getting out of control and eventually turned nasty. Warren Buffett decided to get involved as he had a big stake involved. He dropped in at Clark's office and introduced himself as a friendly shareholder. Having been the target of average shareholders and regarded as a hated man, Clark was obviously glad to hear this. Everyone on the street was selling American Express shares and therefore anyone who bought it then was a friend indeed. Warren appeared like godsend that would resolve all the problems at the time of distress.

Buffett supported Clark. He even went to the court and said, "*Shareholders shouldn't be suing—they ought to be congratulating Clark for trying to put the matter behind them.*" He continued, "*As far as I was concerned, that $60 million was a dividend they'd mailed to the stockholders, and it got lost in the mail. I mean, if they'd declared a $60 million dividend, everybody wouldn't have thought the world was going to hell.*" He explained his stance very clearly.

Though the suit was not withdrawn immediately and the case was dragged for some more time, American Express share price began to appreciate gradually. But Buffett did not sell his stake in a hurry. He admired the way Clark ran the business, which in turn fed back to its growth. Instead of selling the stocks, Warren continued to accumulate more and waited patiently. Within two years the price increased manifold. When he finally diluted his position in American Express, it was trading at $180 per share. His $13 million investment fetched him $20 million profit.

As years went by, the American stock market kept on going up. On one side Vietnam War was in full swing. On the other side, capital market was even hotter. New generation of people who did not fully know the cruel impacts of the Great Depression had entered into the market and freaked out. Most of them were born post 1929 economic tsunami. They assumed that the marker had only one direction - upwards. Stocks of electronic companies were in great demand as everyone was behind them.

Market on the whole was trading at high valuation level. Observing many stocks trading at uncomfortable levels, Warren Buffet kept on accumulating the shares of the boring textile company Berkshire Hathaway. In 1965, when he bought it for Buffett Partnership the stock was trading at around $10 per share. At the time liquid assets of the company alone stood at $19 per share. That apart, other assets and future profitability came free.

On the personal front, year 1965 was bad for Warren. His father Howard Buffett passed away that year.

At the beginning of 1966, asset value of Buffett Partnerships stood at $44 million. Personal wealth of 35 years old Warren Buffett was just short of 7 million American Dollars. He has become one of the very few persons in the US with a wealth that was beyond the reach and imagination of average Americans.

The market was still going up. Invariably all mutual fund houses make it a habit to collect money by launching NFOs (New Fund Offers) in bull runs. Innocent public only look at the recent past and think that the fund managers would repeat their spectacular performance forever. People rarely understand that the market has already risen so much that it would decline further. This is exactly the behavior that the mutual fund houses expect from common public.

Warren Buffett is quite opposite to other money managers in this regard. Entire Wall Street was in celebration mood. But Warren was cautious though. In 1966, when every fund house was announcing new issues, he declared that he was not going to admit any new investments in his partnership. It was an announcement that any fund manager could not even imagine doing at that time.

In his letter to the partners in 1967, he openly and honestly admitted that there were some of the newer mutual funds which gave better recent returns than his own performance. He also warned that the chances for him to spot new ideas and opportunities were shrinking. His letter read, "*if my idea flow should dry up completely, you will be informed honestly and promptly so that we may all take alternative action.*"

Buffett's alarming words and caution were in inverse proportion to the overexcitement and greed that prevailed on Wall Street that time. Demand for electronic stocks increased every day. New companies came out with public offers which were sold out instantly. Market experts predicted that every other company among them would become the next Xerox and IBM. These were Go-Go years for the market which was crazy about electronic stocks.

Mutual Fund houses came up with new innovative schemes that had the word 'electronic' in them. There were mutual fund salesmen combing for new investors. They surged in number. For every seventy investors in the United States there existed a sales man. They hunted for people with surplus money to invest. An entry load as high as 8.5 percent was very common those days - most of it went to the agents as sales commission. A person deciding to invest $100 would eventually see only $91.5 getting invested. Thanks to the recent growth of the stock market and increase in fund values, people did not bother about high sale commission.

It was not only the stock prices that surged in the market. Number of shares traded on exchanges also increased manifold. Only a few bought and held shares with long term perspective. Vast majority of others wanted to make quick money by selling it within days. Market situation perfectly suited that too. In 1950s when Warren Buffett started investing on behalf of his investment partnership, on an average nearly two million shares were traded on the New York Stock Exchange per day. By the year 1967, average daily volume on NYSE was close to ten million shares.

Dow Jones Industrial Average increased 17 percent that year, whereas

Buffett Partnership advanced by 36 percent.

More the market euphoria with Go-Go years' success the greater was Warren's vigilance. In order to constantly remind him not to get carried away by popular opinion, he kept a newspaper clipping of the 1929 crash on his wall. He constantly warned his partners of the risks carried by sustained bull market.

Yet his Partnership grew 59 percent in 1968. Asset under his management ballooned to 104 million dollars. Net profit was 40 million that year. American Express was the shining star. He also managed to register 50 percent profit in Walt Disney shares.

Average daily volume on New York Stock Exchange crossed 13 million shares in 1968, 30 percent higher than the previous year. On June 13, 1968 the volume hit the roof at twenty one million shares. Warren Buffett was better off to be situated in Omaha rather than being at the financial capital New York City. He could avoid all the chaos and craziness that infected Wall Street that time.

Buffett remarked this at his interview to Dun's Review in 1968: "*Omaha is as good a spot as any. Here you can see the forest. In New York, it's hard to see beyond the trees.*"

The reporter suggested him back in the same interview that investment experts in New York had access to inside information and had better chances of making profitable bets. Buffett on the other hand was handicapped by staying at a remote place in Omaha, opined the reporter.

He Replied, "*With enough inside information and a million dollars you can go broke in a year.*"

In the world of investment, this is still remembered as the most popular dialogue about insider information.

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American stock market peaked in 1969. The rules of investment game were getting redefined and its laws rewritten. He was never comfortable playing a game that he did not quite understand. He was jittery and kind of sensed that it was becoming hard for him to discover sensible investments. Having called his partners for a discussion, he clearly explained them that his options were shrinking at rapid pace and expressed his inability to manage their money any further considering the prevailing market environment. He dissolved all investment partnerships.

Warren Buffett was not like typical India cricketer who earned his place in the team through spectacular performance in his initial years. Shamelessly holding his place based on his historical track record despite performing pathetically in recent times might be good for cricketers. Of course Buffet had a proven track record - far better than anyone else on the street, but he did not want to hold people's money for that reason alone. He candidly admitted his hesitation, apprehension and doubt for the benefit of all the stakeholders involved.

When Buffett started his own investment partnership after having returned from Ney York to Omaha following the closure of Graham-Newman firm, he had set a target for himself. That self imposed target was neither to satisfy his partners nor to earn them money, though it was the byproduct. His primary objective was to experiment and validate his approaches himself.

The goal he set for himself was to make 10 percent more than Dow Jones Industrial Average every year. The moment he realized he might not be able to do that, he should step aside.

From the time he first set up his partnerships till the time he dissolved them in 1969, his investments generated 29.5 percent compounded annual growth rate, that too after discounting for his fund management fees. During the same period index grew at 7.5 percent annually. If a person invested $10 in DJIA index in 1957, his money would have become $15.26 in 1969. Had he given that greenback to Buffett, the same investment would have ballooned to $150.27.

Another remarkable aspect to be noted here is that his partnerships did not taste loss any year, whereas the Dow Jones Industrial Average travelled in reverse direction at least five years between 1957 and 1969, creating financial loss to investors and public alike. Buffett proved the academics, who argued that it would be impossible for anyone to avoid loss in the stock market every year and make only profits, wrong. Moreover, having set a target of achieving 10 percent more growth than broad market index, he ended up by beating the market by an astonishing 22 percent.

He offered two choices for his investors at the time of dissolving the partnership. One of the options was to liquidate the holdings and distribute the proceeding. Hearing this news, many investment companies got alert. They were keen to know the identity of investors in Buffett's partnership. They were also prepared to spare sizable amount money to Buffett to get the list aiming to lure those investors. On the grounds on integrity, Buffett did not entertain those requests.

However, Warren Buffett guided his otherwise helpless investors by directing them to a talented man, Chicago born Bill Ruane. The led to the birth of Sequoia Fund that Ruane launched very soon. Bill Ruane was a classmate of Warren Buffett at Columbia University and attended Graham's class together. He was a good student who strongly believed in value investing for longer time horizon.

Then came the second choice that Buffett placed before his partners. It was partnership in lieu of money. His investment partnership had already invested heavily in Berkshire Hathaway stocks. Had investors preferred, they could accept it instead of cash. Even if no one was interested in Berkshire shares, Buffett was ready to buy them out. This assurance sufficed few partners to opt for Berkshire Hathaway shares instead of cash.

In 1956 when Buffett set his first investment partnership, his initial investment was $100. In the end he had accumulated $25 million under his belt. It allowed him to acquire controlling stake in Berkshire Hathaway. Apart from buying the shares held in his erstwhile partnership, he kept on accumulating more stocks of that textile company from the open market.

Warren Buffett had spent enough number of years managing other people's money. It was time for him to mind his own business. I mean his own business.

7. Buffett Policy

Some forty two years before Warren Buffett was born, a massive textile company by the name Hathaway manufacturing was established. When cotton business flourished the company had a good time and its wealth expended. Hathaway enjoyed its prime days during the First World War. Half the work force in New Bedford town was employed by Hathaway.

To trace back the historical and geographical importance of New Bedford, we need to recount the fact that the United States is a country of immigrants. When Europeans, British in particular, migrated and landed on American soil they first established themselves in north eastern parts of the U.S. As this area was primarily filled with English immigrants, it came to be known as New England. It can also be attributed as the cradle of modern American history. New Bedford is a harbor city 51 miles south of Boston in New England.

Over a period of time, people started spreading out to other parts of America. This coupled with the black slaves imported from Africa changed demographic composition. As a result, cheap labor was available in the southern states of America. Employers began moving their textile mills southwards. This resulted in more working people seeking lesser jobs in New Bedford, thus resulting in lower wages. Workers in turn resorted to strike and other sort of boycotts to register their protest. It further affected business viability due to which some more mills were forced to close. Things did not end there.

Great depression that began in 1929 put an end to some of textile companies in New Bedford that continued to survive till then. By the year 1940, number of people employed in textile industry came down to nine thousand. In the due course many companies had disappeared, but Hathaway managed to survive throughout those turbulent years.

As the history of Hathaway goes back this way, there was another company founded a century before Hathaway was established. The company that built America's first cotton mill in 1790 was Berkshire. Like Hathaway, Berkshire also enjoyed great business and profitability during the First World War.

Years following the World War were not so smooth for the textile major. On a comparative basis, Hathaway adapted its operation and products to the changing business dynamics. At least, it tried to improvise its operational efficiency whereas Berkshire functioned with old machinery without much change in its product portfolio.

These two companies merged together in the year 1955 and became a single gigantic entity to be known as Berkshire Hathaway. Combined entity had massive size in multiple dimensions such as fourteen factories, twelve thousand workers and $112 million annual sales. Modern production facilities of Hathaway and huge cash position of Berkshire complemented each other, and posed great challenge for other textile companies in America.

When the merger took place Warren Buffett was working at Graham-Newman. Interested in Berkshire Hathaway, Newman personally visited the company and for reasons known only to him he gave up the idea to buy its shares. Buffett, who accompanied him, was a spectator then.

It was almost proven that the textiles business belonged nineteenth century. Customers no longer waited for the products from a particular company when it came to choosing clothes. Brand loyalty of customer is very rare in garment business. People preferred cheapest product with a given quality, whichever company does that stood out in the competition. New textile mills from southern states in the country produced clothes at lesser prices. On top of that, people had shifted to paper napkins instead of using handkerchiefs.

Numbers of mills came down to seven for Berkshire Hathaway in 1961. Ironically, in previous three years alone the company had invested around $11 million in the business. Modern machineries were installed and production facility improved. But that did not help the business in the marketplace. Competitors dumped garments that they manufactured in other geographical locations where cost of production was competitive. Berkshire Hathaway stood clueless and it produced $2.2 million loss in 1962. Warren Buffett, who was a mere observer all those days, bought two thousand shares of the company for the first time.

Company's liquid assets such as inventory and cash alone amounted to $16 per share whereas the market price of the stock was almost half of this value.

It was a classical case that fit into Graham's formula of stock selection. Buffett's purchase of Berkshire (let us call Berkshire Hathaway as Berkshire going forward) stocks were like any other equity investment. He anticipated the market price of the stock to catch up its value within a couple of years so that he could book his profits. He did not have any other ulterior motive.

Prevailing stock market condition was also conductive for his heavy investment in Berkshire. Broad market was crazy behind electronic stocks even at unsustainable valuations and out-of-flavor textile business like Berkshire was totally banished by investment community. Warren Buffett went against popular opinion.

In 1963 Buffett Partnerships became the largest shareholder in Berkshire Company. Warren's friend and New York stock broker Daniel Cowin got into the board of that textile company that carried a great legacy behind its name. Of course there were many speculations about who was directing Cowin from behind the screen. Some predicted it could be Warren Buffett.

Very soon it came to light that Cowin was acting on behalf of Warren Buffett. The man who had considerable interest in Berkshire visited the mill one day as if to put an end to all the speculations floating around. After having gone through company's financial statement for few years at Berkshire's number one man Jack Stanton's office, he asked him to show some of the plants. As Jack was busy with something, he sent Ken Chase, vice president of manufacturing at Berkshire. Perhaps Jack Stanton did not know at that moment that he was making a costliest mistake of his life. Ken belonged to old Berkshire legacy while Jack came from Hathaway family.

It took two days of Ken Chase's time for Buffett to completely go through the mills. Man from Omaha pierced Ken with an array of questions. In the words of Ken Chase:

"*Warren asked questions like crazy. About the marketing, the machinery, about what I thought should be done, where I thought the company was going, the technical end of it, what kind of products were we selling, who we were selling to. He wanted to know everything.*"

Chase frankly spoke about the problems confronted by the company. Buffett liked it and listened to the modest late-fortyish vice president and did not say much.

If at all there was a cue, it was in his final words before bidding bye. He said, "*I'll be in touch with you, Ken.*"

Jack Stanton was a perplexed man. He had reasons to fear. Warren Buffett can take management control by virtue of being the largest shareholder in the company. Stanton made offers to buy back Berkshire's shares so that the stocks under his control go up. Buffet was about to sell his holdings, but the price offered by Jack Stanton was not acceptable for him. So he could not get out of Berkshire. Had that happened, the history would have been otherwise.

Charlie Munger remembered this whole drama, "*It was an absolute accident that Berkshire became his vehicle.*"

Things did not go well between Stanton who was on top of ivory tower and Cowin who represented Warren Buffett. Something ought to happen.

On a fine spring day Buffett met Ken Chase at the Plaza Hotel in New York. He took Chase out for a walk and bought him a couple of ice cream bars to open a casual dialogue.

"*I'd like to have you become president of Berkshire Hathaway. How do you feel about that?*"

The man proposed for President's position was forty eight and the man proposing him was thirty four. Things got over in ten minutes.

Before materializing his plan in the next board meeting, he had enough number of shares to dictate terms. Warren Buffett also accumulated more shares at an average price of $15 per share. Ken Chase was made the president of Berkshire Hathaway. Company's top management got overhauled.

Ken Chase would take care of weaving, looms, operational administration on a daily basis etc. He was expected to run the business efficiently and make money from it. Buffett would decide what to do with the money generated from the business.

Chase came from a family with long legacy and tradition in weaving industry. His limitless love with textile business was understandable. His desire to modernize the mills and expand the business was natural. On the other hand, Buffett viewed everything practically and rationally. He did not approve any plan to erect new mills.

He told Chase, "*I'd rather have a $10 million business making 15 percent than a $100 million business making 5 percent.*" He knew what he was talking about. Of course, he had other places where he could put the money.

Warren Buffett taking control of Berkshire came during Go-Go years of share market madness. Stocks options were very common those days (even now). It was an instrument devised by the top management for their benefit at the expense of other investors. Through this mechanism, the company can allocate certain numbers of stock option that an executive can convert into equity.

Consider this. A publicly traded company has thousand outstanding shares floating in the market. The CEO of the company creates 100 additional shares by exercising stock option in a year. He continues to do that for five years, at the end of which other investors would still hold same thousand shares whereas this fraudulent Chief Executive Office would have managed to hold five hundred shares with him. Total outstanding shares now amount to 1500.

Had the company made $ 3000 as profit at the beginning, each shareholder would have received $ 3 per share. But now with the introduction of additional shares created with stock option, each shareholder would only get $ 2.

Despite naïve illustration above, the underlying message is loud and clear. Shareholders' stake in the business gets diluted due to excessive use of stock option for senior executives in any company. Business may make a lot of money and profits may also surge every year, but if the equity dilution happens in the form of stock options, real benefits of profit growth do not reach its shareholders.

Warren Buffett vehemently opposed stock options. No other proponent of capitalism in the history of America ever voiced his concern for protecting the interests of small investors. Similarly, he advocated for high level of corporate governance.

At that time Chase was drawing an annual salary of $30,000. Presidents and CEOs of other corporates in the U.S had stock options in the companies they ran. But Buffett categorically ruled out any such nonsense. It was not just Chase, no other executive at Berkshire was eligible for stock option. Nonetheless, Warren Buffett sanctioned a company loan of $18,000 to Chase and suggested him to purchase Berkshire shares in open market. At $18 per share, Ken Chase bought thousand shares in the company.

Buffett respected freedom. He did not interfere with Chase at operational level and gave him complete freedom within the resources allocated to him. He was interested in the profitability of the business and expected Chase help him understand the factors that affected it. According to him, operational efficiency of an executive could only be measured by the returns he generated on the capital employed in the business.

As already mentioned, he would rather have a $10 million business registering 15 percent profit than a $100 million business earning 5 percent profit. As a hardcore investor by profession, he was constantly looking for avenues where he could so deploy his resources that they produced maximum possible returns.

In the past, the textile business was taking in lot of investment. But the returns generated from the business did not quite justify those investments. There was no room for emotions as numbers spoke the facts better than anything else. Therefore, his suggestion to Chase was not seek any further capital for investment, but to run existing operations efficiently and produce optimum results. This was the circle of freedom Buffett defined for Chase. He never intended to intrude within that circle.

Warren Buffett stood by his words when it came to freedom. Once, an unhappy buyer from Sears retail store chain called him up and introduced that they had a common friend from college. Name of the fabric buyer was Roebuck. He requested Buffett to change the salesman of Berkshire who handled Sears account. Buffett bluntly replied him by saying that it was Ken Chase who took care of such issues and Roebuck better approached him. Chase was truly impressed when he came to know this. His respect, loyalty and dedication towards Buffett only increased.

It makes sense to reduce excess fate and tummy to make a person trim and healthy. Same holds good for businesses too. Buffett encouraged Chase to get rid of stagnant stocks and obsolete looms to bring the company into better shape. It worked well.

Erstwhile president of Berkshire Hathaway, Jack Stanton, ran the company from an ivory tower – he had *paper* understanding about what went on at the operational level. On the other hand, Ken Chase was a practical man. In the initial years of Buffett – Chase alliance, the textile business improved at Berkshire. Profits started coming in. Cash position got better. Warren was pleased, but he did not let that profit to be invested back in the garment business.

Only once in 1967 Warren Buffett announced 10 cents dividend to the shareholders of Berkshire. That was the first and last. Thereafter there was no question of dividends, but the shareholders of Berkshire had no complaints. Till then Warren was investing through Buffett Partnerships, from then on he would invest through Berkshire Hathaway. That was the only difference as everything remained same for him at his Kiewit Plaza office in Omaha.

He continued to search for avenues to invest the profit generated from the textiles operation of Berkshire, thanks to Chase. In that pursuit, he spotted an Omaha based insurance company named National Indemnity. In fact, he was studying that company for some time then. It was founded at around the same time he was born.

Invariably every industry and business was affected by the Great Depression. A college dropout by name Jack Ringwalt ventured into insurance business by providing insurance cover for taxi cabs in those depressed times. He was bold. So he took calculated risks by writing policies for risks that other insurers did not want to cover. He charged higher premiums for underwriting such risks. His policy was: '*There is no such thing as a bad risk; there are only bad rates*'

One day in 1967, Buffett invited Ringwalt to stop by his office at Kiewit Plaza. He was not beating around the bush. He liked the answer Ringwalt gave to the question if he was considering to sell National Indemnity. He had few reservations which Buffett understood. If anyone wanted to acquire his business, it was only crooks and bankrupt people. Moreover, he would not want other stockholders to take less price than he would receive from Buffett himself. Also, he wanted to make sure that his employees would not have to worry about losing their jobs.

Warren Buffett did not have problems with his concerns. He proposed to go ahead. The market value of National Indemnity was $33 per share, but Ringwalt felt its real value could be $50 per share.

"*I will take it,*" said Buffett.

He did not have any second thoughts. Deal was closed for $8.6 million.

At that time, the head office of Berkshire Hathaway was situated in New Bedford. Ken Chase would sign annual statements of the company. Things changed soon. Buffett shifted the head office to Omaha. He did not want Berkshire remain as a textile company, but as a corporation whose capital ought to be channeled into lucrative businesses. The company was destined to become largest investment cum holding company in the world.

*

As we may recall, Warren Buffett had become the single largest shareholder in Berkshire after dissolving his investment partnerships. He held 29 percent stake in Berkshire Hathaway and established himself as its chairman in the year 1970. Thereafter, he signed annual statement of the company that was sent to shareholders. He did not stop with mere signature, but also developed the habit of writing letters. Unlike other CEOs he did not hire any MBA grads to do the writing for him.

One may raise eyebrows with a question as to why Warren bought a textile company and started making it focus on other diverse businesses. Many people had the same question back then as well. The rationale behind his decision of not maintaining Berkshire as a mere Textile Company was well justified and only time testified that rationale.

As far as Textile business was concerned, it operated in a capital intensive industry. Plant and machinery were already established. If it was operated optimally it had a potential for steady stream of income, which could be invested in other places.

But the core question that puzzled people was not with the fact that

Berkshire made an investment, but it was more about the logic behind choosing investment business that had no synergy with textile business. In fact, they were two extremely different industries.

Of course they were. In any industry, business transactions complete when customer pays for the product or service he receives from a company. For instance in Textile industry, first comes capital expenditure in the form investment to build the factory and install machinery and equipments. Then, the company has to spend money on working capital requirements to procure raw material and produce finished products. Then comes your marketing expense. Finally, only when the customer buys the product the business gets the money in.

Insurance business is just opposite. A person pays premium at the time of taking a policy. The company gets the money first before spending it. Later on when, remember only when, risk materializes the company has to pay insurance claim to its customers. Unique nature of insurance business that enabled money inflow first and outflow last very much attracted Warren Buffett.

As far as Buffett was concerned, his competency was not running businesses. It was rather his ability to invest. What was needed to keep him busy was capital, and the business he owned should ensure uninterrupted stream of cash flow. Textile business of Berkshire was running profitably now, but he estimated that it could not be relied upon forever.

There was no durable competitive advantage in garment business. New technologies can emerge anytime. Any upcoming company, which builds plants by installing them, might weave clothes and sell them below Berkshire's prices. In order to sustain the business, Berkshire might also be forced reduce the price while cost might remain high. That would eventually result in loss. In short, Buffett saw Berkshire as a massive banyan tree for which textile division served as the central trunk now. Should the root decay over the passage of time, other diverse businesses would support it acting as figs.

After having acquired National Indemnity insurance company, the premium collected through it augmented to the cash flow that already came from

Berkshire's textile business. That provided him lot of freedom and flexibility to play the share market. While he continued to invest in shares, he also started acquiring businesses entirely. He merged such acquired businesses under Berkshire Hathaway.

Takeover is not a new thing in the business world. But even in that Buffet had defined his unique approach.

In ancient times it was customary for emperors to wage war over many countries. After conquering the war emperor would annex the subjugated land under his empire. Having done that, he could hand over the control to the native ruler and let him serve as a vassal. At the end of the year, ruler of the conquered land paid his share of taxes to fill emperor's coffers.

Things were as usual as far as normal life was concerned. Only difference being, the subject of the conquered land accepted him as their emperor, but the emperor is relived from the daily headaches of governing it. He only exercised his control when situation demanded for it. Warren Buffett was almost in the same frame of mind.

Whenever he partially invested in companies or fully acquired them to bring them as a subsidiary under Berkshire Hathaway, he did not look after their daily operations. Instead of that, he requested its erstwhile owner or the executive to run the business as before. It was not because of the apprehension that he could not run businesses. He was not afraid to run any company himself, but that was not his motive. His aim was not to confine his time and energy to a single business unit or company. He was thinking like Alexander who wanted to bring the whole world under his control.

Executives and previous owners of the businesses acquired by Bufffett ran them as usual –as responsibly as the loyal vassal to his emperor. Buffett brought many such local rulers under the governance of his business kingdom. All of them accepted the guidelines prescribed by him. He did not have to be coercive. All they needed were few words of motivation from his mouth. Warren Buffett did not exercise frugality in that respect.

Similarly, the executives of the companies taken over by Buffett also reciprocated positively. They lived up to his expectations. Even though they sold the businesses they built from scratch or had been running for generations, they still continued to run them with same level of dedication. Most of them already had more money they than needed in life. The reason why they decided to work was not to meet their ends and provide for family. They had involvement in the business and loved it. After all it was their baby that they wanted to take care of.

Moreover, they also liked the way Buffett treated them. He never treated with the mentality of a typical boss. "I've bought you out and it is your duty to do what I dictate," was never the message. Never!

More importantly, he never poked his nose in daily affairs of businesses. Previous owners still continued to enjoy the same freedom in making decision for smooth and optimal running of the business. He did not hide the fact that the previous owners cum managers knew more about their respective businesses than him. He often told them, "I am completely dependent on you. This is your company as usual." They were totally pleased and exhilarated.

Having said this does not mean that he would turn blind eyes to the companies he invested or acquired. On the sheer confidence on the abilities of previous owners and managers he did not micromanage things. But he did not miss any symptoms that produced alarming signals.

He once jokingly said, "*If they (the managers running the show) need my help to manage the enterprise, we are probably both in trouble.*"

Warren Buffett's business empire expanded as days progressed. It spread wings in all directions such as Insurance, banking, publication, retail trade etc. Berkshire's textile business was supplying the capital he needed to make those investments.

In his 1977 letter to shareholders Buffett mentioned this fact, "*Management also has been energetic and straightforward in its approach to our textile problems. In particular, Ken Chase's efforts after the change in corporate control took place in 1965 generated capital from the textile division needed to finance the acquisition and expansion of our profitable insurance operation.*"

He was sensitive about the textile unit of Berkshire Company, which was now a diversified corporation. The reason for being sympathetic and continuing it was better explained in the same letter: "*Our mills in both New Bedford and Manchester are among the largest employers in each town, utilizing a labor force of high average age possessing relatively non-transferable skills.*"

He had given clear instructions to Ken Chase on matters involving finance. His suggestion was not to trust anyone but money in business. Berkshire decided to stop any further deliveries to the customers who did not clear their outstanding dues for long.

Moreover, he did not mix family and business. No one was too important to get special offers. As a matter of fact, his wife Susan Buffett once visited Berkshire's retail shop in New York. The employees at the shop charged the same price at which they would have sold to any other customer walking in. Had they not behaved this way, Buffett would have bitten those employees.

As expected, profit from textile business was not attractive as compared with divisions. For instance, it produced a profit of just $45,000 in the year 1970. Insurance businesses fetched a profit of $2.1 million and banking business $2.6 million respectively that year. However, the capital employed in these three sectors was more or less the same.

These discrepancies did not make him close down textile mills right away. He thought about many loyal and elderly workers and their families. His idea was to continue the operation and make it profitable as much as he could.

His obvious corporate social responsibility was missing with some of the shareholders. Few of them questioned the wisdom of remaining in the textile business which, over the longer term, is not sustainable.

He explained the logic on the grounds of social responsibility and loyalty of long term employees etc though the explanation did not make perfect business sense. Shareholders also understood and appreciated his stance. However Buffett was very concerned about the prospects of textiles division. He kept on warning Ken Chase that garment business was likely to eat away the profits earned from other business units of Berkshire.

Writing was on the wall. In fact, textile mills ran for more years than Buffett anticipated. Chase was running the show splendidly. Yet, the business lost $2.7 million in 1981. What could a captain do, despite his experience, energy and abilities, if the ship had a hole in it? Notwithstanding all odds Chase turned the business profitable in the year following that. It was a remarkable thing, but Ken Chase was exhausted by then. He retired the same year.

Subsequent executives who took over the management of garment mills kept on requesting for additional capital to rejuvenate declining business. Buffett was firm. He could see the inevitable. Like elephants those old mills were eating out all the funds put inside. At last, Berkshire Hathaway shut down its textile business in 1985. The company that erected first cotton mill in the Unites States completely got rid of its traditional business identity.

The company got rid of its machinery and equipments in auction. Quoting academics on their emphasis on book value and replacement cost, Buffett mentioned, they would have received an education at the auction Berkshire held in early 1986 to dispose of its textile machinery. Power looms which the company purchased for $5,000 in 1981 were sold at for just $26 in 1985.

Warren Buffett, who was once advocating for not closing down textile division, now decided to do it. He explained the reasons in this letter to shareholders:

"*When Buffett Partnership, Ltd., an investment partnership of which I was general partner, bought control of Berkshire Hathaway 21 years ago, it had an accounting net worth of $22 million, all devoted to the textile business. The company's intrinsic business value, however, was considerably less because the textile assets were unable to earn returns commensurate with their accounting value. Indeed, during the previous nine years (the period in which Berkshire and Hathaway operated as a merged company) aggregate sales of $530 million had produced an aggregate loss of $10 million. Profits had been reported from time to time but the net effect was always one step forward, two steps back.*

At the time we made our purchase, southern textile plants - largely non-

union - were believed to have an important competitive advantage. Most northern textile operations had closed and many people thought we would liquidate our business as well.

We felt, however, that the business would be run much better by a long-time employee whom. we immediately selected to be president, Ken Chace. In this respect we were 100% correct: Ken and his recent successor, Garry Morrison, have been excellent managers, every bit the equal of managers at our more profitable businesses."

"*Though 1979 was moderately profitable, the business thereafter consumed major amounts of cash. By mid-1985 it became clear, even to me, that this condition was almost sure to continue. Could we have found a buyer who would continue operations, I would have certainly preferred to sell the business rather than liquidate it, even if that meant somewhat lower proceeds for us. But the economics that were finally obvious to me were also obvious to others, and interest was nil.*

I won't close down businesses of sub-normal profitability merely to add a fraction of a point to our corporate rate of return. However, I also feel it inappropriate for even an exceptionally profitable company to fund an operation once it appears to have unending losses in prospect. Adam Smith would disagree with my first proposition, and Karl Marx would disagree with my second; the middle ground is the only position that leaves me comfortable."

In the conflict between Adam Smith and Karl Marx, he finally had to incline on the sides of Smith since it was the natural choice he really had.

In the same letter, he shared interesting information to his shareholders.

"*For an understanding of how the to-invest-or-not-to-invest dilemma plays out in a commodity business, it is instructive to look at Burlington Industries, by far the largest U.S. textile company both 21 years ago (when Warren took control over Berkshire Hathaway) and now. In 1964 Burlington had sales of $1.2 billion against our $50 million. It had strengths in both distribution and production that we could never hope to match and also, of course, had* *an earnings record far superior to ours. Its stock sold at 60 at the end of 1964; ours was 13.*

Burlington made a decision to stick to the textile business, and in 1985 had sales of about $2.8 billion. During the 1964-85 period, the company made capital expenditures of about $3 billion, far more than any other U.S. textile company and more than $200-per-share on that $60 stock. A very large part of the expenditures, I am sure, was devoted to cost improvement and expansion. Given Burlington's basic commitment to stay in textiles, I would also surmise that the company's capital decisions were quite rational.

Nevertheless, Burlington has lost sales volume in real dollars and has far lower returns on sales and equity now than 20 years ago. Split 2-for-1 in 1965, the stock now sells at 34 -- on an adjusted basis, just a little over its $60 price in 1964.

Meanwhile, the CPI has more than tripled. Therefore, each share commands about one-third the purchasing power it did at the end of 1964. Regular dividends have been paid but they, too, have shrunk significantly in purchasing power.

This devastating outcome for the shareholders indicates what can happen when much brain power and energy are applied to a faulty premise. The situation is suggestive of Samuel Johnson's horse: "A horse that can count to ten is a remarkable horse - not a remarkable mathematician." Likewise, a textile company that allocates capital brilliantly within its industry is a remarkable textile company - but not a remarkable business.

My conclusion from my own experiences and from much observation of other businesses is that a good managerial record (measured by economic returns) is far more a function of what business boat you get into than it is of how effectively you row (though intelligence and effort help considerably, of course, in any business, good or bad). Some years ago I wrote: "When a management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact." Nothing has since changed my point of view on that matter. Should you find yourself in a chronically-leaking boat, *energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks.*”

*

Year 1985 was very important for Warren Buffett and Berkshire Hathaway for more than one reason. The first one, we already know that the company exited from its garment business. The second one involved insurance business.

American insurance industry came through various changes in 1985. There were large scale damages and calamities. Insurance companies found it hard to settle the claim from their policyholders whose risk they had underwritten. Some insurers were in a situation to file bankruptcy. Few others decided to withdraw some of the risk covers they provided so far. These developments helped Warren Buffett in two dimensions.

People moved away from the insurance companies with thin cash position and took cover from the insurance units held by Berkshire Hathaway. When compared with any other insurance company in the country, Buffett’s companies had thick balance sheet that they can absorb bigger claims in case of eventuality.

Secondly, many insurance companies declined to provide risk cover for new customers. The firms treated them as risky people with high probability of exposure to perils. Buffett’s insurance unit seized the opportunity.

Berkshire’s insurance arms came up with an innovative advertisement. Any person rejected by other insurance companies can apply for any kind of risk exposure, but there was a condition that the minimum insurable interest should be over a million dollar. Buffett was baiting big fish!

He had a knot in the advertisement that got widely published. He would not quote the premium for the risk exposures. Applicants should mention the premium they were willing to pay in the application form itself. If it was satisfactory with Buffett, insurance cover would be given. Otherwise no. There was no question of reconsideration or negotiation. After having been declined insurance from other companies, this was the last opportunity for people. It was too good to ignore. They quoted higher premium which Buffett happily accepted.

More than the individuals in America, insurance companies were equally depressed and frightened. They feared the risk of large scale claims due to natural disasters. Insurance companies wanted to insure themselves first to protect against the risk of insolvency. It came as a great opportunity for Warren Buffett. In the name of reinsurance he provided cover to insurance companies, of course for very big sum in premium.

Twenty one years had gone by since Warren took over the management of Berkshire Hathaway. During that time period Dow Jones Industrial Average doubled whereas the market price of Berkshire shares multiplied 167 times.

That was not the end of his track record. Journey of Warren and Berkshire Hathaway as his investment vehicle still continued.

8. Buying Decision

Thousands were out there on the Wall Street muddling with the stock market. How could Warren Buffett reach a feat that none of them could attain? You may wonder how! If one has to fully understand his life and investment principle, this '*how*' needs to be answered.

One does not need to have highest level of intelligence. Yardsticks he developed in formulating an investment principle, which helped him avoid loss and only produced profit were plan. They were very simple to understand and follow.

"Doctor, what do I eat to lose weight?" asks a patient.

"Don't eat anything," Doctor replies. "You will to become slim."

Buffett's investment approach was as simple as the candid reply above.

People who followed his investment style for many years would agree that it is enough to study Benjamin Graham and Philip Fisher. There is no need to overcomplicate things with technical analysis that involved Greek letters alpha and beta, which no one understood in real sense.

Another aspect to register in mind is the difference between investment and trading. Buying equity shares with a motive to sell it to somebody else for a high price is trade. Stocks are traded like vegetables.

But investment is a different ball game. Mindset of an investor varies vastly from that of a trader. For an investor, equity share is partial ownership in the business of the company – something similar to the title of the land one owns. Anyone who buys share in a company becomes its owner. It's a massive partnership game. The person holding more shares is the majority shareholders and others holding less number of shares are minority shareholders. But overall everyone is a partner.

When we invest in the equity shares of a company with this kind of approach in mind we consider ourselves like the owner of the company. We should analyze the company through the same lens with which we would analyze the business of a restaurant we are interested to buy in our neighborhood. Warren

Buffett reiterated this point over and again.

"*I am a good investor because I am a businessman and I am good businessman because I am an investor,*" said Buffett.

It may sound like egg or chicken riddle, but the underlying message he wanted to convey was that business and investment are so inseparable that no one can make an investment by turning a blind eye to the business prospects of the company.

Before venturing buying any company, an investor should consider the factors such as business competitiveness, anticipated future performance, scope for growth, customer preference, market position etc. His does not have to focus on daily price fluctuations that bring sleepless nights.

One of Buffett's popular quotes is: "*Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years.*"

On the same grounds, he remarked further: "*I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years.*"

An investor's mindset should be different from that of gamblers. Recognizing the difference between the two is the primary trait of disciplined investors, preached Buffett.

Likewise, investment decision should not be done in a hurry without analyzing the facts in details. Putting money into something based on the 'hot news' or 'tips' from the so called investment newsletters can spell doom. Buying stocks in not like owning mobile phones, which you tend to change quite often. Instead, we should act like choosing a life partner, unless you are a person who needs different company every other evening. Spouse or equity share, if properly selected by weighing positives and negatives, it does not have to be changed often.

Well. Having said that, what is the answer to the question, "*How do we select a company for investment, not necessarily for trading?*"

At the beginning of his investment career, Buffett went by the selection criteria defined by Benjamin Graham. The idea was to look for companies that traded below their book value. Over the years he relaxed this rigid template.

Sooner he started believing that the future of the company should be predictable to a reasonable degree. If you are uncomfortable to hold a company for ten years, then do not even hold for ten minutes. That's his take.

The company should be at a strategically advantageous position as opposed to other companies operating in the same industry. "*I will go through annual financial statement of the company under consideration. Then I will study the statement of its competitors*," he used remark very often.

The business should have some unique characteristics as compared with its peers, clearly distinguishable from the crowd. It can be some technology or processes that others cannot simply replicate. Warren Buffett stressed for such competitive advantage. Any business with durable competitive advantage was comparable with castles surrounded by moat.

He also referred such businesses through another interesting analogy. He compared them to owning an unregulated toll bridge, which allows you to increase rates as you wish. Once bought, there was no big concern. A stable bridge does neither need heavy maintenance not incur huge operational cost. It does not take raw material and marketing expenses. Moreover, there is no competition as everyone crossing the river has to use it. Buffett preferred businesses that resembled the bridge.

Warren Buffett was very much attracted towards the companies that possessed moat. Even if they make mistakes, they are very likely to maintain leadership position in their respective markets. In the game of cricket, a good batsman goes on to score a century even if he fails to connect few deliveries. Good batsman and moated businesses are the same. In this connection, Buffett liked Peter Lynch's famous dialogue: "*Go for a business that any idiot can run – because sooner or later, any idiot is probably going to run it.*"

A company may have a great management, but bad times for the whole industry never end. Textile business of Berkshire Hathaway was a classical example. Its bad fortune was none of Ken Chase's mistake.

Companies in commodity business did not possess any moat in whatever form. Customers naturally prefer the company that sells garments cheaper than the rest. On the other hand, the companies enjoying high brand value that operated in industries where customer preference is of paramount importance can be said to be having a business moat. When a customer asks for a particular brand, its competitors lose the game even before contesting. Super-brand companies can effortlessly raise the price when raw material costs surge, whereas its competitors would not have that luxury.

Buffett's moat analogy is quite obvious that anyone can use. It does not take more than average common sense. It a level playing field where everyone is equal. But real success lies in deciding what price we pay for those great businesses.

For example, Coca-cola Company had a history of more than a century. At the age of six, Warren Buffett bough coke bottles from his grandfather's grocery shop and sold them at doorsteps. He knew it was a great business, but waited till his 55th year for making his first investment in it. At the time, share price of Coca Cola was at rock bottom. When a great moated company experiences temporary setbacks, everyone dumps its shares in the marketplace. In reality, they are the most appropriate moments to buy. That was precisely what he had done earlier with American Express stocks during Salad Oil Scandal.

Pouring money in share market for the sake of using off all the cash at hand is totally insane. Willpower and emotional intelligence to patiently wait for right price in good companies is a key quality of good investors. Buffett possessed it. For instance, the market was trading very high in 1973. He also had huge cash position and he just sat on cash.

"*I feel like an oversexed guy on a desert Island. I (didn't) find anything to buy,*" remarked Warren Buffett.

The year before that the investment portfolio of the insurance companies owned by Berkshire Hathaway stood at $101 million, out of which only $17 million was in equity. A year later, share prices declined considerably.

His tone and mood were completely changed as he said, "*I feel like an oversexed guy in a harem. This is the time to start investing*"

In 1982 corporate America was caught by a mania called 'Merger & Acquisitions'. Mad rush towards takeover deals did not infect Buffett. He just watched them passively and wrote to his shareholders as below.

"*As we look at the major acquisitions that others made during 1982, our reaction is not envy, but relief that we were non-participants. For in many of these acquisitions, managerial intellect wilted in competition with managerial adrenaline. The thrill of the chase blinded the pursuers to the consequences of the catch. Pascal's observation seems apt: "It has struck me that all men's misfortunes spring from the single cause that they are unable to stay quietly in one room.'*"

In another letter few years later, he touched upon the same subject with a fable.

"*We believe most deals do damage to the shareholders of the acquiring company. Too often, the words from HMS Pinafore apply: "Things are seldom what they seem, skim milk masquerades as cream." Specifically, sellers and their representatives invariably present financial projections having more entertainment value than educational value. In the production of rosy scenarios, Wall Street can hold its own against Washington.*

In any case, why potential buyers even look at projections prepared by sellers baffles me. Charlie and I never give them a glance, but instead keep in mind the story of the man with an ailing horse.

Visiting the vet, he said: "Can you help me? Sometimes my horse walks just fine and sometimes he limps."

The vet's reply was pointed: "No problem - when he's walking fine, sell him." In the world of mergers and acquisitions, that horse would be peddled as Secretariat."

Moral of the story was loud and clear. Proposal for takeover deals could come from any direction, but he reserved the right to take his own course of action.

One should not end up buying old horse mistaking it for superfast racehorse. For the rest of his life he should spent time and material to maintain it and its health, only to realize that it never runs. This analogy not only holds good for taking over businesses in entirety, but also for taking partial ownership by buying stock on share market.

Buffett recommended people not to pay too much attention to the so called experts, who only made weathermen look more predictable and reliable. In this connection, he also had a story through his 1985 letter to Berkshire shareholders.

"*Ben Graham told a story 40 years ago that illustrates why investment professionals behave as they do:*

An oil prospector, moving to his heavenly reward, was met by St. Peter with bad news. "You're qualified for residence", said St. Peter, "but, as you can see, the compound reserved for oil men is packed.
There's no way to squeeze you in." After thinking a moment, the prospector asked if he might say just four words to the present occupants. That seemed harmless to St. Peter, so the prospector cupped his hands and yelled, "Oil discovered in hell."

Immediately the gate to the compound opened and all of the oil men marched out to head for the nether regions. Impressed, St. Peter invited the prospector to move in and make himself comfortable. The prospector paused. "No," he said, "I think I'll go along with the rest of the boys. There might be some truth to that rumor after all.'""

This was how experts worked. They keep changing their point of views. Most of the times, their beliefs are influenced by popular opinion. Blindly going by their words and investing is definite recipe for disaster. You consider anyone with decent investment track record. He would have invested based on his own conviction backed by detailed analysis, instead of trusting on experts' recommendations.

Another talked about topic involving stock market investment is diversification. Benjamin Graham had been a strong advocate of diversification. After all, it did not make sense to put all our eggs in one basket. Graham suggested spreading the investment in many companies so as to avoid undesirable consequences resulting out of an unlikely failure in a single company.

Warren Buffett did not completely agree with this. No matter how wide the diversification is, value of the investment is bound to decline when the overall market comes down. So, it is prudent to keep the money concentrated in selected few companies, thought Buffett.

Excessive portfolio diversification tends to dilute the benefits from most successful investments. Excessive diversification results from lack of conviction in a selected few companies, he argued.

The success story of America's wealthiest people revealed the fact that they did not diversify their investment in 50-60 corporations. They spotted one wonderful business and stuck with it lifelong. Of course, most of them had invested in their own businesses which they understood better than anything else.

Leaving aside the discussion around diversification for a while, let us shift our focus on what Warren Buffett considers as major selection criteria in buying a company. He paid great attention to the management. Buffett's conviction on honest management was never compromised throughout his career as investor. Many executives in corporate America enjoyed too much of perks themselves, while disregarding the interests of shareholders. Despite great growth potential in the business of those companies, Buffett stayed away from them.

He argued that a company can opt to buy back its own shares when the market price is low, if it was forced to choose between business expansion and buyback. When the company buys back outstanding equity shares from the market, existing shareholders' stake in the business increases. Consider a grocery shop for illustration purpose. It has ten partners with equal interest. The business is doing well. Also it has huge cash position. There are a couple of options in front of them to decide. One is to use the cash to open another shop next street. Second option is to buy out two partners and sever their stake in the shop. By doing this, number of equity shares (partners) come down to eight from ten. Any future profit will be shared by eight partners instead of ten.

Top executives in most of the corporations prefer expansion. Their motive always tends towards expanding the business instead of distributing the cash with the shareholders in the form of dividend or buying back the stocks from the market and thus bringing down number of outstanding shares which ultimately benefits shareholders.

Managers yearn to rule larger corporations since it gives them name and reputation. Moreover, they increase their salary by virtue of company's size in absolute dollar terms. Warren Buffett vehemently disapproved such nonsense. While he did not oppose a company taking over another and achieving better economies of scale, he differed on factors such as business climate and price agreed for takeover.

When majority of the top executives were concerned about their self-interest at the expense of their owners' (shareholders') interests, few companies were buying back the shares with the help of surplus money. Those companies attracted Buffett. Many of the companies he invested heavily had passed this acid test. They were interested in the interests of shareholders and ran the business with higher degree of corporate governance in terms of honesty, transparency and dignity.

It was a win-win situation there. Berkshire made good profit and cash flow by investing or taking over such firms.

Due to this reason, Berkshire Hathaway also became the target of sellers. On one hand major American corporation sat on a pile of cash and looked for businesses for takeover. On the other hand, entrepreneurs preferred selling their businesses to Buffett. All he had to do was to choose the best among them. It was a problem of having too much cash and too many channels to deploy that cash – a clear example of 'the problem of plenty'.

Like a matrimony ad, he ran an ad in his annual letter to shareholders under 'miscellaneous' section. In fact he repeated it every year, stressing Berkshire's acquisition criteria.

"We prefer:

(1) large purchases (at least $5 million of after-tax earnings),

(2) demonstrated consistent earning power (future projections are of little interest to us, nor are "turn-around" situations),

(3) businesses earning good returns on equity while employing little or no debt,

(4) management in place (we can't supply it),

(5) simple businesses (if there's lots of technology, we won't understand it),

(6) an offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast answer - customarily within five minutes - as to whether we're interested. We prefer to buy for cash, but will consider issuance of stock when we receive as much in intrinsic business value as we give. We invite potential sellers to check us out by contacting people with whom we have done business in the past. For the right business - and the right people - we can provide a good home."

Potential seller liked it. Even the shareholders of Berkshire regretted they did not own a business for selling to Buffett.

Defining his acquisition criteria and publishing it made his task easy. Things fell in place naturally. It may be hard for you to believe - he bought a company while walking on the streets of New York City. Let us hear the story from his words.

"*A few years back, management consultants popularized a technique called "management by walking around" (MBWA). At Berkshire, we've instituted*

ABWA (acquisitions by walking around).

In May 1994, a week or so after the Annual Meeting, I was crossing the street at 58th and Fifth Avenue in New York, when a woman called out my name. I listened as she told me she'd been to, and had enjoyed, the Annual Meeting. A few seconds later, a man who'd heard the woman stop me did so as well. He turned out to be Barnett Helzberg, Jr., who owned four shares of Berkshire and had also been at our meeting.

In our few minutes of conversation, Barnett said he had a business we might be interested in. When people say that, it usually turns out they have a lemonade stand - with potential, of course, to quickly grow into the next Microsoft. So I simply asked Barnett to send me particulars. That, I thought to myself, will be the end of that.

Not long after, Barnett sent me the financial statements of Helzberg's Diamond Shops. The company had been started by his grandfather in 1915 from a single store in Kansas City and had developed by the time we met into a group with 134 stores in 23 states. Sales had grown from $10 million in 1974 to $53 million in 1984 and $282 million in 1994. We weren't talking lemonade stands.

Barnett, then 60, loved the business but also wanted to feel free of it. In 1988, as a step in that direction, he had brought in Jeff Comment, formerly President of Wanamaker's, to help him run things. The hiring of Jeff turned out to be a homerun, but Barnett still found that he couldn't shake a feeling of ultimate responsibility. Additionally, he owned a valuable asset that was subject to the vagaries of a single, very competitive industry, and he thought it prudent to diversify his family's holdings.

Berkshire was made to order for him. It took us awhile to get together on price, but there was never any question in my mind that, first, Helzberg's was the kind of business that we wanted to own and, second, Jeff was our kind of manager. In fact, we would not have bought the business if Jeff had not been there to run it. Buying a retailer without good management is like buying the Eiffel Tower without an elevator."

*

Berkshire Hathaway Empire had hundreds of thousands of employees working in various businesses it owned. But in Omaha, at its headquarters employee strength did not cross two digits mark. Multibillion transactions were carried out from an office that looked no better than that of a moderate dentist.

9. Highlights

Even when we miss an ODI cricket match, we don’t fail to watch its highlights. It helps us in catching up turning points, milestones and thrilling actions from the game. Likewise we are going to see some highlights from Warren Buffett’s investment career spanning across decades.

Washington Post

Buffett had distributed Washington Post newspaper when he was a teenage school kid during his father's tenure as a senator. All along his life he was having an eye on that company. It was not until 1971 when Washington Post transformed as a public limited company by issuing share to common public.

A lady, Katherine Graham, was looking after the affairs at Post from top. Of course Katherine Graham was no way linked to Buffett's mentor Benjamin Graham. Fritz Beebe, a close associate of her who was an attorney and provided advice to Katherine, was taking care of finance related matters and running the show as the chairman of the board.

Fate disrupted it when he passed away in two years after the company went public. It left Katherine with no choice than assuming chairman position herself. It was a moment in history as she became the first woman chairman in any Fortune 500 company. Share market viewed this development otherwise. Stock price of Washington Post performed somersault.

At the beginning of 1973, when Washington Post stocks traded at $27 per share, Warren Buffett purchased 18,600 shares. Price continued to decline and reached $23 in May that year. Bufffett accumulated another 40,000 shares at that time. He was buying when everyone else was selling on the street. Towards September 1973 shares breached $20 mark. Buffett was not intimidated. He heaped 87,000 more shares then. In October, he was the largest shareholder in Washington Post outside Katherine Graham's family.

Market capitalization of Post stood around 80 million dollars. The company was totally debt free. Buffett described it as *risk-free* investment and he has reasons to call it so.

It was best described in his own words.

"*If you asked anyone in the business what (the post's) properties were worth, they'd have said $400 million or something like that. You could have an auction in the middle of the Atlantic Ocean at 2:00 in the morning and you would have had people show up and bid that much for them. And it was being run by honest and able people who all had a significant part of their net worth in the business. It was ungodly safe. It wouldn't have bothered me to* *put my whole net worth in it. Not in the least*"

Others on Wall Street dumped Washington Post shares at whatever price, albeit low, it fetched in the market. Ironically most of them were venerable fund managers from leading fund houses. They failed, rather refused, to see the asset values of Post, nor did they attempt to develop an understanding. If there was a reason for their reckless selling action, it was because everyone else was doing so. In fact, all media stocks were available at throwaway prices which could not be explained by any simple logic. They were available for next to nothing.

With all the developments going around, Katherine Graham was frightened at the beginning. She was worried that somebody with the name Warren Buffett was accumulating shares in Washington Post aiming to acquire it or at least take management control. Some of her friends told her good things about Buffett while the rest warned her about the eventuality.

Her anxiety came to an end when Warren Buffett met her to explain his intentions. He clarified that he did not intend to take over the Post under any circumstances and the reason why he bought the shares was because it made sense as a compelling investment. As if to put an end to her anxiety and apprehension, he assured that he would not stop accumulating the shares. It was hard for her to completely understand his motives yet.

Huge number of shares Buffett had in Washington Post allowed him to become a director on the board in the fall of 1974. Till then it was only Katherine Graham's relatives and friends who were on the board. Buffett was clearly an outsider, from a remote place Omaha. But he did not hide his excitement when he attended his first board meeting. He emotionally narrated his childhood story of delivering the very same Washington Post in his bicycle. It was like a homecoming for him.

But he was not a man of stories alone. Sooner Katherine's comfort level with Buffett increased. To some extent he acted as her financial mentor too. Washington Post stocks were trading very low in the market at that time. So he suggested that the company bought back its shares from the open market. Katherine was concerned that she might not have more money for business expansion if the company spends its surplus money in buyback. Though she was born in a family that was traditionally into publishing business, she was weak when it came to financial aspects. Buffett had to explain things and illustrate. His illustration was thought provoking.

Instead of injecting huge capital to fuel overall growth, more growth per share could be achieved by opting buyback. It was like shrinking the number of slices in a pizza. Instead of spending more money in buying another pizza, it makes sense to distribute some cash to the shareholders, do away with them and bring down number of shares for the original pizza itself.

Moreover, you are familiar with the quality and taste of the pizza on hand. Buying a new pizza from an unknown shop or venturing to cook another involves uncertainty. After all, risk is pursuing unknown. A bird in hand is better than two in the bush.

Katherine Graham completely bought Warren's buyback suggestion and agreed to implement it.

Though he had increasing influence on her, Buffett did not interfere on the daily routine activities in the media business of the Post. Katherine highly valued his suggestions. He would motivate her at the times when she was depressed. She would seek his advice on finance matter and follow that advice. Buffett, on the other hand, would encourage her to gain the required wisdom herself and become independent.

Washington Post was a predominant newspaper in Washington. Two out of three in the capital city read that. Other companies fought amongst them for the remaining 33 percent market share. In this backdrop, Time Inc had bought an ailing newspaper called *Star*. Times proposed that Washington Post and Times jointly run Star. If not for warren, she would have accepted the offer.

He strongly argued against such a move. Having 66 percent circulation in Washington, the Post did not have to be nice with not so competitive number two. Thanks to Buffett she made a tougher counteroffer, which Star rejected. There was nothing to lose for the Post as Star would soon go out of business, creating more conductive situation for the Post.

Sizable number of mergers and acquisitions were taking place in the media space. Other media companies such as Capital Cities and Times Mirror seemed to be buying everything that came on their way. Katherine was tempted too, but Buffett restrained her from going after media assets.

That was the kind of reassurances she needed. For a person like Katherine Graham, who was surrounded by enemies and traitors, Buffett was more than a business advisor. Her reliance on him increasingly grew. With him she even attended the meetings of Benjamin Graham investors group, a group formed by a former colleague in Newman-Graham Investment Company. Being a rich widow she desperately needed a reliable male company. Buffett was not only accommodating, but also unthreatening as a male, and they became intimate. They met often and chatted for hours. She took him to her farm in Virginia and her home on Martha's Vineyard. One could understand that the dimensions of their relationship were not just confined within the boundaries of professional acquaintance.

For more than a decade, 11 years to be precise, Warren Buffett was on the board of Washington Post. During his tenure, few interesting things took place. The company started and closed a sports magazine. It bought some newspaper companies and sold some. The company even acquired small interests in cellular phone business. However, the profit Washington Post earned in those venture was meager. Like always, major portion of its profit came from the Post newspaper and four television channels it operated.

If we just look at the overall business growth of the company, in terms of top line, it just grew at just 12 percent annually during his tenure on its board. This was not a phenomenal growth, given the track record and stature of Buffett as an investor. But it was the bottom line that made all the difference. It was simply amazing. In 1974, the company registered 10 percent margin which increased to 19 percent in 1985. It was almost double.

More importantly, the company had retired nearly 7.5 million shares with excess cash, primarily because of Warren Buffett. This buyback exercise reduced the number of outstanding shares by 40 percent. Due to this, profit per share grew by 66.67 percent without increasing the sales by a single penny. Size of pizza slices grew bigger.

Due to all these developments, share prices of Washington Post saw an impressive average annual growth of above 35 percent annually. It stood at 37 percent with dividends taken into account. Of course other media companies also grew during this period, but that was nowhere near the growth produced by the Post. Finally in 1985, when Buffet resigned from Washington Post board, his 10 million dollars had multiplied into an astonishing 205 million dollars.

Buffalo News

If you are visiting Niagara, you cannot miss Buffalo town. It is known for 'Buffalo wings' as well. An evening newspaper, as the name stood for it – Buffalo Evening News – disturbed Warren Buffett. The paper almost controlled entire town in terms of circulation. In Buffalo, there was a leading morning newspaper by the name 'Buffalo Courier Express'. Evening newspaper had twice as much circulation as its morning competitor. It earned 75 percent more in advertising revenue.

Buffett liked the companies that have this kind of durable competitive advantage allowing them to hold on their leadership position. They are like an unregulated toll bridge in a small town. Anyone who had to get in would have to pay toll. Likewise, every advertiser in a one-paper city would have to depend on the paper. Buffalo News perfectly fit into this single bridge analogy. He followed his intuition based on logical reasoning.

Charles Munger and Warren Buffett did not waste much time to make an offer to the newspaper. The formal offer of $32.5 million was irresistible for its owner Manno, who had said $30 million was not enough. This was the largest investment Buffett made for Berkshire Hathaway so far. Even though he owned 10 percent stake in Washington Post, his desire to fully own a media business made him looking for options until it resulted in the purchase of Buffalo News.

There were countless media companies in America which he could have bought out, but Buffalo News was special. Of course it fitted his single bridge formula, but that was not just it. He thought that the bridge operator was allowing many a people to cross without paying the toll. For instance, it only printed evening news. There was no morning edition, nothing on Sundays either. Buffalo Courier Express did both these. Below numbers would better explain the rationale behind the purchase.

Buffalo Evening News circulation – 268,000

Courier Express morning circulation – 123,000

Courier Express Sunday circulation – 270,000

Circulation of courier express was not that impressive on weekdays. It only had one fourth of advertisements that Buffalo evening news attracted. Sundays were different when there was no Buffalo News edition. Courier Express depended heavily on the advertisement revenue from Sunday circulation for its survival.

This situation bothered both Warren and Charlie. They thought that their Buffalo News would soon lose its competitive position without its Sunday edition. Moreover, the company was simply giving away portion of their potential revenue to courier express. So immediately after assuming the position as Chairman at the Buffalo News, he ordered Murray Light to design Sunday paper. A task force was assigned to him to make it happen, while he would be reviewing the progress every month or so.

Within few months Buffalo News brought out its Sunday edition. It order to reach readers real quick, it was decided to sell it below the cost at the beginning. Courier Express sold at 50 cents while (Sunday) paper was given for 30 cents.

The Courier Express was taken by complete surprise. It somehow attempted to prevent Buffett's new venture in Buffalo News. It knew clearly that its very survival depended on Sunday edition. So it took him to the court on charges that he was killing competition and healthy business environment.

On top of everything, the advocate of Courier Express, showed a copy of recent Wall Street Journal article on Warren Buffett, quoting him with the below words.

"*Warren likens owning a monopoly or market-dominant newspaper to owning an unregulated toll bridge. You have relative freedom to increase rates when and as much as you want.*"

Buffalo News was accused for throwing Courier Express out of business. Buffett was asked, "*What you are saying is that owning a monopoly or market dominant paper in a small community is like owning an unregulated toll bridge, is that right?*"

He went on to explain that that Buffalo News had the right to publish Sunday edition like anybody else. After all, Courier Express had been publishing for many, many, many years, all alone in the market.

Judgment day dawned. Courier Express and some section of people had portrayed Buffett as an invader from Omaha, who was taking the people of Buffalo – employees of Courier Express and their families in particular – for a free ride. Courier employees gathered at the court as if the judgment was their final resort to keep up their livelihood.

Constitution of the U.S does not only go by the rules in law book. It also takes in the opinion of the jury, a body formed of people representatives. Based on the recommendations of the jury, the judge would deliver a judgment permissible within the limits of law.

It was not a surprise that a jury of local people prescribed a judgment against Buffalo News. But the judge, however, did not completely prevent its Sunday edition. Still he remarked, "*There are only two newspapers now. If the plan works as I find it is intended to work, there will be but one left*". Judgment severely limited the company's ability to promote, market, and circulate the edition to readers and advertisers.

Courier Express celebrated the judgment by splashing it all across. It also began with a caption on the front page, '*Buffalo Family Owned and Operated*' - just to remind the people and arouse their sentiments.

Warren Buffett had to confront bad press and misinformation campaign. He had to defend unfair criticism and provocations. Employees of Courier Express were so aggressive that they continually targeted Buffalo News. This seriously affected the circulation and advertisement revenue. Local readers and advertisers rallied behind the newspaper that won the verdict. To make things worse, employees at the Evening News could not even publish their self explanation to counter misinformation campaign as they were legally restricted from making defamatory remarks about the Courier-Express. It was like fighting with the hands tied. Courier Express capitalized on the favorable environment that prevailed after court injunction. It also modernized its machinery in a hurry.

One fifth of Berkshire Hathaway's wealth was invested in the Buffalo News Company. Being a new owner of the company, Buffett met the employees often and encouraged them. He expressed his real interest in the business and its success. He would show up wearing T-shirt and casually mix with them. He asked them not to worry about advertisements and the revenue generated through them, and encouraged them to publish quality news. Courier Express was way ahead of Evening News in term of circulation and advertisement revenue in Sunday edition. The Courier Express beat the Evening News by at least 100,000 copies every Sunday.

As a result of these undesirable development, Buffalo News tasted 2.9 million dollar loss in 1978. That was a big blow for Berkshire in general and Warren Buffett in particular. In a note to the investors, Charlie Munger remarked, "*Litigation is notoriously time consuming, inefficient, costly and unpredictable. The ultimate security of the Buffalo Evening News remains in doubt, as it will for a very extended period.*"

Buffett was an upset man. They were troubled times for him. He had to approach the U.S. Court of Appeals in New York which reversed the injunction initially awarded and strongly rebuked Judge Brieant as well.

"*Taking first the issue of intent, we find simply no evidence that Mr. Buffett acquired the News with the idea of putting the Courier out of business as distinguished from providing vigorous competition, including the invasion of what had been the Courier's exclusive Sunday market. All that the record supports is a finding that Mr. Buffett intended to do as well as he could with the News and was not lying awake thinking what the effect of its competition on the Courier would be. This is what the antitrust laws aim to promote, not to discourage.*"

But Buffett was already punished, both socially as well as financially. The damages were hard to repair swiftly, as the situation worsened in 1979 with a loss of a whopping $4.6 million for the Evening News.

To add insult to injury, there were union problems with the workers in Buffalo. Buffett started sweating. He knew that the company would be out of business if the work stopped for a long time. He called the Evening News's chief bargainer Richard Feather over the phone from Omaha and informed decisively that if the paper didn't publish he couldn't process the payroll, and asked the entire staff to quit. If the Sunday edition did not come out, he would close the paper for good. The bargainer knew what Buffett meant. Things were back on track.

Business gradually but slowly improved. It continued to lose money but at a diminishing rate. It was not until 1982 that it could reach 200,000 circulation levels. Even then it was lesser than that of Courier Express. What was noteworthy here is that even Courier Express was under loss. War on Sunday circulation continued and people of Buffalo thought that one of these two papers had to be closed down. It was Courier Express that vanished first as it was losing $3 million a year, twice as much as the Evening News. In the next few months it closed down completely.

The day Courier Express disappeared from scene, the Evening News changed its name to the Buffalo News. As the morning slot was empty it started a morning edition too. In six months its Sunday circulation touched 360,000. It had a telling effect on the readership and advertisement revenues. It translated to $19 million profit that year. When Buffett invested in it, its annual profit was mere $1.7 million. That was a true test for perseverance and sticking to conviction.

Buffalo News operated in a market where there was no competition to mention. Towards the end of late eighties it earned more than $40 million a year. Though former workers of Courier Express and their families carried their dislike for Buffalo News, they had no other choice than reading what they detested. Berkshire had an uninterrupted source of revenue from Buffalo News as it reached invariably all households in Buffalo.

In this whole episode of Buffalo News one crucial fact was noteworthy. Even the people who took him to the court for comparing Newspaper business with unregulated toll bridge might not have known that he owned such bridge, literally. Detroit International Bridge Co. was the owner of the Ambassador Bridge between Detroit and Windsor, across Lake Erie from Buffalo. It was the only toll bridge owned by shareholders in the United States. Warren Buffett owned 24 percent stake in it.

Perhaps Courier Express lawyer Furth did not have a clue about this.

GEICO

Back in 1951, when he was studying in Columbia business school, Warren Buffett had visited GEICO. As he later recalled it, "*The time I spent in Ben's classes was a personal high, and quickly induced me to learn all I could about my hero. I turned first to Who's Who in America, finding there, among other things, that Ben was Chairman of Government Employees Insurance Company, to me an unknown company in an unfamiliar industry.*"

GEICO was based in Washington, DC. On a fine Saturday he took the train to Washington and headed for its headquarters in the downtown. Though the office remained closed, he was able to meet Lorimer Davidson, Assistant to the President. He spent nearly four hours explaining about insurance industry and how it operated. Buffett returned to Columbia with a special interest for GEICO.

Nearly 25 years later, in 1976, he would set his eyes on GEICO big time. From being a small insurance outfit, it had grown enormously to become one of America's leading automobile insurance companies. Lorimer Davidson, who was so generous to Buffett quarter century ago, had become its CEO in due course and taken the company to new heights. It was fourth largest auto insurer in the country.

After his retirement in 1970, GEICO had a change in management. Insurance industry also underwent changing climate. New no-fault laws erupted in the industry and inflation rose in general economy. This hurt all insurers in the country who struggled to maintain their profitability. New management at GEICO adapted relaxed approach to garner more market share in those testing times. It deviated from its conventional approach of insuring low risk drivers. GEICO started providing insurance cover for risky drivers at relatively low premium. Number of policies soared and the premium volume also grew simultaneously. All seemed to be wonderful, but the claims also increased disproportionately. It seriously hit the bottom line at GEICO, which registered a shocking loss of $126 million in 1975. It share price, which traded around $42 a couple years back, now languished below 2 dollars.

Buffett thought it was the appropriate time for him. In fact, he has been waiting for an opportunity to get into GEICO – like he did in Washington Post. It was available at mouthwatering valuation making it hard for him to resist.

Moreover, he felt that he had a moral responsibility to rescue GEICO in which his mentor Benjamin Graham not only served as a chairman in the past but also had his savings even then. It would be a good way of paying his gratitude to the master by helping the company come back on track.

Though GEICO was headed by Ben Graham in the past, it was nowhere near his '*margin of safety*' yardstick to consider as a suitable investment candidate now. Dissident shareholders threw out existing management and elected Jack Byrne as the CEO, who took some drastic remedial actions. He fired seven hundred employees and notified over 300,000 risky policyholders to find another insurer. Insurance regulatory body threatened to cancel GEICO's license, but Byrne was firm.

GEICO had the history of functioning as a low cost insurer. Its operating expenses were just 15 percent of the total premium collected. For other companies in the industry it was around 25 percent. This had allowed GEICO to charge lower premium and subsequently get more market share. With this inherent strength in the backdrop, Buffett thought, the company would be fine if it settled the bad claims of recent times. It would, after all, be a one-off exercise.

Buffett was convinced that it was the right moment to get in. He sent a message to Jack Byrne through Katherine Graham that he wanted to meet him. Byrne turned it down suggesting some other time.

Would Buffett did not give up. In no time, former legendary CEO of GEICO Lorimer Davidson called Byrne and asked if he had ignored Warren Buffett. On hearing the answer, he shouted, "*How can you be so dumb?*" It was not prudent for Byrne to miss an opportunity to meet Warren Buffett at GEICO's low point.

On the night before Washington Post board meeting, Byrne visited Katherine Graham's mansion and met Buffett. They concluded that GEICO should be rescued at any cost. In the next few hours Berkshire Hathaway purchased 500,000 shares of GEICO –at around $2 per share.

Byrne later recalled, "*That night at Kay's(Katherine Graham) was the turning point.*" It was another classical example of a wonderful business going through bad times, like American express in 1960s. But still company was not fully out of danger.

The company had to convince the regulators for more time. Then it successfully negotiated with other insurers to provide reinsurance cover – thus limiting its liability in case of major risks. GEICO gradually recovered from what was supposed to be a one-off setback.

However Benjamin Graham did not last long before the GEICO was back on track. He passed away in 1976 in his eighty second age, with the hope that his disciple would fully rescue GEICO.

(Around the time when GEICO bankruptcy fears floated around, Benjamin Graham wanted to publish the revised version of his *Intelligent Investor* book. He requested Warren Buffett to assist in that endeavor. The student gladly agreed and gave some suggestions that could be incorporated in the new version. Graham, on the other hand, did not prefer to change the traditional approach that was part of his first version. Graham advocated not to put more than three fourth of one's wealth in the stocks. On the contrary, Buffett preferred to put entire wealth into stocks if the investment was compellingly attractive and convincing. Due to such small differences of opinion, *Intelligent Investor* was not jointly revised by both of them. Graham completed the task himself.)

In six months since Buffett took his first exposure in GEICO, its shares quadrupled to $8.12. Over a period of time Berkshire doubled its stake in GEICO. Buffett wrote in one of his letters to Berkshire shareholders, "*Because I believed both in Jack and in GEICO's fundamental competitive strength, Berkshire purchased a large interest in the company during the second half of 1976, and also made smaller purchases later. By yearend 1980, we had put $45.7 million into GEICO and owned 33.3% of its shares.*"

This allowed Buffett to have controlling stake in GEICO.

Warren Buffett had full faith in Jack Byrne. He reciprocated the trust by running the business responsibly. Like Ken Chase of the textile division of Berkshire Hathaway and Katherine Graham of Washington Post, his professional relationship with Byrne also flourished.

Over a period of time the company bought back its shares from the open market and reduced number of outstanding shares. For fifteen years, from 1980 to 1995, Berkshire did not purchase even a single share in GEICO. Still its interest in GEICO increased from 33.3 percent to 50 percent, thanks to buyback initiatives.

In 1995 more than 3.7 million cars in the US took insurance cover from GEICO. Berkshire offered to buy remaining portion (50 percent) of the stakes in GEICO from other shareholders and succeeded in that attempt. Berkshire paid an astonishing 2.3 billion dollar to buy those interests. The price Berkshire paid seemed to be on the higher side. But due to the fact that the insurance industry was set to grow phenomenally in the US and also because GEICO was a prominent player in that field Berkshire was prepared to pay higher premium.

In his letter to his shareholders that year Warren Buffett made a special mention about GEICO.

"*(at the age of 21) I wrote a short report late in 1951 about GEICO for "The Security I Like Best" column in The Commercial and Financial Chronicle, a leading financial publication of the time. More important, I bought stock for my own account.*

You may think this odd, but I have kept copies of every tax return I filed, starting with the return for 1944. Checking back, I find that I purchased GEICO shares on four occasions during 1951, the last purchase being made on September 26. This pattern of persistence suggests to me that my tendency toward self-intoxication was developed early. I probably came back on that September day from unsuccessfully trying to sell some prospect and decided - despite my already having more than 50% of my net worth in GEICO - to load up further. In any event, I accumulated 350 shares of GEICO during the year, at a cost of $10,282. At yearend, this holding was worth $13,125, more than 65% of my net worth.

You can see why GEICO was my first business love. Furthermore, just to complete this stroll down memory lane, I should add that I earned most of the funds I used to buy GEICO shares by delivering The Washington Post, the chief product of a company that much later made it possible for Berkshire to turn $10 million into $500 million.

Alas, I sold my entire GEICO position in 1952 for $15,259, primarily to switch into Western Insurance Securities. This act of infidelity can partially be excused by the fact that Western was selling for slightly more than one times its current earnings, a p/e ratio that for some reason caught my eye. But in the next 20 years, the GEICO stock I sold grew in value to about $1.3 million, which taught me a lesson about the inadvisability of selling a stake in an identifiably-wonderful company."

He went on to speak about Lorimer Davidson.

"Let me bring you up to date on Davy. He's now 93 and remains my friend and teacher. He continues to pay close attention to GEICO and has always been there when the company's CEOs - Jack Byrne, Bill Snyder and Tony - have needed him. Our acquisition of 100% of GEICO caused Davy to incur a large tax.
Characteristically, he still warmly supported the transaction.

Davy has been one of my heroes for the 45 years I've known him, and he's never let me down. You should understand that Berkshire would not be where it is today if Davy had not been so generous with his time on a cold Saturday in 1951. I've often thanked him privately, but it is fitting that I use this report to thank him on behalf of Berkshire's shareholders."

Not forgetting the past was one of the key attributes of Buffett's long term success.

Over the years GEICO became major engine of growth for Berkshire. The secret behind its low cost operation was achieved by completely eliminating the agents and dealing directly with the motorists. Other companies approached their policyholders through agents. This scenario allowed GEICO to competitively price its products. In his 2005 letter to Berkshire shareholders

Buffett wrote, "*When Berkshire acquired control of GEICO in 1996, its annual advertising expenditures were $31 million. Last year we were up to $502 million. And I can't wait to spend more.*"

On January 2, 1996, Berkshire acquired the remaining 50% of GEICO for $2.3 billion in cash, about 50 times the cost of its original purchase. Warren Buffett was more than happy to spend that money as its potential was so imminent. He would recount this in his 2009 annual letter as, "*GEICO's customers have warm feelings toward the company as well. Here's proof: Since Berkshire acquired control of GEICO in 1996, its market share has increased from 2.5% to 8.1%, a gain reflecting the net addition of seven million policyholders.*"

Nebraska Furniture Mart

Buffett did not have any rigid rule while looking for investment options. He was open to any company in any industry as long as it had competitive advantage. Well, generally people visit furniture mart to buy table and chairs. Buffett, on the other hand, bought a whole furniture mart.

In the summer of 1983 he entered into Nebraska Furniture mart and started a conversation with its owner. After talking casually for few minutes, he asked whether she would consider selling her stake to Berkshire.

"*Yes,*" was the reply.

Warren wanted to know what her ask would be.

Once she specified the amount, Buffett shook hands with her. He pulled out a one-page agreement ready from his coat pocket. Within few days he handed over the check for $55 million to her. She did not even verify the amount, but accepted it. The age of this lady who held back ten percent stake and sold remaining 90 percent in Nebraska Furniture Mart to Warrant Buffett was 90.

Fifty five million dollars was the largest investment Warren Buffett has made in his investing career.

Owner of the furniture mart was Rose Blumkin - people called her Mrs.B. She was born in a Russian village and spent her childhood with seven brothers and sisters. All of them slept in one room. At the age of 21 she married Isadore Blumkin who headed for America. Five years later, in 1919, she settled with her husband in Omaha without a penny in their kitty. Her husband ran pawnshop and secondhand clothes store. Mrs.B knew no English, not even a single word. Her children who learned it in the school taught her back at home.

In 1937, she was forty four. Still struggling to support her family, she managed to pull together $500 and rented a store on Farnam Street in Omaha to open a furniture store. She thought big and looked up to the American Furniture Mart in Chicago which served as the hub of wholesale furniture activity in the country. Her motive was to make it the center for furniture business in Nebraska State, not remain as yet another store in the neighborhood. With that vision she named her store '*Nebraska Furniture Mart*'. Incidentally this store was one block away from the original Buffett grocery run by Warren's grandfather Earnest Buffett. When Nebraska Furniture Mart was founded, Warren Buffett was busy selling coca cola as a six year old boy.

Mrs.B believed with the mission statement: "Sell cheap and tell the truth" In his 1983 letter to shareholders, Warren rightly recalled the history of the mart:

"*Omaha retailers began to recognize that Mrs. B would offer customers far better deals than they had been giving, and they pressured furniture and carpet manufacturers not to sell to her.*

But by various strategies she obtained merchandise and cut prices sharply. Mrs. B was then hauled into court for violation of Fair Trade laws. She not only won all the cases, but received invaluable publicity. At the end of one case, after demonstrating to the court that she could profitably sell carpet at a huge discount from the prevailing price, she sold the judge $1400 worth of carpet."

Buffett had been observing the Nebraska Furniture Mart for a long time. He quickly glanced through the tax returns of the mart and learnt that it was earning about $15 million a year pretax. That seemed enough for him - he did not perform any of his regular scrutiny such as, obtaining audited financial statements, checking real estate records, assessing inventory etc. He believed that they would be in order and presented the check for $55 million. Trust was one reason, but there were other reasons too.

Nebraska Furniture Mart was the biggest furniture store in the U.S generating $100 million revenue. It accounted for two third of total furniture sales in Omaha. Many furniture stores gave away the idea of opening a shop in Omaha suspecting their ability to compete with Mrs.B, a reason good enough for Buffett to acquire it.

Despite buying out the business, Buffett requested Mrs.B to run the furniture mart as usual, which she was accepted gladly. He would remark, "*She remains Chairman and is on the sales floor seven days a week.*" The shop was her world, which she created from scratch. A local newspaper quoted her saying, "*I come home to eat and sleep, and that's about it. I can't wait until it gets* *daylight so I can get back to the business*"

In fact, Buffett had retained her by offering three times her previous salary, which explains how far he valued her service and administrative abilities.

In May 1984 Mrs.B, who spoke broken English, was felicitated with a Honorary Doctorate in Commercial Science by New York University. Previous recipients of honorary degrees in business from the university included the CEO of Exxon Corp, CEO of Citicorp, CEO of IBM, CEO of General Motors and FED chairman. Buffett acclaimed it in his annual letter to shareholders, "*She's a "fast track" student: not one day in her life was spent in a school room prior to her receipt of the doctorate.*"

He has been observing her from his childhood. His continued to admire her like a child. He talked about her like a schoolboy would talk about his grandmother. If she could covert $500 to the largest furniture store in the country, then imagine what she would have done with $1000, he would comment.

In 1976 the Furniture Mart's sales was $44 million. It rose to $132 million in the next 10 years. While the business and sales flourished, difference of opinion erupted between Mrs.B and her grandsons who were running the store. She criticized Buffett for allowing them to run to do so and quit in anger. She called her grandsons as 'Hitlers' and accused they were wasting the time in meetings. The 96 years young lady did not remain calm after quitting and staying at home for few months.

She opened a new store called "Mrs. B's Warehouse," adjacent to the Furniture Mart. Buffett had to be on his toes.

He realized the mistake he had done. At the time of buying the Nebraska Furniture Mart from her he did not include 'conflict of interest' clause in the agreement, which would have protected the interests of the business he bought from her. He knew it was stupid to compete with her. So he took two dozen pink roses to Mrs. B on her birthday.

He would eventually buy this new store from Mrs.B by paying $5 million. This time he did not forget to include all intricate clauses.

Time passed by. In 1993, sales of the furniture mart increased to $200 million. Buffet made a special mention for BFM and Mrs.B in that year's letter to Berkshire shareholders. He remarked:

"*Mrs. B - Rose Blumkin - had her 100th birthday on December 3, 1993. (The candles cost more than the cake.) That was a day on which the store was scheduled to be open in the evening. Mrs. B, who works seven days a week, for however many hours the store operates, found the proper decision quite obvious: She simply postponed her party until an evening when the store was closed.*

Naturally, I was delighted to attend Mrs. B's birthday party. After all, she's promised to attend my 100th"

Warren Buffett was 63 when he wrote this. Rose Blumkin did not keep up her words - she passed away in 1998, at her 104.

But the furniture mart she founded has become an integral part of Berkshire family and the legacy that Warren Buffett carries with him.

Coca Cola

Two things people from Asia prefer to see in Atlanta are CNN headquarters and coca cola museum.

Coca cola had its beginning in Atlanta and now it is everywhere in the world. There are few, only a few, parts in this world where coca cola has not penetrated. Young to old, east to west, everyone drinks it. But what they don't know is that a portion of what they pay for a tin of coke goes to Warren Buffett?

Like in Washington Post and GEICO, an opportunity awaited him to reestablish his connection with Coca cola also. The company was started in 1880. It sold the same beverage for more than a century. Coca cola had a unique taste.

Buffet had realized this much early in his life. At the age of six he knew how people were addicted to the taste of coke, when he sold it from door to door. The energy and refreshment the beverage produced was unmatchable with any other aerated drink. These attributes, he thought, were important for the company to spread its wings from Atlanta to everywhere around the globe.

The business model of coca cola was very simple to understand. It had the pricing power with superior competitive advantage and moat. Its brand value was unparallel and can be attributed to global unregulated toll bridge. The company, however, faced a temporary challenge in late seventies.

Philosophers say that most problems in this world come in the form of money. For the poor it is due to scarcity of money and for the rich it is due to abundance. Coca cola fell into the second category. It had too much money to deal with. In mid-seventies its Chief Executive Paul Austin had the problem of handling $300 million surplus cash. He diversified into an array of businesses that had nothing to do with conventional soft drinks it was known for. The company invested in water purification, wine, shrimp farming, plastics, nutritional drinks, and fruits and vegetables.

Compared with coke, the profit from these businesses was meager. On top of this the cola major also had problems with its international business. Sales in overseas markets were left to the bottling partners. Some of them did not do justice in terms of maintaining the standards. All these factors collectively made the share prices of Coca Cola languish in seventies.

Eighties were no different. Goizueta, subsequent CEO of Coca Cola who took over in 1981, also further accelerated diversification. Next year the company bought Columbia Pictures from Hollywood. Annual report gave more importance to the movie and vineyard divisions than its tradition beverage business. It devoted six pages to its film studio and wine business and only three pages to overseas cola sales.

The company rolled out diet coke in the next few years. Coca Cola locked its horns in a fierce competition with Pepsi and in that process started introducing new drinks. It went to the extent of abandoning its century old and time-tested syrup formula and coming out with *New Coke*. That was the height of stupidity that proved counterproductive. The old drink was eventually introduced back due customer expectations .

In the later part of eighties the company realized its mistake with too much diversification and mismanaging soft drinks business. It gradually exited from other ventures and started focusing more on expanding its coke business – especially in overseas markets.

Philippines were a good example. An increased attention there allowed the company to capture two third of market share it had earlier lost to Pepsi. It also strengthened bottling operations in South American countries including Brazil, African countries such as Egypt, some parts in East Asia and Europe. It tried to penetrate into every promising market.

In the period 1984-87, during which there was an increased focus on overseas sales, Cola's foreign profit surged from $607 million to $1.11 billion. Despite sales in terms of gallons rose by 34 percent, it could register more than 87 percent rise in profit primarily due to its leadership position.

Warren paid more attention to the changed strategies of Coca Cola. Numbers spoke more than anything else. Overseas profit of the company was a tad more than half (52 percent) in 1984 and it was close to 75 percent in 1987. Initiatives taken by the new management started yielding the fruits of success.

What was more interesting for him was the untapped potential for coke in international arena. There was whole lot of geographies where it had enormous scope for expansion. He would later write to his shareholders, "*What was already the world's most ubiquitous product [had] gained new momentum, with sales overseas virtually exploding.*"

Above all these changed business dynamics, there was another key factor that caught his attention and ignited curiosity. Its management was using surplus cash to buy back stocks. Resorting to buyback was one of best ways of rewarding the shareholders, according to him. Reducing the number of slices in the pizza was a true indicator of good corporate governance.

Buffett repented in one of his annual reports for not having invested in Coca Cola earlier.

"*I continued to note these qualities for the next 52 years as Coke blanketed the world. During this period, however, I carefully avoided buying even a single share, instead allocating major portions of my net worth to street railway companies, windmill manufacturers, anthracite producers, textile businesses, trading-stamp issuers, and the like. (If you think I'm making this up, I can supply the names.) Only in the summer of 1988 did my brain finally establish contact with my eyes.*"

In 1988 the stock had fallen 25 percent from its previous peak. A section of security analysts felt it was still overvalued and due for further correction. Again, this fitted into Buffett's theory of an extraordinary business going through bad phase. Indeed Coca Cola was going through good phase as far it is operations were concerned, it was only the market that thought otherwise.

Top management of the cola major sensed something abnormal as one broker was buying its shares in huge number. Donald Keough, number two in Coca Cola, suspected that the broker was buying it for warren. Interestingly, Donald and Warren had been childhood neighbors. CEO Roberto Goizueta requested him to speak to Warren right away which he obliged. When probed the man in Omaha acknowledged that he was accumulating stocks in Cola, but asked him not to disclose the news till he signaled him. In the next one year Berkshire Hathaway poured in $1.02 billion in Coca Cola to garner nearly 7 percent stake with an average cost at $10.96.

In the next three year profit of Coca Cola surged 64 percent. Wall Street's perception about the company's fortunes revived even more. Market men clearly understood that it was no longer an American company, but an international business powerhouse. (In reality Cola had gone global many years ago. It was bottled and sold in China back in 1928)

As a result of changed perception amongst investment community, share prices of the company grew faster than its profit. Within five year stock surged to $74.5 turning his $1.02 billion investment into $13 billion fortune. The company also bought back shares at times.

"*In fact, if I had been thinking straight I would have persuaded my grandfather to sell the grocery store back in 1936 and put all of the proceeds into Coca-Cola stock. I've learned my lesson: My response time to the next glaringly attractive idea will be slashed to well under 50 years,*" remarked Buffett.

After having made the investment in Coca Cola, Buffett had not sold them. The company continues to hold an important place in the investment portfolio of Berkshire Hathaway. In other words, Coca Cola has been the synonym for Berkshire's ongoing success.

10. Lesson Learnt

Life is not all about highlights and success stories. What is more important than a series of success is how a person manages to get over unforeseen failures. Salomon Brothers is one such story in Warren's investment career.

The story goes back to Ferdinand Salomon who migrated to New York towards the fag end of nineteenth century. He carried out his family business of money broking by arranging short term loan for security firms on Wall Street. He had four sons - three of them assisted him in the business at the beginning of 20^{th} century.

Ferdinand was a conservative Jew who firmly believed in observing Sabbath (weekly off) on Saturday, but the sons insisted to work as Wall Street was open for half day on Saturdays. The rift widened and the sons decided to quit. In 1910, they raised $5,000 to start on their own – a venture they named as 'Salomon Brothers'.

This entity grew in due course. They specialized in bond underwriting, a business that flourished in corporate America over the decades. As a matter of fact even Warren Buffett's Berkshire had hired Salomon Brothers to raise $20 million in early seventies. Later in the decade, IBM awarded a major contract to Salomon for $1 billion debt offering. That was a defining moment because Wall Street bellwether Morgan had just then refused to underwrite this mega fundraising exercise by IBM.

In the late 1980s, apart from traditional bond business Salomon Brothers also got into equities as well. Business magazines started recognizing it as the "King of Wall Street." But it was true that the profit from equities and investment banking was nowhere its bonds business. An undeterred chief executive John Gutfreund poured in money in these divisions to strengthen them. Its payroll increased threefold in a span of few years and operating expenses ballooned.

The stock market was at its peak in 1987, making equity investment expensive. Buffett exited from some of the investments Berkshire had made in the past. He was left with very few choices where he could put his money. At around the same time Salomon Brothers share price had dropped by one third.

Buffett had high regards for Gutfreund who had helped arranging quick finance for Berkshire in the past. He also trusted his integrity. Though Salomon Brothers was not exactly for a valuation he would have preferred, Buffett decided to invest in it primarily due to the faith he had in Gutfreund and the prevailing market conditions.

Unfortunately he failed to notice the chaotic situation in Salomon and some of the frauds that even Gutfreund had no knowledge about. He might have considered Salomon Brothers as another fitting example of wonderful business going through bad phase. He made a $700 million investment in Salomon preferred shares, something safer than common stocks. Both Warren Buffett and Charles Munger had a seat on Salomon board.

On the personal front Gutfreund lived a luxury life. He remarried a flight attendant – much younger than him. Others shareholders felt that she was having too much influence on Gutfreund in running the business and concerned that she was influencing major decisions. There was no control in the company - it did not have a dedicated Chief Financial Officer.

Employees were given generous salaries and other perks. For instance, Salomon's profit in 1990 plunged by $118 million whereas bonus to employees increased by $120 million. Ironically, the share price was not better than what it was eight years ago. During the same period Dow Jones had gone up three times, an indication of how badly investment community perceived Salomon's business fortunes. Shareholder did not gain anything from the company, but the perks and bonus for employees were increasing every year. Buffett strongly opposed these.

On top of the perks, what was even more shocking to Warren Buffett was the salary level in Salomon. Company was making meager profits, but 106 executives were drawing more than a million dollar annual salary. Usually Buffett did not interfere with the CEOs of the companies in which he invested; he would rather stand by them in all the initiatives they took. But in this case he was against Gutfreund. He met the executive committee and asked them to cut perks. He voted against the bonus plan, first time voting against the management as a director. This news of him voting against Gutfreund fuelled speculations in Wall Street.

Another problem within Salomon Brothers was gradually building up underneath the surface, which would make this bonus and salary problem look too small. Name of the problem was Paul Mozer. He was in his thirties – an energetic young man and the head of government bond desk at Salomon. Mozer was hard working, he installed trading screen at his apartment and took calls from London early in the morning. He was shrewd, but equally crooked.

Before getting into the scam that Mozer architected,it is important for us to get some insights about government bonds. Like individuals and corporate all over the world, governments also borrow money. They do so through issuing bonds, which are sold by the government and people buy them. When the bond matures it can be surrendered and the money can be taken back with interest. If a bond investor cannot wait till maturity (redemption) he can sell those bonds in the open market where they are traded. Bond prices fluctuate based on interest rate and other macroeconomic indicators. Market for government bonds is very big. Volume of bond trading was more than equity turnover on New York Stock Exchange.

There was a special place for primary dealers, a group of firms recognized by the Federal Reserve Bank of New York with whom the federal bank did bulk of its trading. Only these primary dealers can submit bid in treasury auction on behalf of their clients. Out of thirty nine primary dealers in the U.S., Salomon was most respected which also took biggest share of bonds. Mozer was the in-change of government bond section at Salomon. His job was to bid for bonds at treasure auction of the government.

In the past government was too much dependent on Morgan banker for treasury auction which accounted for half of the amount. It feared that Morgan might become a monopoly and pose a threat. Due to this the U.S. government imposed 35 percent upper limit for a dealer. Securities were awarded on prorate basis. Mozer found a loophole to bypass this process.

Only the awarding was limited to 35 percent, but not bidding. Mozer made use of that. In 1990, for example, he bid for double the (total) number of securities up for auction. Salomon was awarded major portion of g-notes even after prorating. A government official who was in charge of the Treasury auctions figured this out and warned Mozer not to do it again hoping that it was not going to repeat.

But Mozer disregarded that warning. Within a couple of weeks $5 billion bonds were up for auction. He submitted bids for $10 billion. Michael Basham, the official who had just mildly warned him on the previous occasion, was surprised to see this again. He rejected Mozer’s bid to the tune of $8.25 billion saying that bids too were limited to 35 percent.

Mozer should have realized the gravity of the mistake he dared to commit and kept his mum. Instead he exhibited weird behavior threatening Basham and taking up the matter with treasury secretary. He also took it to the press which infuriated treasury officials. Section of Salomon top management was alarmed and patched up with undersecretary of auction in the government. They made Mozer apologize. The matter, however, did not reach Gutfreund at Salomon.

Having left without any legal action against him after indulging in a massive scandal, Mozer should have felt lucky. Any sensible man would have realized such grave mistakes and corrected. Mozer was a man at different level. He was determined.

He submitted bids on the names of the clients who had not actually authorized him to do so. In 1990 he submitted fake bid of $1 billion on behalf of Mercury Asset Management, which had no idea about what was going on. He later sold from Mercury’s account to Salomon’s account. Same modus operandi continued in 1991 when he submitted 35 % bid for two clients and another 35% for Salomon – totaling 105%. Three accounts were awarded 57% of the total issue.

Eventually all allotted securities were transferred to Salomon account. Treasury officials did not have a clue that all the bonds were going to one account. Usually when Mozer submitted phony bids on behalf of the clients, he would write "No Confirm" on the bid form to make sure that the client will not get any notification about bond awarding.

This time a Treasury official sent a letter to an official in Mercury Asset Management by name Charles Jackson, despite 'No confirm' indication. The bid was submitted by Salomon on behalf of Mercury. Jackson was taken by surprise as he had not authorized any such bid.

Mozer, to whom the copy of the same letter was sent, was desperate to cover himself. He rang up Jackson and told him that the bid was due to an error by a clerk at Salomon which he was correcting now. He also asked him not make an issue about of the letter from treasury. Jackson let it go. Fearing that Jackson or Treasury official might report to Salomon management, he went up to his boss Meriwether and 'proactively' informed that there was a human error – one-off kind.

When CEO Gutfreund came to know about this fake bid he was terribly shocked. Top management knew how criminal and serious it was. Gutfreund feared it could spoil the reputation of the company and potentially impact its future. Meriwether defended Mozer as a hardworking and efficient guy. They left without taking any action against Mozer. Also they felt it was important for them to keep the President of the New York Fed, whom Gutfreund knew very well at personal level, informed about the mistake. (All these exercises were on the assumption that the fake bid was not going to repeat again)

Habits die hard – bad habits die harder. He just had his second warning cum lucky moment, but was not prepared to give up. Perhaps he was determined to spell disaster for Salomon Brothers. In the next auction for two year treasury notes also he continued his tricks. This time he not only applied on behalf of two clients, but also submitted bids at a very high price. As a result 87 percent of the total issue was awarded to three accounts (Salomon and its two clients).

Other dealers had commitments to deliver two year notes, but $10.6 billion worth of securities were grabbed by Mozer. People were desperate for these securities driving the both the demand and price. Mozer made a quick $18 million in this crunch.

It was very obvious that only Salomon could have done this. Other dealers and traders cried foul for the crunch of securities which produced loss to many and forced some of them out of business. The issue was taken up by Securities and

Exchange Commission. Political pressure mounted. Investigation was set up and old records of Salomon Brothers were pulled out.

A monstrous scam in the financial sector was slowing uncovered. Gutfreund was a concerned man because Salomon had just started reviving its fortunes. The company was targeted by both civil and criminal investigating agencies. Market reacted badly to these developments at Salomon as the stock price dropped to $27 from $37 within a fortnight. Situation was so bad that the primary dealership for government securities was at risk.

Things were clearly getting out of control and it dawned on Gutfreund when he woke up in a morning to see his picture in the New York Times. As a devastated man he called it a day. From New York he called up Buffett in Omaha and said, "*I just read my obituary. Look at the paper.*" He went on to inform his decision to quit. Further, he requested Buffett to assume the position of CEO and rescue Salomon Brothers.

Warren Buffett was under no obligation to assume responsibility to run the business at Salomon. It was unwarranted. He hesitated to agree as he had always been careful about not getting into such complications. Despite being one of the richest men in the world, his life had been running smoothly in Omaha.

Moreover, his investment in Salomon Brothers was through preferential shares – not common equity shares. If the company goes broke it should first pay the debts before paying anything to the shareholders. Being a preferential shareholder, Berkshire's capital would be returned before reserving anything for common shareholders – but certainly after retiring debts. So Buffett knew that his $700 million investment in Salomon Brothers was not at too much risk even at the eventuality of liquidation.

It was not common for him to take up management position in the companies he invested in. He knew how it would change his life and lifestyle. Also he preferred not to go out of Omaha. Magazines predicted that he would not step into Gutfreund's shoes. His son warned him, "*Everybody who ever wanted to take a shot at you is going to do it now.*"

He proved everybody's prediction wrong. Like a superman at the time of danger, he decided to accept the role. He perceived it as a challenge to his reputation and integrity. As the biggest shareholder and member of the board, he felt responsible for the failure of its management.

Buffett flew eastward to New York to accept CEO position at Salomon Brothers. While he was flying, trading of its shares were halted on the exchanges and its normal business had come to standstill. Employees and shareholders held their breath hoping that he would put the company back on track. They eagerly awaited his arrival.

One executive at Salomon reflected the mood, "*The whole firm had put down their phones. They knew there was a meeting of the office of the chairman going on. We had this curious suspended animation while we were waiting for the CEO to get here on his plane.*"

He forgot his sense of humor at least for the time being. A normally relaxed Buffett was on his toes - swift, brisk and alert like a warrior at battlefront. He knew there were good number of people around to stab him if he took his eyes off.

One of the first things he did after taking up the CEO position at Salomon was to meet regulatory authorities. He and Munger went to see Richard Breeden, chairman of the SEC and assured full cooperation in the investigation. Richard was impressed when he heard Buffett saying, "*Call us anytime someone doesn't give you what you want. You'll have a new person to deal with in twenty minutes.*"

He pleaded the authorities not to cancel primary dealership in dealing government securities and bought more time.

Then he addressed media. In the three-hour long press conference, he declared he was going to discharges the duties of CEO without drawing any salary. He said that he would continue in that position till he sees Salomon out of woods. After that, he said, Deryck Maughan would run the company. It was also announced that Salomon may bid at Treasury auctions for its own account, though still not on behalf of its customers.

He took some drastic actions with extreme caution. He summoned company's legal advisor Donald Feuerstein who held the position of the general counsel under erstwhile CEO Gutfreund. Donald was asked to leave without explanations. He appointed one Robert Denham to that position. Robert was a partner at Munger Tolles in Los Angeles, which Charles Munger ran. Also he had been Bufffett's lawyer looking after legal matters in Berkshire. It was hard for Robert to turn down Buffett's request, "*Bob, I really need you.*"

Gutfreund did not maintain direct contact with his managers and review their performance regularly. That was why a scam to this altitude did not come to his attention at all. The company could not afford any further scams. He wanted everyone to completely comply with the rules and said, "*Anything not only on the line, but near the line, will be called out.*" Also, he shared his home telephone number with top managers at Salomon and instructed them to call him any time should there be any indication of further misconduct.

Warren Buffett was effortlessly putting the company back on track. There was no doubt about it. He got another opportunity to exhibit his full potential. Though it can be perceived as a challenge, Buffett fully capitalized on that and would steal the show.

He was not ashamed to stand in front of people's court. Guilt should be worried, he was not guilt. He was neither a criminal nor a conman. He was the richest American, statesman and trendsetter in the world of investment. Yet, as the CEO of Salomon Brothers he needed to appear before Congress and explain what went on.

Media was in full attention. People from all walks of life gathered to see what he had to say. They included observers of financial world, Salomon executives, legal experts, politicians from both major political parties, social observers etc. Many photographers clicked him. Television channels caught him live and beamed it all over the country.

Some representatives of the house congratulated him for throwing Salomon's former top management. Some members, though acknowledged he was not involved in the fraud, held him responsible.

It was not unusual for big men to appear before congress committee, but none of them ever uttered sorry. But Buffett did not hesitate to accept the mistakes. His starting note itself brought people to the edge of their seats.

He began, "*I would like to start by apologizing for the acts that have brought us here. The Nation has a right to expect its rules and laws will be obeyed. At Salomon, certain of these were broken.*"

He informed the representatives of the people of America that they had changed old management and the new one is determined to completely comply. Finally he remarked, "*the spirit of compliance is as important, or more so, as the words.*"

He also spoke on behalf of eight thousand employees by saying that most of them were '*hardworking, able, and honest*' indicating that they should not be punished for the guilt of one person called Mozer.

At the end of his explanation, he sent a message to the employees of Salomon Brother through their television screens.

"*I want employees to ask themselves whether they are willing to have any contemplated act appear on the front page of their local paper the next day, to be read by their spouses, children and friends. ... If they follow this test, they need not fear my other message to them: Lose money for the firm and I will be understanding; lose a shred of reputation for the firm, and I will be ruthless.*"

Buffett handled the hearing calm and composed. It was a performance par excellence.

Investigations by regulatory agencies revealed everything. Paul Mozer, main architect behind whole episode, was levied multi million fine and sentenced in prison. Salomon Brothers, as a company, had to pay a fine of $290 million – second largest penalty ever levied against a U.S. financial institution. The amount included $100 million set aside for private suits filed by other dealers. It was a single mistake that cost the company heavily.

All the problems that Salomon Brothers faced from legal and regulatory perspective were either resolved or settled. Nonetheless for Salomon it was not like the older days still. Troubles spurt from many direction with varying size and shape for the company now. People demanded higher salary, bonus etc.

Salomon Brothers was never the same again. The company struggled to regain its old reputation. Business was dull. Employees worked hard, but were soon exhausted as it did not translate into business profitability. Buffett would meet them every now and then to boost their morale.

He said, "*I have seen a couple of companies taken into the emergency ward. . . . American Express in 1963 and GEICO in 1976. ... At GEICO a few people made mistakes. It went from being an organization with enormous pride to an organization that was in doubt. Policyholders were leaving by the tens of thousands. I have to tell you that the period did last for some time. Jack Byrne had to wrestle with one alligator after another.*"

As long as he held the CEO position at Salomon Brothers, he felt as if he was doing tight rope waking. He had never been so distressed except when his wife Susan underwent surgery. Salomon Brother days were defining moments in his life.

Finally in June 1992 he resigned as the Chief Executive Office of Salomon after holding that post for crucial nine months. During that period when he was running the show, the company's stock price rose 25 percent.

He felt he no longer needed to spend his life in busy New York. The prison in the World Trade Center (the twin towers that would later be demolished by Bin Laden's men in 2001) where Salomon functioned was not meant for him. It was time for him to return to Omaha.

Interestingly, when he stepped down from Salomon Berkshire shares traded at $9,100. Next year it touched $17,800. Investment community celebrated his return to Omaha and his full attention to its investment decisions.

As far as Salomon story was concerned, there are people who consider it to be the black chapter in his career. For others, however, Salomon episode was an opportunity for the world to understand his true quality as a human than his success as an investor.

11. Spreading the Wings

Warren Buffett’s life was not spent in making money alone. Of course he earned unimaginable sum of money, but he also earned millions of investors and shareholders of Berkshire who held him above god. Perhaps that was his single success that brought him larger-than-life stature.

One should attend Berkshire Hathaway’s annual shareholders meeting in Omaha to personally feel the vibration and the mood of celebration. Thousands of people arrive there every year for this special day when he directly interacts with them. Numbers have only been increasing with visitors from the U.S and other parts of world.

There are people who bought just a single share in Berkshire to earn entry ticket to the annual meeting and be able listen to what he got to say. They spent more money in travelling to Omaha than what they spent to buy the share in the first place. The crowd included mutual fund managers, experts in the stock market and economists along with regular longtime investors of Berkshire and aspiring young investors. They fled to Omaha as if going on a pilgrimage carrying copies of his annual report & special letter to shareholders.

Buffett would be out of media limelight most of time, in fact throughout the year. Shareholder meeting was an exception. He would freely mix up with investors, address them and answer their questions. The way he answered the questions was unique - he had the right blend of logical reasoning, seriousness and humor & story telling. He encouraged them ask questions, good questions.

He expected people asking right questions and emphasized the need for to do so with a tale.

“*A man migrated to a new village. He wanted to get acquainted with folks, so he went over to the village square and saw an old-timer with kind of a mean-looking German shepherd.*

He looked at the dog a little tentatively and he said, "Does your dog bite?"

The old-timer said, "Nope."

So the stranger reached down to pet him and the dog lunged at him and practically took off his arm, and the stranger as he was repairing his shredded coat turned to the old-timer and said, "I thought you said your dog doesn't bite."

The guy says, "Ain't my dog."

Unlike the stranger bidden by dog, Warren believed that shareholders of Berkshire Hathaway were matured and sensible. He proudly wrote about this in his 1984 annual letter.

"*Many annual meetings are a waste of time, both for shareholders and for management. Sometimes that is true because management is reluctant to open up on matters of business substance. More often a nonproductive session is the fault of shareholder participants who are more concerned about their own moment on stage than they are about the affairs of the corporation. What should be a forum for business discussion becomes a forum for theatrics, spleen-venting and advocacy of issues. (The deal is irresistible: for the price of one share you get to tell a captive audience your ideas as to how the world should be run.) Under such circumstances, the quality of the meeting often deteriorates from year to year as the antics of those interested in themselves discourage attendance by those interested in the business.*

Berkshire's meetings are a different story. The number of shareholders attending grows a bit each year and we have yet to experience a silly question or an ego-inspired commentary.

Instead, we get a wide variety of thoughtful questions about the business. Because the annual meeting is the time and place for these, Charlie and I are happy to answer them all, no matter how long it takes."

Buffett treated his shareholders like extended family members and partners in privately held business. He knew the importance, though not entirely obligatory by law, of being transparent with shareholders. It can be quoted from one his annual letters.

"*In some ways, our shareholder group is a rather unusual one, and this affects our manner of reporting to you. For example, at the end of each year about 98% of the shares outstanding are held by people who also were shareholders at the beginning of the year. Therefore, in our annual report we build upon what we have told you in previous years instead of restating a lot of material. You get more useful information this way, and we don't get bored.*

Furthermore, perhaps 90% of our shares are owned by investors for whom Berkshire is their largest security holding, very often far and away the largest. Many of these owners are willing to spend a significant amount of time with the annual report, and we attempt to provide them with the same information we would find useful if the roles were reversed.

In contrast, we include no narrative with our quarterly reports. Our owners and managers both have very long time-horizons in regard to this business, and it is difficult to say anything new or meaningful each quarter about events of long-term significance.

But when you do receive a communication from us, it will come from the fellow you are paying to run the business. Your Chairman has a firm belief that owners are entitled to hear directly from the CEO as to what is going on and how he evaluates the business, currently and prospectively. You would demand that in a private company; you should expect no less in a public company. A once-a-year report of stewardship should not be turned over to a staff specialist or public relations consultant who is unlikely to be in a position to talk frankly on a manager-to-owner basis.

We feel that you, as owners, are entitled to the same sort of reporting by your manager as we feel is owed to us at Berkshire Hathaway by managers of our business units. Obviously, the degree of detail must be different, particularly where information would be useful to a business competitor or the like. But the general scope, balance, and level of candor should be similar. We don't expect a public relations document when our operating managers tell us what is going on, and we don't feel you should receive such a document.

In large part, companies obtain the shareholder constituency that they seek *and deserve. If they focus their thinking and communications on short-term results or short-term stock market consequences they will, in large part, attract shareholders who focus on the same factors. And if they are cynical in their treatment of investors, eventually that cynicism is highly likely to be returned by the investment community.*

Phil Fisher, a respected investor and author, once likened the policies of the corporation in attracting shareholders to those of a restaurant attracting potential customers. A restaurant could seek a given clientele - patrons of fast foods, elegant dining, Oriental food, etc. - and eventually obtain an appropriate group of devotees. If the job were expertly done, that clientele, pleased with the service, menu, and price level offered, would return consistently. But the restaurant could not change its character constantly and end up with a happy and stable clientele. If the business vacillated between French cuisine and take-out chicken, the result would be a revolving door of confused and dissatisfied customers.

So it is with corporations and the shareholder constituency they seek. You can't be all things to all men, simultaneously seeking different owners whose primary interests run from high current yield to long-term capital growth to stock market pyrotechnics, etc.

The reasoning of managements that seek large trading activity in their shares puzzles us. In effect, such managements are saying that they want a good many of the existing clientele continually to desert them in favor of new ones - because you can't add lots of new owners (with new expectations) without losing lots of former owners.

We much prefer owners who like our service and menu and who return year after year. It would be hard to find a better group to sit in the Berkshire Hathaway shareholder "seats" than those already occupying them. So we hope to continue to have a very low turnover among our owners, reflecting a constituency that understands our operation, approves of our policies, and shares our expectations. And we hope to deliver on those expectations."

Normally all chief executives would love more people investing in the shares of the company they run. It is quite natural to see new investors and increased trading activity. Buffett never wanted that to happen in the case of Berkshire stocks. Time and again he advised shareholder to hold for longtime, not to get into the vicious cycle of buying & selling.

In his interactions with shareholders in the annual meetings, Warren has always been giving responsible genuine answers. Yet he never missed opportunities to be humorous.

For instance, one shareholder rose to ask him, "*Now you are richest person in America. Whatz your next goal?*"

Warren replied, "*That's easy. To be oldest man in America*"

In another instance he needed to check if the mike was working at the beginning of a Berkshire Hathaway annual meeting. He slightly tapped the microphone and started testing it with '*one million, two million, three million*' instead of '*1 . .. 2 .. 3*'

Ability to joke on-the-fly is an art. Buffett effortlessly performed that art many a times. In his 1997 annual report he remarked about previous year's annual meeting. He wrote, "*(Last year) there was only one crisis: The night before the meeting, I lost my voice, thereby fulfilling Charlie's wildest fantasy. He was crushed when I showed up the next morning with my speech restored*"

*

Shareholder meeting of Berkshire Hathaway was held in New Bedford, Massachusetts during the initial days. As the organization slowly lost its identity as a textile company and transformed as a holding company, he shifted the venue of annual shareholder meeting to Omaha. Those were still initial years when not too many people bothered to visit Nebraska. Crowd was so small that the cafeteria of its National Indemnity, Insurance Company in which Berkshire invested, could accommodate them. Despite low turnaround, Buffett would take their questions, explain business prospects etc by giving due importance they deserved as partial owners.

As year passed by, his fame spread in all directions. Out of town shareholder started coming, in increasing numbers every year, due to the success record he continued to chronicle at Berkshire and the quality of his annual reports. He moved the meeting venue to the basement of the Red Lion hotel. Number of shareholders attending the meeting increased exponentially that forced him rent an Art Museum, playgrounds etc.

In his 1997 annual letter he wrote about the meeting.

"*Last year about 7,500 attended the meeting. They represented all 50 states, as well as 16 countries, including Australia, Brazil, Israel, Saudi Arabia, Singapore and Greece. Taking into account several overflow rooms, we believe that we can handle more than 11,000 people, and that should put us in good shape this year even though our shareholder count has risen significantly. Parking is ample at Aksarben; acoustics are excellent; and seats are comfortable.*"

Number of overseas shareholders and the country of their dwelling have been on the raise in Berkshire's case, because most of the people in the world of investment want to hold at least one share and get a chance to interact with him. In the recent past, special reception is arranged exclusively for overseas investors on the day before annual meeting. Munger and Buffett would spend time with them.

In his 2009 letter he would mention, " *Our best guess is that 35,000 people attended the annual meeting last year (up from 12 – no zeros omitted – in 1981).*"

All publicly held companies send annual report to their shareholders. Either the chairman of the board or the CEO would sign them. But in reality those reports are prepared by public relationship department, battery of MBA recruits or something of that sort. Reports contain half truths or sugar coated lies. Berkshire annual reports were an exception in corporate world.

Buffett wrote the letters himself and he felt that that the CEO had the moral obligation to write his own words and stood as a living example. His 1979 annual report rightly echoed it, in which he said, "*When you do receive a communication from us, it will come from the fellow you are paying to run the business.*"

*

A good musician is the one who would complement good music composed by others. Likewise, it is impossible to become an expert in writing before being a veracious reader. Buffett is a living example for this rule of thumb. He read countless number of annual reports of various companies from diverse industries. He knew what made sense for him as an investor and what did not. So it was easy for him to prepare '*model'* annual reports in simple language. In between he added jokes and little stories to make them more readable and interesting.

His letters to shareholders are widely read and globally acclaimed. They were trendsetters and served as examples for what a chief executive should convey his owners. He wrote once, "*We will be candid in our reporting to you, emphasizing the pluses and minuses important in appraising business value. Our guideline is to tell you the business facts that we would want to know if our positions were reversed. We owe you no less.*"

Annual reports of other companies were colorful with eye-catching pictures and animated graphs. As if making up for all of them, Berkshire report would be dull in black and white, with text and some tables. He never had to impress upon anyone through meaningless glamour.

On the first page of the annual reports, many CEOs and chairmen frequently mention referred to the share price movement and illustrated how much 'wealth' they have created for the shareholders in the last one year. Top managements normally project it as an achievement. Most chief executives spent more time in managing the share price instead of managing the business, let alone managing it profitably. They jumped over to issue statements for every price movement on the bourses.

Buffett uniquely approached business performance of a company and its share price in the secondary market. He encouraged Berkshire Shareholders approach in the similar manner. As a matter of fact, in all annual report he would report at what rate the book value of Berkshire Hathaway had grown from the time he took over its management in 1965. This table appeared on the first page of the report. Alongside would be a comparison with S&P 500 growth, with dividends included. He knew that the share prices would follow intrinsic value some day or the other.

When explaining this in his 2009 annual report he elaborated:

"*Our metrics for evaluating our managerial performance are displayed on the facing page. From the start, Charlie and I have believed in having a rational and unbending standard for measuring what we have – or have not – accomplished. That keeps us from the temptation of seeing where the arrow of performance lands and then painting the bull's eye around it.*

Selecting the S&P 500 as our bogey was an easy choice because our shareholders, at virtually no cost, can match its performance by holding an index fund. Why should they pay us for merely duplicating that result?

A more difficult decision for us was how to measure the progress of Berkshire versus the S&P. There are good arguments for simply using the change in our stock price. Over an extended period of time, in fact, that is the best test. But year-to-year market prices can be extraordinarily erratic. Even evaluations covering as long as a decade can be greatly distorted by foolishly high or low prices at the beginning or end of the measurement period.

The ideal standard for measuring our yearly progress would be the change in Berkshire's per-share intrinsic value. Alas, that value cannot be calculated with anything close to precision, so we instead use a crude proxy for it: per-share book value. Relying on this yardstick has its shortcomings.

Additionally, book value at most companies understates intrinsic value, and that is certainly the case at Berkshire. In aggregate, our businesses are worth considerably more than the values at which they are carried on our books. In our all-important insurance business, moreover, the difference is huge. Even so, Charlie and I believe that our book value – understated though it is – supplies the most useful tracking device for changes in intrinsic value. By this measurement, as the opening paragraph of this letter states, our book value since the start of fiscal 1965 has grown at a rate of 20.3% compounded annually.

We should note that had we instead chosen market prices as our yardstick, *Berkshire's results would look better, showing a gain since the start of fiscal 1965 of 22% compounded annually. Surprisingly, this modest difference in annual compounding rate leads to an 801,516% market-value gain for the entire 45-year period compared to the book-value gain of 434,057%*"

There could not have been any better explanation for measuring management performance in corporate America and corporate world.

Another quality that differentiated him from other Wall Street experts was his courage to candidly acknowledge his limitations and lessons learnt from his past mistakes. Many executives do not draw a circle and shoot the arrow. They rather throw the arrow and then draw a circle around it. Buffett rationally analyzed his actions in retrospect. He never hesitated to accept his mistakes.

Managers in most companies boast short term performance, increase in stock price in one year to be particular. Buffett did not attach too much importance to one-off numbers and yearly performance. According to him, one year was too short a period to assess management performance. He recommended at least five year period, if not more, to evaluate and compare management competence. Businesses that earn lesser profit than its peers in a span of five years were in danger zone, he argued.

On the same yardstick he observed in 2009:
"*We have never had any five-year period beginning with 1965-69 and ending with 2005-09 – and there have been 41 of these – during which our gain in book value did not exceed the S&P's gain. Second, though we have lagged the S&P in some years that were positive for the market, we have consistently done better than the S&P in the eleven years during which it delivered negative results. In other words, our defense has been better than our offense, and that's likely to continue.*"

Berkshire Hathaway is the largest holding company on the planet. It is an empire that had many fully owned subsidiaries which operated in diverse industries and market conditions. Each business had managers to run them. They are expected to earn profit by efficiently running them. Properly channeling those profits into meaningful investment was up to Warren and

Charlie.

Many times he said he was nowhere near the managers of those individual businesses. He would confess that he was struggling to find suitable investment as the size had grown. Nonetheless, he continued to buy good businesses for fair value even when markets seemed to peak.

*

If anyone had been the CEO of any company for 25 years he would have celebrated silver jubilee with lot of fanfare. Buffett could have celebrated this special moment in any manner, spending any money, for the fantastic success he had consistently delivered at Berkshire. But he chose to do something different. The decision was to list major mistakes he committed over a quarter century in his 1989 annual letter.

"*It's a good idea to review past mistakes before committing new ones. So let's take a quick look at the last 25 years.*

My first mistake*, of course, was in buying control of Berkshire. Though I knew its business - textile manufacturing - to be unpromising, I was enticed to buy because the price looked cheap. Stock purchases of that kind had proved reasonably rewarding in my early years, though by the time Berkshire came along in 1965 I was becoming aware that the strategy was not ideal.*

If you buy a stock at a sufficiently low price, there will usually be some hiccup in the fortunes of the business that gives you a chance to unload at a decent profit, even though the long-term performance of the business may be terrible. I call this the "cigar butt" approach to investing. A cigar butt found on the street that has only one puff left in it may not offer much of a smoke, but the "bargain purchase" will make that puff all profit.

Unless you are a liquidator, that kind of approach to buying businesses is foolish. First, the original "bargain" price probably will not turn out to be such a steal after all. In a difficult business, no sooner is one problem solved than another surfaces - never is there just one cockroach in the kitchen.

Second*, any initial advantage you secure will be quickly eroded by the low* *return that the business earns. For example, if you buy a business for $8 million that can be sold or liquidated for $10 million and promptly take either course, you can realize a high return. But the investment will disappoint if the business is sold for $10 million in ten years and in the interim has annually earned and distributed only a few percent on cost. Time is the friend of the wonderful business, the enemy of the mediocre.*

You might think this principle is obvious, but I had to learn it the hard way - in fact, I had to learn it several times over. Shortly after purchasing Berkshire, I acquired a Baltimore department store, Hochschild Kohn, buying through a company called Diversified Retailing that later merged with Berkshire. I bought at a substantial discount from book value, the people were first-class, and the deal included some extras - unrecorded real estate values and a significant LIFO inventory cushion. How could I miss? So-o-o - three years later I was lucky to sell the business for about what I had paid. After ending our corporate marriage to Hochschild Kohn, I had memories like those of the husband in the country song, "My Wife Ran Away With My Best Friend and I Still Miss Him a Lot."

I could give you other personal examples of "bargain-purchase" folly but I'm sure you get the picture: It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price. Charlie understood this early; I was a slow learner. But now, when buying companies or common stocks, we look for first-class businesses accompanied by first-class managements.

***That leads right into a related lesson**: Good jockeys will do well on good horses, but not on broken-down nags. Both Berkshire's textile business and Hochschild, Kohn had able and honest people running them. The same managers employed in a business with good economic characteristics would have achieved fine records. But they were never going to make any progress while running in quicksand.*

I've said many times that when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact. I just wish I hadn't been so energetic in creating examples. My behavior has matched that admitted by Mae West: "I *was Snow White, but I drifted."*

A further related lesson*: Easy does it. After 25 years of buying and supervising a great variety of businesses, Charlie and I have not learned how to solve difficult business problems. What we have learned is to avoid them. To the extent we have been successful, it is because we concentrated on identifying one-foot hurdles that we could step over rather than because we acquired any ability to clear seven-footers.*

The finding may seem unfair, but in both business and investments it is usually far more profitable to simply stick with the easy and obvious than it is to resolve the difficult. On occasion, tough problems must be tackled as was the case when we started our Sunday paper in Buffalo. In other instances, a great investment opportunity occurs when a marvelous business encounters a one-time huge, but solvable, problem as was the case many years back at both American Express and GEICO. Overall, however, we've done better by avoiding dragons than by slaying them.

My most surprising discovery*: the overwhelming importance in business of an unseen force that we might call "the institutional imperative." In business school, I was given no hint of the imperative's existence and I did not intuitively understand it when I entered the business world. I thought then that decent, intelligent, and experienced managers would automatically make rational business decisions. But I learned over time that isn't so. Instead, rationality frequently wilts when the institutional imperative comes into play.*

For example: (1) As if governed by Newton's First Law of Motion, an institution will resist any change in its current direction; (2) Just as work expands to fill available time, corporate projects or acquisitions will materialize to soak up available funds; (3) Any business craving of the leader, however foolish, will be quickly supported by detailed rate-of-return and strategic studies prepared by his troops; and (4) The behavior of peer companies, whether they are expanding, acquiring, setting executive compensation or whatever, will be mindlessly imitated.

Institutional dynamics, not venality or stupidity, set businesses on these courses, which are too often misguided. After making some expensive *mistakes because I ignored the power of the imperative, I have tried to organize and manage Berkshire in ways that minimize its influence. Furthermore, Charlie and I have attempted to concentrate our investments in companies that appear alert to the problem.*

After some other mistakes*, I learned to go into business only with people whom I like, trust, and admire. As I noted before, this policy of itself will not ensure success: A second-class textile or department-store company won't prosper simply because its managers are men that you would be pleased to see your daughter marry. However, an owner - or investor - can accomplish wonders if he manages to associate himself with such people in businesses that possess decent economic characteristics. Conversely, we do not wish to join with managers who lack admirable qualities, no matter how attractive the prospects of their business. We've never succeeded in making a good deal with a bad person.*

Some of my worst mistakes were not publicly visible*. These were stock and business purchases whose virtues I understood and yet didn't make. It's no sin to miss a great opportunity outside one's area of competence. But I have passed on a couple of really big purchases that were served up to me on a platter and that I was fully capable of understanding. For Berkshire's shareholders, myself included, the cost of this thumb-sucking has been huge.*"

After listing out major mistakes and lessons learned in the first 25 years at helm of affairs at Berkshire, he finished it with a witty note: "*We hope in another 25 years to report on the mistakes of the first 50. If we are around in 2015 to do that, you can count on this section occupying many more pages than it does here.*"

Above all, one constant warning from the annual letter to the shareholders was that his past performance record could not be matched in the future because of the sheer size of Berkshire and its investments.

He said, "*A fat wallet is the enemy of superior investment results.*"

To quote from another annual letter: "*We continue, however, to need "elephants" in order for us to use Berkshire's flood of incoming cash.*

Charlie and I must therefore ignore the pursuit of mice and focus our acquisition efforts on much bigger game."

However the shareholders did not take it seriously, because despite his warning his track record as a successful investor continued.

12. Investor Education

You might have seen or at least heard about moviemakers who genuinely worry about poor quality of the films made. They might express a sense of helplessness and quote commercial elements, not content quality, for the success of their creations. But how many of them really attempt make good films and transform the way industry functions is a different question altogether.

Likewise there are countless people having disgusting opinion about the institution called capital market and level of stupidity prevailing there. How many of them, indeed, ever tried to educate investors and create awareness amongst them is a question boggling the minds of everyone for years.

Warren Buffett stood apart in that respect. He has always been an answer to this long lasting question. At least he has initiated steps that would largely help people understand various aspects of businesses and begin educating themselves.

When we buy equity shares in a company it implies that we become part owners in the company. It is another form of investment like a house or farmland. Shares are not to be seen as a trading commodity. There is a lot of difference in the approaches we deploy for buying vegetables and looking for a plot to build a house. Buffett advised people to get the mindset that they are going to become owners of the business while buying shares in any company. One should not think himself like a trader.

Share market is just a place that provides a platform to sell our ownership to others. We should not allow it to become the court that would dictate what price to pay and evaluate the value of the company based on that price. If the business of the company we invest in does well, then eventually its share price will follow suit. He would say, "*I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years.*"

When share prices continue to slide, many people let their blood pressure go up by seeing their portfolio value reducing. It is needless, Buffett would suggest. Instead of seeing stock market fluctuations as an enemy, we should learn to see it as a friendly thing and try to benefit from such fluctuations. To quote Warren's words, '*Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment successes.*'

Many a times Warren Buffett mentioned, "*We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.*"

"*You are dealing with a lot of silly people in the marketplace; its like a great big casino, and everyone else is boozing. If you can stick with Pepsi, you should be okay,*" he would often tell this to the people who followed him.

It is painful and depressive to see the price of the scripts we bought not moving up when everything is inching up on the bourses. Buffett won't worry if the market does not rerate immediately. In fact he would be delighted to see the stock price languishing for a long time, allowing him to buy more. It is like Wall Street extending thanksgiving sales till Christmas.

There could not have been many people in the world who officially declared that stockbrokers and other self-styled market experts are primarily responsible for all foolishness that prevailed in the capital market. Bufffett was one of the most vocal amongst them who never hesitated to put forward his criticism.

In one of his famous quotes, Warren said, "*If a graduating MBA were to ask me, "How do I get rich in a hurry?", I would not respond with a quotation from Ben Franklin or Horatio Alger, but would instead hold my nose with one hand and point with the other hand toward wall street*", indicating how greedy market men were.

He would write in another annual letter.

"*One of the ironies of the stock market is the emphasis on activity. Brokers, using terms such as "marketability" and "liquidity", sing the praises of companies with high share turnover (those who cannot fill your pocket will confidently fill your ear). But investors should understand that what is good* *for the croupier is not good for the customer. A hyperactive stock market is the pickpocket of enterprise.*

For example, consider a typical company earning, say, 12% on equity. Assume a very high turnover rate in its shares of 100% per year. If a purchase and sale of the stock each extract commissions of 1% (the rate may be much higher on low-priced stocks) and if the stock trades at book value, the owners of our hypothetical company will pay, in aggregate, 2% of the company's net worth annually for the privilege of transferring ownership.

This activity does nothing for the earnings of the business, and means that 1/6 of them are lost to the owners through the "frictional" cost of transfer. (And this calculation does not count option trading, which would increase frictional costs still further.)

All that makes for a rather expensive game of musical chairs. Can you imagine the agonized cry that would arise if a governmental unit were to impose a new 16 2/3% tax on earnings of corporations or investors? By market activity, investors can impose upon themselves the equivalent of such a tax.

Days when the market trades 100 million shares (and that kind of volume, when over-the-counter trading is included, is today abnormally low) are a curse for owners, not a blessing - for they mean that owners are paying twice as much to change chairs as they are on a 50-million-share day. If 100 million-share days persist for a year and the average cost on each purchase and sale is 15 cents a share, the chair-changing tax for investors in aggregate would total about $7.5 billion - an amount roughly equal to the combined 1982 profits of Exxon, General Motors, Mobil and Texaco, the four largest companies in the Fortune 500.

These companies had a combined net worth of $75 billion at yearend 1982 and accounted for over 12% of both net worth and net income of the entire Fortune 500 list. Under our assumption investors, in aggregate, every year forfeit all earnings from this staggering sum of capital merely to satisfy their penchant for "financial flip-flopping". In addition, investment management fees of over $2 billion annually - sums paid for chair-changing advice -

require the forfeiture by investors of all earnings of the five largest banking organizations (Citicorp, Bank America, Chase Manhattan, Manufacturers Hanover and J. P. Morgan). These expensive activities may decide who eats the pie, but they don't enlarge it."

Further he did not hesitate to illustrate that brokers drain national wealth: "*We are aware of the pie-expanding argument that says that such activities improve the rationality of the capital allocation process. We think that this argument is specious and that, on balance, hyperactive equity markets subvert rational capital allocation and act as pie shrinkers. Adam Smith felt that all no collusive acts in a free market were guided by an invisible hand that led an economy to maximum progress; our view is that casino-type markets and hair-trigger investment management act as an invisible foot that trips up and slows down a forward-moving economy.*"

Many companies resort to stock split exercise in order to improve liquidity on the bourses. Berkshire Hathaway shares were never split, even though it trades above $100,000 mark. He continued his explanation to justify his stance.

"*Contrast the hyperactive stock with Berkshire. The bid-and-ask spread in our stock currently is about 30 points, or a little over 2%. Depending on the size of the transaction, the difference between proceeds received by the seller of Berkshire and cost to the buyer may range downward from 4% (in trading involving only a few shares) to perhaps 1 1/2% (in large trades where negotiation can reduce both the market-maker's spread and the broker's commission). Because most Berkshire shares are traded in fairly large transactions, the spread on all trading probably does not average more than 2%.*

Meanwhile, true turnover in Berkshire stock (excluding inter-dealer transactions, gifts and bequests) probably runs 3% per year. Thus our owners, in aggregate, are paying perhaps 6/100 of 1% of Berkshire's market value annually for transfer privileges. By this very rough estimate, that's $900,000 - not a small cost, but far less than average. Splitting the stock would increase that cost, downgrade the quality of our shareholder population, and encourage a market price less consistently related to *intrinsic business value. We see no offsetting advantages.*"

Stock brokers and recommendations are as inseparable as their motive to increase trading activity. Warren would jokingly say, "*Never ask a barber if you need a haircut.*"

In his view, stock recommendations and earning estimations etc revealed more about the group of people that published these estimates than the estimates themselves. More than what they estimated in terms of what was going to happen, these reports reflected what they wanted to happen for a particular stock, he suspected. They are like opinion poll that influence poll opinion.

Language and tone of the recommendations vary depending on who authored those reports. A good investor, therefore, should ignore such predictions thrown at him in the marketplace, and use his own logical reasoning. For example, you would have never heard a mutual fund manager advising that markets are set for correction and therefore you should redeem all your units.

Buffett tried to ignore macroeconomic indicators. According to him, good investors and businessmen stood to gain very little by paying too much attention to them. Indeed they were a source of distraction. He wrote in his 1994 letter to shareholders explaining this.

"*We will continue to ignore political and economic forecasts, which are an expensive distraction for many investors and businessmen. Thirty years ago, no one could have foreseen the huge expansion of the Vietnam War, wage and price controls, two oil shocks, the resignation of a president, the dissolution of the Soviet Union, a one-day drop in the Dow of 508 points, or treasury bill yields fluctuating between 2.8% and 17.4%.*

But, surprise - none of these blockbuster events made the slightest dent in Ben Graham's investment principles. Nor did they render unsound the negotiated purchases of fine businesses at sensible prices. Imagine the cost to us, then, if we had let a fear of unknowns cause us to defer or alter the deployment of capital. Indeed, we have usually made our best purchases when apprehensions about some macro event were at a peak. Fear is the foe of the faddist, but the friend of the fundamentalist.

A different set of major shocks is sure to occur in the next 30 years. We will neither try to predict these nor to profit from them. If we can identify businesses similar to those we have purchased in the past, external surprises will have little effect on our long-term results."

People should be responsible for their actions they take and decision they make. One of his popular wordings from 1982 annual letter, widely quoted in investment community, reiterates this. It goes like this:

"*The market, like the Lord, helps those who help themselves. But, unlike the Lord, the market does not forgive those who know not what they do. For the investor, a too-high purchase price for the stock of an excellent company can undo the effects of a subsequent decade of favorable business developments.*"

Based on whether our investments succeed or fail to impress, we would associate it with our talent or luck respectively. For example, if the price moves up after we bought a share we would like to associate it with our sheer talent. On the contrary, if the price declines after our purchase we would associate it with our bad luck. In really both these might be wrong. It is highly possible to deceive ourselves by confusing a random success and coincidence with our stock picking ability.

Many things that are validated by logical reasoning would not go well with emotions. Buffett was at a maturity level with which he could ensure that his emotions and rational thought processes did not conflict with each other. He has a rare ability to detach his emotional feeling and virtually put them in a hanger before heading to work every morning.

Berkshire Hathaway's net worth jumped by an astonishing 48.2 percent, $613.6 million in absolute value, in 1985 alone. Any other executive in his shoes would have partied big time. Can you imagine what Buffett did and how he viewed that feat?

He said, "*It is fitting that the visit of Halley's Comet coincided with this percentage gain: neither will be seen again in my lifetime.*" (Experts say it is visible from Earth every 76 year)

In another instance, Berkshire's gain in net worth during 1995 was a phenomenal $5.3 billion, or 45.0%. But Warren played it down. He said, "*There's no reason to do handsprings over 1995's gains. This was a year in which any fool could make a bundle in the stock market. And we did. To paraphrase President Kennedy, a rising tide lifts all yachts.*" There cannot be any fitting example for his modesty.

Throughout his investment career Warren Buffett followed the famous Mr.Market approach that his mentor Benjamin Graham preached him. At times market would throw opportunities at throwaway price. During those times Buffett would buy big time, beyond the imagination of normal investors, without any hesitation.

For example Washington Post stocks were available at an average price of $5.63 per share in 1973 when Warren bought it. In 1987 (single year alone), it produced $10.3 profit per share after tax. Similarly if we take the example of GEICO, the average price at which Berkshire Hathaway bought in 1976, 1979 and 1980 was mere $6.67. The company returned $9.01 profit per share in 1987 alone. Like these two samples, there were many instances where Mr. Market proved to be his friend.

One of important mistakes which should to be avoided is the *profit-booking-itch* that develops on price increase to a considerable level. The business may possess the potential to grow many times still. After listing Berkshire's investment in common stocks, Buffett described this concept of holding on good investments. He wrote:

"*We continue to think that it is usually foolish to part with an interest in a business that is both understandable and durably wonderful. Business interests of that kind are simply too hard to replace.*

Interestingly, corporate managers have no trouble understanding that point when they are focusing on a business they operate: A parent company that owns a subsidiary with superb long-term economics is not likely to sell that entity regardless of price. "Why," the CEO would ask, "should I part with my crown jewel?" Yet that same CEO, when it comes to running his personal *investment portfolio, will offhandedly - and even impetuously - move from business to business when presented with no more than superficial arguments by his broker for doing so. The worst of these is perhaps, "You can't go broke taking a profit." Can you imagine a CEO using this line to urge his board to sell a star subsidiary? In our view, what makes sense in business also makes sense in stocks: An investor should ordinarily hold a small piece of an outstanding business with the same tenacity that an owner would exhibit if he owned all of that business.*"

Even Bill Gates sold his stake in Microsoft during its ascent to success, but Warren Buffett never sold a single share in Berkshire Hathaway. If the business had moat around it, durable moat, then those investments may be held forever. Rather than saying 'may be held', Buffett would say, 'should be held'.

Berkshire Hathaway was trading at around eight dollars in 1965 when Warren Buffett accumulated it. Now it is trading well over hundred thousand dollar level (above $130,000 to be precise). However the company has never done stock split act. Buffett has spoken about it many times. In 1983 annual letter he made a special mention about it.

"*We often are asked why Berkshire does not split its stock. The assumption behind this question usually appears to be that a split would be a pro-shareholder action. We disagree. Let me tell you why.*

One of our goals is to have Berkshire Hathaway stock sell at a price rationally related to its intrinsic business value. (But note "rationally related", not "identical": if well-regarded companies are generally selling in the market at large discounts from value, Berkshire might well be priced similarly.) The key to a rational stock price is rational shareholders, both current and prospective.

If the holders of a company's stock and/or the prospective buyers attracted to it are prone to make irrational or emotion-based decisions, some pretty silly stock prices are going to appear periodically. Manic-depressive personalities produce manic-depressive valuations. Such aberrations may help us in buying and selling the stocks of other companies. But we think it is *in both your interest and ours to minimize their occurrence in the market for Berkshire.*

To obtain only high quality shareholders is no cinch. Mrs. Astor could select her 400, but anyone can buy any stock.

Entering members of a shareholder "club" cannot be screened for intellectual capacity, emotional stability, moral sensitivity or acceptable dress. Shareholder eugenics, therefore, might appear to be a hopeless undertaking.

In large part, however, we feel that high quality ownership can be attracted and maintained if we consistently communicate our business and ownership philosophy - along with no other conflicting messages - and then let self selection follow its course. For example, self selection will draw a far different crowd to a musical event advertised as an opera than one advertised as a rock concert even though anyone can buy a ticket to either.

Through our policies and communications - our "advertisements" - we try to attract investors who will understand our operations, attitudes and expectations. (And, fully as important, we try to dissuade those who won't.) We want those who think of themselves as business owners and invest in companies with the intention of staying a long time. And, we want those who keep their eyes focused on business results, not market prices.

Investors possessing those characteristics are in a small minority, but we have an exceptional collection of them. I believe well over 90% - probably over 95% - of our shares are held by those who were shareholders of Berkshire or Blue Chip five years ago. And I would guess that over 95% of our shares are held by investors for whom the holding is at least double the size of their next largest. Among companies with at least several thousand public shareholders and more than $1 billion of market value, we are almost certainly the leader in the degree to which our shareholders think and act like owners. Upgrading a shareholder group that possesses these characteristics is not easy.

Were we to split the stock or take other actions focusing on stock price rather *than business value, we would attract an entering class of buyers inferior to the exiting class of sellers. At $1300, (When Warren wrote this letter stock was trading at $1300, but now it is above $1,20,000 per share) there are very few investors who can't afford a Berkshire share. Would a potential one-share purchaser be better off if we split 100 for 1 so he could buy 100 shares?*

Those who think so and who would buy the stock because of the split or in anticipation of one would definitely downgrade the quality of our present shareholder group. (Could we really improve our shareholder group by trading some of our present clear-thinking members for impressionable new ones who, preferring paper to value, feel wealthier with nine $10 bills than with one $100 bill?) People who buy for non-value reasons are likely to sell for non-value reasons. Their presence in the picture will accentuate erratic price swings unrelated to underlying business developments.

We will try to avoid policies that attract buyers with a short-term focus on our stock price and try to follow policies that attract informed long-term investors focusing on business values. just as you purchased your Berkshire shares in a market populated by rational informed investors, you deserve a chance to sell - should you ever want to - in the same kind of market. We will work to keep it in existence."

It was quite a convincing rational explanation, not only to Berkshire shareholder but for the entire investment community and corporate world.

*

In one of the shareholder meetings, one investor stood up and asked, "*What happens to this place if you get hit by a truck?*"

Perhaps the shareholder was concerned about the future of Berkshire Hathaway and the fate of its countless investments if he were dead. After all he was the man who built that empire. The concern was genuine indeed.

Buffett jokingly replied, "*I'm glad they are still asking the question in this form. It won't be too long before the query becomes: "What happens to this place if you don't get hit by a truck?"*"

Jokes apart, his answer was simple. Buffett's personal savings as well as the savings of his close relatives were completely in Berkshire. More than the shareholders, he had larger stake in Berkshire and had reasons to have a succession plan in place.

His reply was:
"*I feel strongly that the fate of our businesses and their managers should not depend on my health - which, it should be added, is excellent - and I have planned accordingly. Neither my estate plan nor that of my wife is designed to preserve the family fortune; instead, both are aimed at preserving the character of Berkshire and returning the fortune to society.*

Were I to die tomorrow, you could be sure of three things: (1) None of my stock would have to be sold; (2) Both a controlling shareholder and a manager with philosophies similar to mine would follow me; and (3) Berkshire's earnings would increase by $1 million annually, since Charlie would immediately sell our corporate jet, The Indefensible (ignoring my wish that it be buried with me)."

On the same topic he would further add, "*When you have able managers of high character running businesses about which they are passionate, you can have a dozen reporting to you and still have time for an afternoon nap.*"

Berkshire had stake in many diverse businesses which were run by able managers. Buffett knew that the businesses will continue to run like ever before. He kept a letter in his drawer instructing his managers what they ought to do if he did not wake next day morning. He said, "*When they open that envelope, the first instruction is to take my pulse again*" and the letter would begin with a line: "*Yesterday I died. That is unquestionably bad news for me but it is not bad news for our business.*" Similarly he had another envelop addressed to the director of the board instructing them what Berkshire would be like after he died.

All in all, he said, "*We are prepared for the truck.*"

*

Corporate governance is a never ending topic that concerns many innocent investors. Buffett felt, "*Both the ability and fidelity of managers have long needed monitoring. Most CEOs, it should be noted, are men and women you would be happy to have as trustees for your children's assets or as next-door neighbors. Too many of these people, however, have in recent years behaved badly at the office, fudging numbers and drawing obscene pay for mediocre business achievements.*"

He argued, "*Directors should behave as if there was a single absentee owner, whose long-term interest they should try to further in all proper ways*" to emphasize that the responsibility to protect investor interest rested with independent directors. They should be prepared to throw away the management if the performance were mediocre and conflicted with owners' interest, as he described in his 2002 annual letter:

"*... directors must get rid of a manager who is mediocre or worse, no matter how likable he may be. Directors must react as did the chorus-girl bride of an 85-yearold multimillionaire when he asked whether she would love him if he lost his money. "Of course," the young beauty replied, "I would miss you, but I would still love you.*"

In the 1993 annual report, he also said directors had another job: "*If able but greedy managers overreach and try to dip too deeply into the shareholders' pockets, directors must slap their hands.*"

Independent director are not really able to function independently for all practical purposes. He remarked once, "*The current cry is for "independent" directors. It is certainly true that it is desirable to have directors who think and speak independently – but they must also be business-savvy, interested and shareholder oriented.*" They rarely have the bones to confront the management on behalf of shareholders.

Over a span of 40 years till 1993, Buffett had been on 19 public-company boards (excluding Berkshire's) and had interacted with nearly 250 directors. Most of them were "independent" as defined by rules. But the great majority of them lacked the three qualities he valued. As a result, their contribution to shareholder well-being was minimal at best and, too often, negative. These people, decent and intelligent though they were, simply did not know enough about business and/or care enough about shareholders to question foolish acquisitions or egregious compensation.

Most of the times, independent directors are either directly or indirectly proposed by CEOs. Therefore it is imperative for them to be loyal to the management. Moreover, many independent directors saw a seat on a board as a profession and a means of earning. Since they did not hold even a single share on those companies on whose board they sat, their willingness to represent shareholder interest is seriously questionable and in serious suspicion.

Corporate governance has always been a subject of discussion. In his 2006 letter, Buffett quoted a reference from his Salomon Brothers experience. He wrote:

"*Corporate bigwigs often complain about government spending, criticizing bureaucrats who they say spend taxpayers' money differently from how they would if it were their own. But sometimes the financial behavior of executives will also vary based on whose wallet is getting depleted. Here's an illustrative tale from my days at Salomon. In the 1980s the company had a barber, Jimmy by name, who came in weekly to give free haircuts to the top brass. A manicurist was also on tap. Then, because of a cost-cutting drive, patrons were told to pay their own way. One top executive (not the CEO) who had previously visited Jimmy weekly went immediately to a once-every-three-weeks schedule.*"

Corporate fraud, of course, depends on the level of monitoring and accessibility to company properties. For instance, even entry level employees can take home office stationary. Warren Buffett totally rejected unjustifiable perks of all sorts in every form that top executives and other employees at lower rungs enjoyed. It is prudent not to invest in such companies. An ordinary investor can seldom change the behaviors of the management, but the decision to invest in such companies is completely up to him.

Being a hardcore critic of lavish spending of corporate bigwigs throughout his life, Buffett crossed the limits he set himself in one instance. In 1986 Berkshire bought a corporate jet which he mentioned in his annual letter as well. He wrote:

“*Your Chairman, unfortunately, has in the past made a number of rather intemperate remarks about corporate jets. Accordingly, prior to our purchase, I was forced into my Galileo mode. I promptly experienced the necessary "counter-revelation" and travel is now considerably easier - and considerably costlier - than in the past. Whether Berkshire will get its money’s worth from the plane is an open question, but I will work at achieving some business triumph that I can (no matter how dubiously) attribute to it. I’m afraid Ben Franklin had my number. Said he: "So convenient a thing it is to be a reasonable creature, since it enables one to find or make a reason for everything one has a mind to do.*"

In the same letter he spoke about/against adding a staff economist, a corporate strategist, an institutional advertising campaign or something else simply because the money currently was rolling in. Such things did Berkshire no good. On the same node he added the following.

“*Our goal is to do what makes sense for Berkshire's customers and employees at all times, and never to add the unneeded. ("But what about the corporate jet?" you rudely ask. Well, occasionally a man must rise above principle.)*”

He rightly named the jet "*The Indefensible*" because of his past criticism of such moves by other CEOs.

In the next annual letter following sentence was printed in tiny font. It read: “*I’d rather buy a good stock than a good jet, but there’s nothing that we can see buying even if it went down 10 %”*. Interestingly the crash that started later 1987 saw DJIA losing almost one third of its value.

Before we come to the end of this chapter on Warren Buffett’s view on the market, market men, corporate governance etc, let us touch base with his view about investing, if at all it is, in gold. He believed that gold was nonproductive and it did not help the economic progress of societies. While addressing at Harvard he said, “*It gets dug out of the ground in Africa, or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head.*”

13. Personal Life

Now it is time to focus on Susan (Thompson) Buffett. Her marriage with Warren Buffett was very successful - the couple had three children. For over a quarter century they had a fantastic marriage without any major problems.

Then?

Susan left her husband. You might wonder why. What made her eave a world famous investor and second richest man on the planet?

The reason had nothing to do with money. It was about her inner identity and a sense of being worthy in her conscience.

Women expect undiminished love and affection. It is a universal rule. Men, on the contrary, are from a different planet. Though they continue to be filled with love, they tend not to be expressive - due to which intimacy between couples gradually declines. Thanks to excessive pressure and challenges in external mechanical life, husbands fail to give same amount of importance as they shower at the beginning of their marriage. After all, priorities change.

Many men start saying, “Job is my first wife.” They spend their time at work or towards work related tasks at home. Wives tolerate this at the beginning when their world is filled with kids - they somehow manage to be busy. But things, sadly, are never the same. Once children grow up, go to school and sort of become independent, wives are pushed to emptiness. They are caught into the vicious state filled with a mix of feelings like loneliness, blankness, desire and anxiety.

For middle-aged housewives this phase of life is very malicious. They feel like having nothing in life for them even though they are surrounded by worldly luxuries around them. The vacuum makes them truly vulnerable. Any person or thing that interests them can easily fill that vacuum. Women do not hesitate to completely surrender their body and soul, in response to this sudden unexpected attention. This is how many women drift away and get into extramarital affairs.

The story was not too different in Susan’s case. Warren Buffett was very busy concentrating his business. His tireless pursuit for value investments, a process that made him and many others rich, occupied his time. In this backdrop, whether he paid adequate attention towards Susan and her emotional needs seemed quite subjective. Qualities that have made Buffett a legendary investor played chaos with his personal life.

Their daughter, little Susie, said later, "*Mom spent a lot of time supporting Dad so he could do his thing. Dad was so intent, so focused. He just did the same thing all the time.*"

Susan had that thing in her to help others. She cared for others and involved in many social activities. By involving herself in something or the other she managed to be busy instead of sitting at one corner of the living room. Nonetheless, she realized that she did not have an identity on her own, except the image of Warren Buffett's wife. The desires she had buried deep inside her started sprouting gradually. It was so irresistible when their younger son Peter was just graduating from high school.

Her interest in music started coming out. She chose music as a tool to make her own identity and kill her boredom. Susan began singing at nightclubs.

The information that Susan, wife of Warren Buffett who is considered as the god of investing, sang at nightclub might raise many eyebrows. To top that, the question how Buffett allowed her might come up as well. That's because all rich men we have heard about are known for bringing women from nightclubs and keeping with them inside four walls, not for letting their wives go out and perform at nightclub.

In fact it was Buffett who encouraged her to develop her singing career. Susan recalled it later, "*It was Warren. He's the one. He said to me, susie, you are like somebody who has lost his job after 23 years. Now what are you going to do? He knew I wanted to sing. But I was scared to death.*" She had more praise for him: "*Warren understands me and he wants me to stay alive. If you love someone you do*"

Even as a child Buffett was not found of girls and particularly attracted towards them because of the mental pressure his mother exerted on him. But Susan fully absorbed him and melted. She was the backbone and central thread that ran Buffett family. He depended on her for almost everything in personal life. He was not as expressive to his children as he was in his annual letters with shareholders. Susan literally took care of everything, thus allowing him to concentrate on his career. She also protected him from his mother Leila Buffett towards whom Warren had developed lot of dislike and did his best to avoid her.

As a child, Warren did not like fighting with friends of his age group in the neighborhood. He always wanted to focus on things that he could do. His younger sister Roberta would save him from provoking kids. She would say, "*We are very protective to Warren. I don't know how it started, but it was that way even growing up.*" She was Susan's roommate in college. After the marriage Susan took over the protection. She shielded him from all external pressures of this world, like the shell of a snail and provided him the comfort and warmth he needed.

Opposed to this, Warren had to shield another woman the same way Susan protected him. The woman was Katherine Graham from Washington Post. Being a rich widow she completely depended on Buffett to overcome personal insecurity and overcome her inexperience on finance related matters. He was always there extending a hand of friendship. His primary motive in Washington Post was, of course, to make profit; but that did not prevent him entering into a special relationship with her.

One of the directors in the Post said, "*It was kind of goofy. She would have these pre-meeting dinners. And we'd all leave. And Warren wouldn't go. I never saw anything sexual about it.*" In one of the interviews Graham hinted, "*I was still young enough that it raised eyebrows.*"

Warren kept a pair of change clothes at her place in Washington. He stayed at her house whenever he visited Washington – he was in Washington at least once in a month. When he initiated steps to take control over GEICO he met its chief executive at her home. She was around when Buffett met Bill Gates for the first time. Susan was aware of his increasing closeness with the top woman at Washington Post, but she did not take it seriously.

It should be said that Warren and Susan filled each other and mutually complemented that helped the relationship flourish. Warren would be in his own world with books and annual reports of companies. Susan, on the contrary, was a free bird. In his own words, "*She sort of roams. She is free* *spirit.*" However she never failed to express her love and support, and made him feel secure.

She spent time with less privileged children to lift their spirits. Unlike typical wives of chief executives in corporate world, who took part is social service activities for the sake publicity and time pass, Susan involved herself wholeheartedly. She strongly opposed the schools and teachers that discriminated African American kids. Susan was a passionate abortion-rights activist. Even on those days when HIV virus was not widely known across the globe, she carried out AIDS awareness campaigns. In San Francisco she took an AIDS patient to her home. She travelled to remote geographies such as India, Turkey, and Africa due to her interest in population control.

Though Warren did not spend as much time with his kids as Susan did, he had the habit of sparing time with them despite his busy schedule. He was a good father – understanding and considerate, but not very expressive at the same time. Early in life he took his daughter, little Susie, to his office on Saturdays. He played football with his elder son Howard and helped younger son Peter in solving his mathematics homework.

But these were rare occurrences. Otherwise he would normally be in his own world and immerse deeply into it. He paid little attention to the little things around him and his abstractedness was strikingly obvious. Once he went up to Susan and asked what happened to the greenback wallpaper in the study room. She had changed it two years back.

Most of his time was devoted to reading annual reports of thousands on companies and speaking on the telephone with Charles Munger. He hardly had any time exclusively for the kids, sons in particular. Boys felt they were emotionally neglected by him. In relative terms, he shared little tenderness with little Susie. While on one side Susan Buffett herself was depressed, she had to reach out to her own father to sort out behavioral problems the boys had. Warren was like he had blinders on.

In all these circumstances Susan ran the family smoothly and took care of the children. It was a life of sacrifice. At one stage, she felt she was exhausted beyond description. She yearned for more of the usual sort of sharing that one would have with her partner. She would stay up alone in the night listening to music while Warren would be busy with his usual annual reports.

At one stage she was determined to rediscover her lost life and seriously thought about singing career. She had lived for her husband and children - now she had to live herself. Susan, at least, resolved to live one such free life.

In 1997, at the age of forty five, she left her husband Warren Buffett back in Omaha and moved to San Francisco in California. They lived separately from then onwards, but remained married legally. There wasn't any need to seek legal separation.

Though Warren had agreed to let her go, he was clearly a devastated man. Her departure was an irreparable blow. Careful constructed shelter that had protected him from all unpleasant and distracting things and allowed him to pursue his work was finally falling apart. It was hard for him to realize that his house was going to miss her warmth and soul-penetrating closeness. He told his sister Doris, "*Susie was the sun and the rain in my garden for twenty-five years.*"

He was miserably lonely and burst into tears on the telephone with her. She soothed him and told him it was an evolutionary process. They talked on the phone quite often, invariably every day and remained close. At Christmas time they got together with their children and their families at the California Beach house which Warren had bought on Susan's insistence in Laguna Beach, south of Los Angeles back in 1971. Warren and Susan did not give up their two week off for New York trip. Despite all these (virtually being in touch), sudden changes and separation created irreplaceable vacuum in him.

As if feeling compelled and morally responsible to fill the vacuum she created, Susie called several women in Omaha and suggested they go out with Warren to dinner or a movie. In that process she introduced thirty one year old Latvian-born Astrid Menks, a waitress at the French Café in Omaha, to Warren.

In the next one year Astrid moved in with Warren at his Farnam Street house and lived with him ever since. It took place with Susan's approval and blessing. Susan was still his legal wife. Her decision and action was something unimaginable by normal women. Her understanding and accommodative nature were unparallel.

It is very difficult to answer or comprehend the reason behind the couple choosing not to divorce. Perhaps they did not want to embarrass each other with alimony and things of that sort. In any case if he had to die before her, Susie would inherit his wealth. Moreover, money had never been a problem with them. It was the soul searching identity that Susan wanted to obtain, which made them live separately.

Both Susan and Warren were close despite the distance and personal pursuit that separated them psychically. She accompanied him in almost all public appearances. She participated in the board meetings of Berkshire where she was a director as one of its largest shareholder. There was a good understanding between Warren, Susie and Astrid. Both the ladies remained good friends. Presents sent to the relatives were from "Warren, Susie and Astrid". None of them spoke about the triangular relationship openly in media.

Marriage of Warren and Susan was running with this makeshift arrangement. His children had grown up by this time and were on their own now.

There is nothing worse in this world than having a parent with unmatched track record. When society compares you with your incomparable father and expects you to match up to him, it is very hard to live up to that mammoth benchmark. Fortunately Buffett couples did not give that punishment to their children.

Their children grew up without the shades of identity and expectation that rich kids normally carried with them. Warren and his wife treated them like ordinary children from other families because they knew that children won’t appreciate the value of money if they got it easily. He did not force things related to his profession on them against their desire. He was very clear about it.

His daughter and two sons attended public school. Buffett wanted them to lead normal life. He suggested them to do something that they enjoyed in any field of their choice and follow eminent personalities in those fields as their role models. According to him, it did not really matter how much they would earn, but the pursuit of interest did.

When his daughter little Susie was in high school she did not have any clue what he did. "*For years I didn't even know what he did. They asked me at the school what he did, and I said he was a security analyst, and they thought he checked alarm systems,*" she said later after growing up.

The children were provided with good food and clothes - nothing beyond that. They should earn everything else after growing up. As far as he was concerned money was an important thing. At the same time it was irrelevant as well.

He did not lead a lavish lifestyle because he had excessive money. Nor did he boost up his arrogance. In reality money gave him the freedom that he always loved. Freedom is way too different from security. For Warren, security is a form of prison. It denoted a typical middleclass mentality - looking for good, safe, secured job coupled with stable salary. On the contrary, freedom is limitless and beyond boundaries. Money gave him the freedom he needed to perform the activities as and when he wished. Along with the sense of freedom it bestowed, money helped satisfying his psyche. His love for money just meant it. Unnecessarily spending money was a taboo in his dictionary.

Above all, it is imperative to mention that Buffett was totally against children inheriting wealth from parents. The U.S government had the food stamp scheme to provide assistance to low and no-income people and families. Buffett commented that inheritance of wealth is the 'food stamp' arrangement of wealthy. He was strongly in favor of inheritance tax. His argument was simple. People should make a mark for themselves without depending on the success of their parents. He was against choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners in the 2000 Olympics.

Even for small presents that he would give his children, Buffett kept some kind of a target. It would be a test for himself. When he dieted he would write $10,000 check to his daughter Susie, payable unless his weight dropped before stipulated time. She would try to pull him for an ice cream, but the determined father would resist as he loved the money to stay with him.

He was emotionally detached and impersonal when it came to money. One time his daughter needed $20 to park her car at airport. She borrowed it from him, but only after writing a check for that amount. If there is anything called present, it was $10,000 gift he gave to his children and their spouses respectively. ($10,000 was the tax-deductible limit for gifts)

In money matters he exhibited the same behavior to his relatives as he did with his children. His elder sister Doris, who was his partner when he made his first stock purchase at the age of eleven, was not an exception by any means. She thought of making big money in derivatives by selling naked options in 1987. Market nosedived and produced heavy loss of $1.4 million to her. She approached Warren, who emphatically refused to pay off the debt. He agreed to manage a family fund and provide for her monthly expenses from it, but she had no choice but default the huge debt.

Though Doris was hurt by his refusal, Warren was unmoved. He did not flex the rules – be it sister or daughter. One time, Warren was escorting Bill Gates through Borsheim's jewelry store (owned by Berkshire) and noticed a box in the corner labeled "Buffett Lay-Away." Warren asked an employee what it was. She embarrassingly told that his daughter had asked them to save a string of pearls, which she was buying on installment. Bill Gates was indeed taken by surprise.

Little Susie's birthday was approaching in few months then. As a birthday gift Warren paid off the balance and took everyone by surprise. There was a reason for people to be surprised because he never gave such birthday presents to his children.

Warren's daughter started working at the age of sixteen as a salesperson at the Carriage Shop. Of the three children, Susie was the one who understood Warren most and showered love at him. She hated to be called a wealthy woman, because she was not. Poor Susie's first marriage was in chaos, which did not last long. She moved to Washington where Katharine Graham helped her find a job at The New Republic.

She remarried a lawyer by the name Allen Greenberg and soon became pregnant. Susie knew that her father would not spare any dime and hence asked him for a loan of $30,000 at prevailing market rate. Warren did not agree. He rather suggested, "*Why not go to the bank and take a loan out like everyone else?*"

Countless people became wealthy by holding Berkshire Hathaway shares. His own daughter had sold them long back when it was under $1,000. Had she not sold it then, it would have been handy when she was in need.

Warren and his wife had high regards for little Susie's second husband Greenberg. In 1987 he offered "Allen-the-perfect-son-in-law" the job of managing Susan Buffett foundation as a salaried employee. As a result, daughter and son-in-law moved to Omaha. They bought a house few blocks from Warren's and continue to live in the same city. Father was glad to have his daughter around him, a gesture he valued much after letting his elder Susie go by. She dropped her kids at Warren's place where Astrid took care of them. In a way, Warren Buffett was successful in integrating Astrid in his original family. Having his daughter and her kids around really made up what Warren had missed all his life. He would visit their house, sit down on the floor, and play with the grandchildren.

He rightly told Katherine Graham that Susie's return to Omaha had changed his life.

Like daughter Susie, Warren's second child Howard had also sold his Berkshire shares very early in his life. He did some business with that money. When the business went broke he went out and worked at many places and finally returned to Omaha, where he remarried and settled down finally.

During that time he wanted to get into farming. Luckily Warren did not reject his request when approached. At the same time he simply did not buy the farm and let him plow right away. Warren agreed to help as a business partner. Under that agreement he would buy the form and rent to Howard. Son had to pay the rent as per existing commercial terms and pay tax on the form income.

Howard wanted to take Warren to the farm, located forty-five minutes north of Omaha, to share the farming experience he was going through. He said, "*I can't get him to come out and see how the crops are going.*" Warren was not too emotional about the farming activity. He would laughingly say, "*Send me a rent check, and make sure it's big enough.*"

In six years he went to the farm only twice. For the son farming was a fulfilling activity, but for the father it was a business that did not make economic sense. He remarked, "*No one goes to the supermarket to buy Howie Buffett's corn.*"

Howards ran for county commissioner of Omaha post. People assumed that he would be financed by his father. That could have happened only in dreams, as Warren Buffett said “*I asked him to spell his name in lowercase letters so that everyone would realize that he was the Buffett without the capital*”

Still he assured that he would contribute 10 percent of the fund his son raised elsewhere. Interestingly Howard won the election. His political and social life improved thereafter. So was the relationship with his father.

The problem with Warren was that though he had concerns about his children he did not openly express it. He was in his own universe, consumed by thoughts. His younger son Peter once gave him a birthday card. Warren just sort of opened it and closed it - he read it that fast and immersed into his routine stuff again. Little son was waiting for some response. At least a thanks, appreciation … nothing.. Peter was the youngest though.

Peter was no better than his siblings in getting rid of Berkshire shares and ignoring the advice from his father. At least in the case of Howard, he was in need of money to invest in new business venture. But Peter sold his stake in Berkshire to twenty-four-track tape recorder for $30,000. He had excessive passion in music, something like his mother. Peter slowing built a music production company and started making a mark for himself. He scored music for the movie *Dances with Wolves* and composed several widely acclaimed albums.

Of course Peter Buffett repented for having sold Berkshire shares too young. He was happy reflecting his self esteem by saying, "*It's so nice to say I've gotten to this point without it.*"

Like other two children of Warren, even peter had troubled marriage. During those time, when his mother was already on her own, Warren was a great emotional support.

Warren had strong belief and convictions in life that he hardly flexed. For example, he did not believe that you cannot do any good to a person by giving him/her something that he/she did not really deserve. He rather believed that only by letting them earn what they need we tend to help them. That was precisely why he did not extend help to his own children & sister in their financial mess.

Despite shortcomings in family life, Warren’s children did fairly okay in the fields of their interest like average people in American society. He was pleased and rather proud that they had created their own identity instead of being known as multibillionaire Warren Buffett's children. They also treated this reorganization from him as a big lifetime award.

Warren's wife Susan Buffett died in 2004 at her 72nd year. Two years later Warren married his long time companion Astrid on his birthday. It was a simple function at his daughter's house in Omaha.

14. Dot Com saga

The United States of America went through a transformation in the second half of 1990s. Dot com fever, propelled by the spread of personal computers and internet, hit the whole nation. From the common men in Main Street to the most sophisticated executives in Wall Street there was virtually no one who did not speak about the dot com boom. New companies mushroomed almost every other day with an inevitable 'dot com' suffix to their name. People were mad at them. They did not hesitate to pour all the money in such stocks.

Beffett was not convinced. He was rather concerned. It was evident from his 1996 annual letter.

"*I should emphasize that, as citizens, Charlie and I welcome change: Fresh ideas, new products, innovative processes and the like cause our country's standard of living to rise, and that's clearly good. As investors, however, our reaction to a fermenting industry is much like our attitude toward space exploration: We applaud the endeavor but prefer to skip the ride.*

Today, See's(a candy business that Berkshire invested in) is different in many ways from what it was in 1972 when we bought it: It offers a different assortment of candy, employs different machinery and sells through different distribution channels. But the reasons why people today buy boxed chocolates, and why they buy them from us rather than from someone else, are virtually unchanged from what they were in the 1920s when they See family was building the business. Moreover, these motivations are not likely to change over the next 20 years, or even 50.

We look for similar predictability in marketable securities. Take Coca-Cola: The zeal and imagination with which Coke products are sold has burgeoned under Roberto Goizueta, who has done an absolutely incredible job in creating value for his shareholders. Aided by Don Keough and Doug Ivester, Roberto has rethought and improved every aspect of the company. But the fundamentals of the business - the qualities that underlie Coke's competitive dominance and stunning economics - have remained constant through the years.

I was recently studying the 1896 report of Coke (and you think that you are behind in your reading!). At that time Coke, though it was already the leading soft drink, had been around for only a decade. But its blueprint for the next 100 years was already drawn. Reporting sales of $148,000 that year, Asa Candler, the company's president, said: "We have not lagged in our efforts to go into all the world teaching that Coca-Cola is the article, par excellence, for the health and good feeling of all people." Though "health" may have been a reach, I love the fact that Coke still relies on Candler's basic theme today - a century later.

Candler went on to say, just as Roberto could now, "No article of like character has ever so firmly entrenched itself in public favor." Sales of syrup that year, incidentally, were 116,492 gallons versus about 3.2 billion in 1996.

I can't resist one more Candler quote: "Beginning this year about March 1st . . . we employed ten traveling salesmen by means of which, with systematic correspondence from the office, we covered almost the territory of the Union." That's my kind of sales force.

Companies such as Coca-Cola and Gillette might well be labeled "The Inevitables." Forecasters may differ a bit in their predictions of exactly how much soft drink or shaving-equipment business these companies will be doing in ten or twenty years. Nor is our talk of inevitability meant to play down the vital work that these companies must continue to carry out, in such areas as manufacturing, distribution, packaging and product innovation. In the end, however, no sensible observer - not even these companies' most vigorous competitors, assuming they are assessing the matter honestly - questions that Coke and Gillette will dominate their fields worldwide for an investment lifetime. Indeed, their dominance will probably strengthen. Both companies have significantly expanded their already huge shares of market during the past ten years, and all signs point to their repeating that performance in the next decade.

Obviously many companies in high-tech businesses or embryonic industries will grow much faster in percentage terms than will The Inevitables. But I would rather be certain of a good result than hopeful of a great one.

Of course, Charlie and I can identify only a few Inevitables, even after a lifetime of looking for them. Leadership alone provides no certainties: Witness the shocks some years back at General Motors, IBM and Sears, all of which had enjoyed long periods of seeming invincibility. Though some industries or lines of business exhibit characteristics that endow leaders with virtually insurmountable advantages, and that tend to establish Survival of the Fattest as almost a natural law, most do not. Thus, for every Inevitable, there are dozens of Impostors, companies now riding high but vulnerable to competitive attacks. Considering what it takes to be an Inevitable, Charlie and I recognize that we will never be able to come up with a Nifty Fifty or even a Twinkling Twenty. To the Inevitables in our portfolio, therefore, we add a few "Highly Probables."

You can, of course, pay too much for even the best of businesses. The overpayment risk surfaces periodically and, in our opinion, may now be quite high for the purchasers of virtually all stocks, The Inevitables included. Investors making purchases in an overheated market need to recognize that it may often take an extended period for the value of even an outstanding company to catch up with the price they paid.

A far more serious problem occurs when the management of a great company gets sidetracked and neglects its wonderful base business while purchasing other businesses that are so-so or worse. When that happens, the suffering of investors is often prolonged. Unfortunately, that is precisely what transpired years ago at both Coke and Gillette. (Would you believe that a few decades back they were growing shrimp at Coke and exploring for oil at Gillette?) Loss of focus is what most worries Charlie and me when we contemplate investing in businesses that in general look outstanding. All too often, we've seen value stagnate in the presence of hubris or of boredom that caused the attention of managers to wander. That's not going to happen again at Coke and Gillette, however - not given their current and prospective managements."

Those were sensible words from Warren Buffett at a time when many companies were forced to suffix 'dot com' to their name to pep up the demand in the marketplace. Wall Street was prepared to pay any price for such organizations. Stock price of such businesses rose much faster than their profits. New industry specific *technology mutual fund schemes* were born to cash in the prevailing market conditions. Investors, who would hesitate to pay 10 or 15 times under normal circumstances, were more than willing to pay 100, 200 and even 1000 times the annual earning for internet companies. Share market was totally crazy and it ran out of control beyond any rationale.

Rising market limited Buffett's ability to spot suitable investment candidates. Unless quality business was available at affordable price he won't put his money in. To quote from his annual letter, '*Investors making purchases in an overheated market need to recognize that it may often take an extended period for the value of even an outstanding company to catch up with the price they paid.*'

He observed that the markets were trading at high levels. At the same time he did not predict that the market would take a beating anytime soon, but all he knew was it was foolish to invest in such times. Mr.Market was in cheerful mood.

*

In 1998, Warren Buffett said, "*We slightly increased our holdings in American Express, one of our three largest commitments, and left the other two unchanged. However, we trimmed or substantially cut many of our smaller positions. Here, I need to make a confession (ugh): The portfolio actions I took in 1998 actually decreased our gain for the year. In particular, my decision to sell McDonald's was a very big mistake. Overall, you would have been better off last year if I had regularly snuck off to the movies during market hours.*"

Berkshire was flooding with money and Buffett had the problem of plenty, as he would openly acknowledge in 1998 annual letter. He acknowledged, "*At yearend, we held more than $15 billion in cash equivalents (including high-grade securities due in less than one year). Cash never makes us happy. But it's better to have the money burning a hole in Berkshire's pocket than resting comfortably in someone else's. Charlie and I will continue our search for large equity investments or, better yet, a really major business acquisition that would absorb our liquid assets. Currently, however, we see nothing on* *the horizon.*"

As he became more and more cautious, more and more investors were attracted towards the market. Normal citizens were getting converted as 'investors' and it was an easy game out there. At least, it appeared so. Making money had never been so easy before.

Warren Buffett and Charles Munger might not have invested in internet companies, but they were not unaware of the benefits that internet produced. Berkshire launched its website www.berkshirehathaway.com. Unlike other companies, the bland website was not sensational at all.

It also reduced postal expense for sending quarterly reports. In 1998 annual letter he had a special mention for this. He said, "*Berkshire's Internet site has become a prime source for information about the company. While we continue to send an annual report to all shareholders, we now send quarterlies only to those who request them, letting others read these at our site. In this report, we again enclose a card that can be returned by those wanting to get printed quarterlies in 1999.*"

*

1999 was clearly a watershed year that would have tested everybody's temptation. Market flied high with leaps and bounds. Equities seemed to have only one direction – up. Yet, no new generation dot-com company figured in Berkshire's investment portfolio. Per share book value of Berkshire increased by 0.5 percent that year against 21 percent increase in S&P 500.

His annual letter that year not only reflected this fact, but also had a clear explanation of his stance.

"*Several of the companies in which we have large investments had disappointing business results last year. Nevertheless, we believe these companies have important competitive advantages that will endure over time. This attribute, which makes for good long-term investment results, is one Charlie and I occasionally believe we can identify. More often, however, we can't — not at least with a high degree of conviction. This explains, by the way, why we don't own stocks of tech companies, even though we share the general view that our society will be transformed by their products and services. Our problem — which we can't solve by studying up — is that we* *have no insights into which participants in the tech field possess a truly durable competitive advantage.*

Our lack of tech insights, we should add, does not distress us. After all, there are a great many business areas in which Charlie and I have no special capital-allocation expertise. For instance, we bring nothing to the table when it comes to evaluating patents, manufacturing processes or geological prospects. So we simply don't get into judgments in those fields.

If we have a strength, it is in recognizing when we are operating well within our circle of competence and when we are approaching the perimeter. Predicting the long-term economics of companies that operate in fast-changing industries is simply far beyond our perimeter. If others claim predictive skill in those industries — and seem to have their claims validated by the behavior of the stock market — we neither envy nor emulate them. Instead, we just stick with what we understand. If we stray, we will have done so inadvertently, not because we got restless and substituted hope for rationality. Fortunately, it's almost certain there will be opportunities from time to time for Berkshire to do well within the circle we've staked out.

Right now, the prices of the fine businesses we already own are just not that attractive. In other words, we feel much better about the businesses than their stocks. That's why we haven't added to our present holdings. Nevertheless, we haven't yet scaled back our portfolio in a major way: If the choice is between a questionable business at a comfortable price or a comfortable business at a questionable price, we much prefer the latter. What really gets our attention, however, is a comfortable business at a comfortable price.

Our reservations about the prices of securities we own apply also to the general level of equity prices. We have never attempted to forecast what the stock market is going to do in the next month or the next year, and we are not trying to do that now. But, as I point out in the enclosed article, equity investors currently seem wildly optimistic in their expectations about future returns.

We see the growth in corporate profits as being largely tied to the business done in the country (GDP), and we see GDP growing at a real rate of about 3%. In addition, we have hypothesized 2% inflation.

If profits do indeed grow along with GDP, at about a 5% rate, the valuation placed on American business is unlikely to climb by much more than that. Add in something for dividends, and you emerge with returns from equities that are dramatically less than most investors have either experienced in the past or expect in the future. If investor expectations become more realistic — and they almost certainly will — the market adjustment is apt to be severe, particularly in sectors in which speculation has been concentrated.

Berkshire will someday have opportunities to deploy major amounts of cash in equity markets — we are confident of that. But, as the song goes, "Who knows where or when?" Meanwhile, if anyone starts explaining to you what is going on in the truly-manic portions of this "enchanted" market, you might remember still another line of song: "Fools give you reasons, wise men never try.'"

Single year performance did not matter much for Warren and Charlie. Despite relatively low performance that year, they hoped to beat the general market return over any ten year period.

Many people thought that Buffett had lost his magical touch in stock picking. In a fast changing dynamic world he was still an old aged investor who had difficulty to shred his orthodox approach, they clamored. But Warren knew exactly what he was doing which was reflected by him as, "*If we have a strength, it is in recognizing when we are operating well within our circle of competence and when we are approaching the perimeter.*" Others hardly had any competence, let alone drawing a circle around it.

Expectation from equity investment was very high. A bird in the hand was worth two in the bush, if not more. Warren went back in history to draw a fairy tale in his 2000 annual letter to illustrate this point by quoting the smart man called Aesop back in 600 B.C.

"*To flesh out this principle, you must answer only three questions. How certain are you that there are indeed birds in the bush? When will they emerge and how many will there be? What is the risk-free interest rate (which we consider to be the yield on long-term U.S. bonds)? If you can answer these three questions, you will know the maximum value of the bush and the maximum number of the birds you now possess that should be* *offered for it. And, of course, don't literally think birds. Think dollars.*"

Adding more to his expectation, he wrote, "*Last year, we commented on the exuberance and, yes, it was irrational, that prevailed, noting that investor expectations had grown to be several multiples of probable returns. One piece of evidence came from a Paine Webber-Gallup survey of investors conducted in December 1999, in which the participants were asked their opinion about the annual returns investors could expect to realize over the decade ahead. Their answers averaged 19%. That, for sure, was an irrational expectation: For American business as a whole, there couldn't possibly be enough birds in the 2009 bush to deliver such a return.*"

He was very critical about the people who mindlessly partied in Y2K pub. In the same 2000 annual letter he continued:

"*Now, speculation — in which the focus is not on what an asset will produce but rather on what the next fellow will pay for it — is neither illegal, immoral nor un-American. But it is not a game in which Charlie and I wish to play. We bring nothing to the party, so why should we expect to take anything home?*

The line separating investment and speculation, which is never bright and clear, becomes blurred still further when most market participants have recently enjoyed triumphs. Nothing sedates rationality like large doses of effortless money. After a heady experience of that kind, normally sensible people drift into behavior akin to that of Cinderella at the ball. They know that overstaying the festivities — that is, continuing to speculate in companies that have gigantic valuations relative to the cash they are likely to generate in the future will eventually bring on pumpkins and mice. But they nevertheless hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There's a problem, though: They are dancing in a room in which the clocks have no hands."

He had strong words for high valuations: "*It was as if some virus, racing wildly among investment professionals as well as amateurs, induced hallucinations in which the values of stocks in certain sectors became decoupled from the values of the businesses that underlay them.*

What actually occurs in these cases is wealth transfer (not wealth creation), often on a massive scale. By shamelessly merchandising birdless bushes, promoters have in recent years moved billions of dollars from the pockets of the public to their own purses (and to those of their friends and associates). The fact is that a bubble market has allowed the creation of bubble companies, entities designed more with an eye to making money off investors rather than for them. Too often, an IPO, not profits, was the primary goal of a company's promoters. At bottom, the "business model" for these companies has been the old fashioned chain letter, for which many fee-hungry investment bankers acted as eager postmen."

Bubble was the word, indeed it was. Yes, technology bubble kept on swelling till eventuality dawned very soon.

Stock market touched its peak in the spring of 2000. In March market touched its lifetime high as Warren would note in his 2001 annual letter: "*Here's one for those who enjoy an odd coincidence: The Great Bubble ended on March 10, 2000 (though we didn't realize that fact until some months later). On that day, the NASDAQ (recently 1,731) hit its all-time high of 5,132. That same day, Berkshire shares traded at $40,800, their lowest price since mid-1997.*"

In 2000, S&P 500 fell 9.1 percent whereas Berkshire's book value per share increased by 6.5 percent. Overall market continued to slide for two years. To make things worse for the technology stocks, a vast majority of them never made a comeback.

Many people in America burnt their fingers when dot com bubble finally burst. A great majority of them belonged to average middle class, middle age population. They entered the market without basic education and self developed cognizance about equity markets. Experts genuinely believed that the government was also responsible for that in some way or the other. People, who would have otherwise been quite content with good, stable job and modest income, were indirectly persuaded to invest in stocks. Having done that, the government possibly failed to educate them by providing financial literacy and prudence.

The period in history between the Second World War (ended in 1945) and

Vietnam War was a crucial phase in American economy. During this period the U.S saw one of its fastest economic growths. Opportunities multiplied abundantly. Population growth was phenomenal too. That is why the United States Census Bureau considers a baby boomer as someone born between 1946 and 1964.

Many changes that their parents had not seen or heard about were introduced in Baby Boomer generation. One such change was 401(K). When their parents were working, employers were expected to provide for retirement benefit. A certain portion of the salary was deducted and set aside for retirement corpus to be converted into annuity. While pension income thus obtained might be lesser than the usual salary one would have received during working life, it was assured. This gave people the opportunity to retire and lead a decent retirement life even if they never saved and personally planned for retirement separately.

Things changed later with 401(K) schemes. In this the employer is under no obligation to provide for employees' retirement. Instead of paying a pension as long as the retired employee lived, companies only had to cover the administration expenses plus any company match programs during employment. There is no obligation or additional expense after the employee retired.

401(K) contribution was not mandatory, except for the lucrative benefits from tax planning point of view. Employer will have to match the contribution only if the employee is planning it himself. Schemes also allowed purchasing the shares of the same company they worked for. This was the case with vast majority of them, while there were few plans that allowed investing in other companies/avenues too.

Basically the people from this generation were averse to investing in equity stocks. But 401(K) deferred benefit schemes were designed to invest in share market. So even unknowingly majority of baby boomers were putting their money in share market every month. Money continued to come into the market.

More importantly, large proportion of people from this generation worked, both men and women. They earned well and also spent well. Baby boomer generation that started working in seventies bought homes in large scale and led to widespread inflation. In order to control inflation, the authorities were forced to push up the interest rate up to 20 percent at one stage. Customer demand led to expansion of capacity in many industries. This further gave way to innovation, productivity and efficiency, and helped the U.S to reassure its place as an economic super power in the world.

Over a period of time, spending became the way of life in the country and it spread like a deadly disease. Credit card, loan, mortgage etc became the blood of circulation in American economy. Consuming, not producing, was considered superior. Value of goods and services getting imported to the U.S outpaced their exports. Trade deficit continued to increase.

As per Warren's 2004 annual letter to shareholders, a 318-page Congressional study of the consequences of unrelenting trade deficits was published in November 2000 and has been gathering dust ever since. He started thinking seriously.

If a nation continues to import more than its export for a prolonged period of time, then its currency will certainly lose its value. Warren Buffett predicted that it could happen to the greenback. In fact, neither Berkshire nor its chairman ever traded in currencies till March 2002. But things should change. At yearend 2004, Berkshire owned about $21.4 billion of foreign exchange contracts, spread among 12 currencies. Warren wrote to his shareholders:

"*Our country's trade practices are weighing down the dollar. The decline in its value has already been substantial, but is nevertheless likely to continue. Without policy changes, currency markets could even become disorderly and generate spillover effects, both political and financial. No one knows whether these problems will materialize. But such a scenario is a far-from-remote possibility that policymakers should be considering now. Their bent, however, is to lean toward not-so-benign neglect. The (congressional) study was ordered after the deficit hit a then-alarming $263 billion in 1999; by last year (2004) it had risen to $618 billion.*

Charlie and I, it should be emphasized, believe that true trade – that is, the exchange of goods and services with other countries – is enormously beneficial for both us and them. Last year we had $1.15 trillion of such *honest-to-God trade and the more of this, the better. But, as noted, our country also purchased an additional $618 billion in goods and services from the rest of the world that was unreciprocated. That is a staggering figure and one that has important consequences.*"

To appreciate the consequence we need to do swift revision of history and quote Warren's November 10, 2003 article in Fortune. In that article he pointed out some interesting figures.

"*Simply put, after World War II and up until the early 1970s we operated in the industrious Thriftville style, regularly selling more abroad than we purchased. We concurrently invested our surplus abroad, with the result that our net investment—that is, our holdings of foreign assets less foreign holdings of U.S. assets—increased (under methodology, since revised, that the government was then using) from $37 billion in 1950 to $68 billion in 1970. In those days, to sum up, our country's "net worth," viewed in totality, consisted of all the wealth within our borders plus a modest portion of the wealth in the rest of the world.*

Additionally, because the U.S. was in a net ownership position with respect to the rest of the world, we realized net investment income that, piled on top of our trade surplus, became a second source of investable funds. Our fiscal situation was thus similar to that of an individual who was both saving some of his salary and reinvesting the dividends from his existing nest egg."

All seemed rosy until baby boomer generation started working and spending. Warren continued:

"*In the late 1970s the trade situation reversed, producing deficits that initially ran about 1% of GDP. That was hardly serious, particularly because net investment income remained positive. Indeed, with the power of compound interest working for us, our net ownership balance hit its high in 1980 at $360 billion.*

Since then, however, it's been all downhill, with the pace of decline rapidly accelerating in the past five years. Our annual trade deficit now exceeds 4% of GDP. Equally ominous, the rest of the world owns a staggering $2.5 trillion more of the U.S. than we own of other countries.

More important, however, is that foreign ownership of our assets will grow at about $500 billion per year at the present trade-deficit level, which means that the deficit will be adding about one percentage point annually to foreigners' net ownership of our national wealth. As that ownership grows, so will the annual net investment income flowing out of this country. That will leave us paying ever-increasing dividends and interest to the world rather than being a net receiver of them, as in the past. We have entered the world of negative compounding—goodbye pleasure, hello pain.

Since one generation gets the free ride and future generations pay in perpetuity for it, there are—in economist talk—some pretty dramatic "intergenerational inequities."

An otherwise calm and composed Warren Buffett cried wolf. Yet, he knew that the country had consistently made fools of those who were skeptical about either its economic potential or its resilience.

The U.S trade deficit has to be viewed from all possible angles by taking into account every potential factor. One reason that could possibly go against closing down trade deficit is the demographic composition in that country. Seventy five million baby boomers are not very far from their retirement. More nonworking people might be added in the U.S than the working population. Medical expenses, that are already high, will further increase. People will start pulling out from their 401(K) retirement kitty. On one side constant stream of funds that helped fill equity tank will dry up. On the other side, it will trigger more out stream resulting in a potential depletion of the tank. Such a scenario can further weaken U.S. dollar.

Against these entire backdrop, Buffett's decision to spread his investment wings outside the Unites States and offset the impact due to weakening dollar is comprehensible. It is another indication of his practical approach towards investing in modern global economy.

In the year 2003 Berkshire Hathaway invested $500 million in Petro China. Post that ninety percent of the business was owned by Chinese government and the rest, of course, by Buffett. At the time of making the investment, Petro China was fourth most profitable oil company in the world. It should be said that Warren made a killing, because he paid one third of what he should have paid if he were to acquire a similar company in the western world. In 2006, he went to Israel for shopping. Berkshire purchased 80% of ISCAR for $4 billion. ISCAR’s products were small, consumable cutting tools that are used in conjunction with large and expensive machine tools.

Thus, Berkshire’s overseas investment finally becomes irresistible for Buffett.

15. Elephant Hunt

From an ailing textile company in the sixties, Berkshire Hathaway transformed into a massive holding company beyond anyone's imagination, because of one man – Warren Buffett. Two tables shown below, from his 2005 annual letter, speak for themselves.

Year	Per share investment (in $)	Per share earnings (in $)
1965	4	4
1975	159	4
1985	2,407	52
1995	21,817	175
2005	74,129	2441
Compound Growth Rate 1965-2005	28%	17.2%
Compound Growth Rate 1995-2005	13%	30.2%

In this table, investment was referred to what Berkshire owned on a per-share basis. In making this calculation, Warren excluded investments the company held in its finance operation because these were largely offset by borrowings.

Profit column was more interesting, as it only referred to the dividends that Berkshire earned from the companies it invested and also the float generated from insurance businesses. It did not refer to the cumulative EPS of all the companies it owned/invested, but it only referred to the actual cash flow that Berkshire realized.

Comparative growth rates of Berkshire's two elements of value had changed in the latest decade(till 2005), a result reflecting his ever-increasing emphasis on business acquisitions. Warren said, he and Charlie, wished to increase the value under both the columns. In reality they were mutually exclusive parameters, he felt.

In his annual letter he elaborated it further with a wit. He wrote, "*Charlie Munger, Berkshire's Vice Chairman and my partner, and I want to increase the figures in both tables. In this ambition, we hope – metaphorically – to avoid the fate of the elderly couple who had been romantically challenged for some time. As they finished dinner on their 50th anniversary, however, the wife – stimulated by soft music, wine and candlelight – felt a long-absent tickle and demurely suggested to her husband that they go upstairs and make love. He agonized for a moment and then replied, "I can do one or the other, but not both.*"

Berkshire is filled with cash. As Buffett had time and again mentioned, he was confronted with a constant problem as the size grew. He said: "*Two conditions at Berkshire are far different from what they once were: Then, we could often buy businesses and securities at much lower valuations than now prevail; and more important, we were then working with far less money than we now have. Some years back, a good $10 million idea could do wonders for us (witness our investment in Washington Post in 1973 or GEICO in 1976). Today, the combination of ten such ideas and a triple in the value of each would increase the net worth of Berkshire by only ¼ of 1%. We need 'elephants' to make significant gains now - and they are hard to find.*"

He would further touch that topic again in his 2006 letter.

"*We continue to need elephants in order for us to use Berkshire's flood of incoming cash. Charlie and I must therefore ignore the pursuit of mice and focus our acquisition efforts on much bigger game.*
Our exemplar is the older man who crashed his grocery cart into that of a much younger fellow while both were shopping. The elderly man explained apologetically that he had lost track of his wife and was preoccupied searching for her. His new acquaintance said that by coincidence his wife had also wandered off and suggested that it might be more efficient if they jointly looked for the two women.

Agreeing, the older man asked his new companion what his wife looked like. "She's a gorgeous blonde," the fellow answered, "with a body that would cause a bishop to go through a stained glass window, and she's wearing tight *white shorts. How about yours?" The senior citizen wasted no words: "Forget her, we'll look for yours.""*

Warren Buffett had a constant answer for many years to counter a readymade question. He has been asked about his retirement and succession plans for over two decades. But he never had an open answer. He answer would be, "*Retirement plans? About 5 to 10 years after I die.*"

Berkshire's subsidiaries were run by able and reliable managers. Buffett could still afford to have a nap post lunch. He continued to insist that his sudden absence would not make a big difference, as the company was already prepared for the truck.

Of course Buffett is old, perhaps older than many people who could probably run businesses, if not business empires. Shareholders are naturally concerned about who is going to be his successor. If a person beats the market one single year, he could be considered as lucky. But if a man has been able to do it for nearly 5 decades there should be something special about him. Obviously, insurmountable expectation will be put on his successor's shoulder.

Many years ago people speculated that Charles Munger was going to be Buffett's successor to the throne at Berkshire. Over the passage of time, Munger also grew older simultaneously with Warren. In fact, Vice Chairman was older than the chairman himself.

Warren elaborated this subject in his 2006 annual letter.

"*I have told you that Berkshire has three outstanding candidates to replace me as CEO and that the Board knows exactly who should take over if I should die tonight. Each of the three is much younger than I. The directors believe it's important that my successor have the prospect of a long tenure.*

Frankly, we are not as well-prepared on the investment side of our business. There's a history here: At one time, Charlie was my potential replacement for investing, and more recently Lou Simpson has filled that slot. Lou is a top-notch investor with an outstanding long-term record of managing GEICO's *equity portfolio. But he is only six years younger than I. If I were to die soon, he would fill in magnificently for a short period. For the long-term, though, we need a different answer.*

At our October board meeting, we discussed that subject fully. And we emerged with a plan, which I will carry out with the help of Charlie and Lou.

Under this plan, I intend to hire a younger man or woman with the potential to manage a very large portfolio, who we hope will succeed me as Berkshire's chief investment officer when the need for someone to do that arises. As part of the selection process, we may in fact take on several candidates.

Picking the right person(s) will not be an easy task. It's not hard, of course, to find smart people, among them individuals who have impressive investment records. But there is far more to successful long term investing than brains and performance that has recently been good.

Over time, markets will do extraordinary, even bizarre, things. A single, big mistake could wipe out a long string of successes. We therefore need someone genetically programmed to recognize and avoid serious risks, including those never before encountered. Certain perils that lurk in investment strategies cannot be spotted by use of the models commonly employed today by financial institutions.

Temperament is also important. Independent thinking, emotional stability, and a keen understanding of both human and institutional behavior is vital to long-term investment success. I've seen a lot of very smart people who have lacked these virtues.

Finally, we have a special problem to consider: our ability to keep the person we hire. Being able to list Berkshire on a resume would materially enhance the marketability of an investment manager. We will need, therefore, to be sure we can retain our choice, even though he or she could leave and make much more money elsewhere.

There are surely people who fit what we need, but they may be hard to identify. In 1979, Jack Byrne and I felt we had found such a person in Lou Simpson. We then made an arrangement with him whereby he would be paid well for sustained over-performance. Under this deal, he has earned large *amounts. Lou, however, could have left us long ago to manage far greater sums on more advantageous terms. If money alone had been the object, that's exactly what he would have done. But Lou never considered such a move. We need to find a younger person or two made of the same stuff.*"

He returned to the same topic again in 2009 letter to shareholders.

"*I will continue to keep the directors posted on the succession issue. You can be equally sure that the principles we have employed to date in running Berkshire will continue to guide the managers who succeed me and that our unusually strong and well-defined culture will remain intact. As an added assurance that this will be the case, I believe it would be wise when I am no longer CEO to have a member of the Buffett family serve as the non-paid, non-executive Chairman of the Board. That decision, however, will be the responsibility of the then Board of Directors.*"

But the world knows that anyone can replace his position, but not become another Warren Buffett.

The game of cricket had only one Sir Don Bradman.

That did not prevent the likes of Vivian Richards and Sachin Tendulkar emerging to prominence, and leave a mark for themselves.