

THE REAL WARREN BUFFETT

Managing Capital,
Leading People

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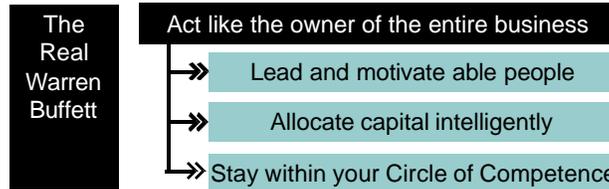
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MAIN IDEA

Warren Buffett has served for 37 years as chairman and chief executive of Berkshire Hathaway. During that time, the company's market value has grown from \$600 million to \$109 billion – a compound growth rate of 25% per year. (If Berkshire were to continue that rate of growth for the next 34 years, it would absorb the entire U.S. economy). Today, Berkshire generates annual revenues of \$30 billion and employs 112,000 people.

So what is it Warren Buffett is doing differently (and better) than everyone else? This is more than being a good stock picker and investor. Instead, Warren Buffett acts like a CEO who owns the company. He has developed a framework which allows him to do three specific tasks exceptionally well:



The challenge, therefore, in emulating the accomplishments of Warren Buffett and Berkshire Hathaway is not to become better at assembling a stock portfolio but to become a better CEO.

“Capital markets offer a sophisticated arena in which to emulate Warren Buffett who, with a personal fortune of \$37 billion, is currently the second richest man in America behind Bill Gates. They also offer a thousand opportunities to make the mistakes that will ground your compound returns in the average and stunt your growth. Buffett was, and is, able to identify opportunity. He has been, and is, able to circumvent most errors of decision making, and to learn from those he does make. He has combined this into a form of leadership that allows him free expression of his talent. And he has endowed managers within Berkshire Hathaway who also allocate capital with the ability to do so on a similarly informed basis. Warren Buffett appreciates the challenges of attempting to act like an owner of an enterprise when functioning as its manager. He has discovered the difficulties of getting Berkshire’s subsidiary managers to act like owners too. The end product allows Buffett to allocate capital where he sees fit, when he sees fit, and at the pace he sees fit. As Buffet says: ‘When returns are ordinary, an earn-more-by-putting-up-more is no great managerial achievement. You can get the same result personally while operating from your rocking chair. Just quadruple the capital you commit to a savings account and you will quadruple your earnings’. He recognizes that ‘if retained earnings are employed in an unproductive manner, the economics of Berkshire will deteriorate very quickly’. His focus in the allocation of capital therefore revolves around this reality. Ideally, he would prefer to find opportunities to reinvest Berkshire’s excess capital in existing businesses. The key to Buffett’s ability to compound is his ability to harvest the cash from cash-generative businesses and reinvest this elsewhere.”

– James O’Loughlin

1. Act like the owner of the entire business Page 2

Managers act differently from owners. There are a different set of priorities and disciplines at work. The key to Warren Buffett’s success with Berkshire Hathaway, however, has always been that he acts and makes decisions consistent with an owner’s perspective rather than trying to apply a manager’s viewpoint. That frees him to act efficiently rather than with one ear listening to what the analysts and commentators are saying.

2. Lead and motivate able people. Pages 3 - 4

Warren Buffett does not believe in exercising hands-on involvement in the management of the businesses acquired by Berkshire Hathaway. Instead, he finds businesses which are already well managed and leaves those people in place with a minimum of interference. He motivates and inspires those managers to continue growing their own businesses utilizing all the resources of Berkshire. He cultivates a huge degree of trust because of his principles and personal integrity.

3. Allocate capital intelligently. Pages 5 - 6

The Warren Buffett aura is such most people assume everything he touches turns to gold. This is not really the case – he does make mistakes. The most impressive aspect of his performance as a capital allocator is his rapid reaction time. He is extremely proactive in reacting to changes in the business environment by adjusting his capital allocation practices. Buffett’s ability to learn from his mistakes lays the foundation for his outstanding track record of success as a manager of capital.

4. Stay within your Circle of Competence. Pages 7 - 8

Warren Buffett is very careful to make investments which are within his own personal “Circle of Competence”. This Circle of Competence, for him, consists of facts, mental models and information which is important and knowable. He never clutters up his mind sitting around strategizing or trying to focus on events that may or may not arise in the future – like economic forecasts, political considerations and so forth. Warren Buffett brings a logical emotional balance to his decisions.

