Rumours of the death of the conglomerate are much exaggerated

"Our gain in net worth during 2003 was $13.6 billion, which increased the per-share book value of both our Class A and Class B stock by 21%". This takes some beating as a succinct and compelling opening to a Chairman's Statement.

Thus spake Warren Buffett, Chairman of Berkshire Hathaway and one of the world's richest men, in his recent annual statement to shareholders **(Note 1)**. Yes, that's $13,600,000,000 (£7.5 billion) in 12 months. Indeed, as a shareholder you may think that very little more needs to be said, particularly since, in the 39 years that Mr Buffett has been at the helm, per-share book value has grown at 22% per annum *compound*.

But long time readers of the Sage of Omaha's annual discourses know better than to stop there. For there are lessons that many public company chairmen may wish to take on board in the candour, and the lack of management speak, in which Mr Buffett illuminates for shareholders the key business issues of a (extremely unfashionable) complex conglomerate, ranging from earthquake insurance through newspapers to sweet shops. Refreshingly, the following words and phrases are nowhere to be found: "strategy", "core activities", "competitive advantage", "downsizing", "focus", "exceptional items", or "shareholder value".

Berkshire Hathaway (BH) is by any measure a huge undertaking, but there is no room for bragging in Mr Buffett's world. *$63 billion* of revenues and *$180 billion* of assets are summarised in equally succinct fashion. Insurance – "that's where the money is" (BH earned *$1.7 billion* in underwriting gains). Financial Products – "I manage a few opportunistic strategies…it was fun while it lasted" (contributing to *$1.9 billion* of earnings). "We are neither enthusiastic nor negative about the portfolio we hold" (which happens to be *$35 billion* of US equity holdings). BH also owns Northern Electricity and Yorkshire Electricity in the UK which "had 6,800 employees…now they employ 2,539…serving about the same number of customers as when they were government owned and are distributing more electricity". If this is what becomes of being unfashionable, you may want to get your flares out.

The acquisition of Wal-Mart's McLane (sales a mere $23 billion) distribution subsidiary is described with equal panache. "I had a single meeting of about two hours with Tom Scoewe, Wal-Mart's CFO, and we then shook hands. Twenty nine days later Wal-Mart had its money. We did no due diligence. We knew everything would be exactly as Wal-Mart said it would be – and it was."

Not everything goes right. "...It's confession time: I'm sure I could have saved you $100 million or so, pre-tax, if I had acted more promptly to shut down Gen Re's …derivatives business". Also, "I failed...in not spotting [insurance] underreserving a few years back. Not only did we report inaccurate figures…the error resulted in our paying very substantial taxes earlier than was necessary. Aaaarrrggghh (sic)."

It is a curious observation on human nature that admission of mistakes actually enhances confidence in management – because we all know from our own experience that if you are trying hard, occasionally some things just don't work out. A view of a business where everything in the garden is rosy tends to alert us that someone is being economical with some of the verité.

Of course, it is easy to be self deprecating after you have made your mark in the world. Perhaps the more interesting thing about BH as a US public company is that there would be huge pressure from institutions – cheered on, no doubt, by investment bankers – to break up the business of a UK equivalent. This would be rationalised by the current sentiment for "focus" on one particular core business. (BH is minded of the converse that, in a focussed business, when the economics of that business turn bad the management has nowhere to go.)

There are a few pithy observations on the way. On excessive executive pay: "The couriers for this epidemic of greed were usually consultants and human relations departments, which had no trouble perceiving who buttered their bread". On non executive directors: "In addition to being independent, directors should have business savvy, a shareholder orientation and a genuine interest in the company. The rarest of these qualities is business savvy – and if it is lacking, the other two are of little help."

BH's extraordinary success comes principally from the business savvy of Messrs Buffett and Munger (76 year old Charlie Munger, 73 year old Mr Buffett's long time partner). You can't teach that. But what you can learn is the extraordinary clarity and discipline of what the central function – all 16 of them - at BH does and doesn't do. As Mr Buffett recounted in his 2002 report, "Unlike LBO operators and private equity firms, we have no "exit" strategy – we buy to keep...Berkshire's operating CEO's are masters of their crafts and run their businesses as if they were their own. My job is to stay out of their way and allocate whatever excess capital their businesses generate. It's easy work." He also cannily recognises the crucial importance of attracting and retaining excellent operating managers – in 38 years not one subsidiary CEO has left BH to work elsewhere.

The future is just as clear. "Our board knows that the ultimate scorecard on its performance will be determined by my successor…upon my death or disability, or when I begin to lose my marbles"

(There is I suppose just one quite interesting piece of bragging - in 2003 BH paid $3.3 billion in tax, equal to 2.5% of total income tax paid by *all* US corporations in 2003 – indeed, if only there were another 539 Berkshires, no other business or individual in America would have to pay a single penny in income tax.)

Lest we become overly seduced by Mr Buffett's combination of folksiness and hard financial facts, the success of Berkshire Hathaway begets some interesting dilemmas. For example, are institutional investors truly more effective long term allocators of excess capital – as they imply - than company managements? Has the conglomerate business model been unfairly consigned to the waste bin? In terms of business size and scope, is there such a thing as too big? Or is Berkshire Hathaway simply a true "one off", with an unsolvable (although not as far as Mr Buffett is concerned) management succession problem? Is a break up or exit always inevitable?

Those debates require more space than I have here but, for those wanting to enhance confidence in their stewardship, such as Chairmen or indeed for anyone reporting to investors, stakeholders, lenders etc, there is undoubtedly one lesson to learn from BH; and that is to be humble, be clear, and to be intellectually honest in your analysis of events.

Finally, I wonder if BH's ultimate secret is perhaps in the old saying, look after the pennies and the pounds will look after themselves? I again leave the last word to Mr Buffett, whose model is the widow who went to the local newspaper to place an obituary notice. Told that there was a 25-cents-a-word charge, she requested 'Fred Brown died'. She was then informed there was a seven word minimum. "Okay" the bereaved woman replied, "make it 'Fred Brown died, golf clubs for sale'".

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Note 1 http://www.berkshirehathaway.com/letters/2003ltr.pdf