Lawrence Cunningham: How the unique Warren Buffett shareholder has built and preserved Berkshire

By Lawrence A. Cunningham Special to The World-Herald May 4, 2018

Warren Buffett walks through the crowd at the annual Berkshire Hathaway meeting in 2015, when attendance set the record of 42,000.

BRENDAN SULLIVAN/THE WORLD-HERALD

2018 Berkshire Hathaway shareholders meeting special section

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***If you are one of the 40,000 Berkshire Hathaway shareholders visiting Omaha this weekend, you are vital to the company's future. You are part of a group that has contributed to a unique corporate culture, whose continuity depends not only on outstanding managers but also on quality owners. Berkshire's owners, who epitomize the "Warren Buffett shareholder," are as unusual as the company they own.

What makes these shareholders so special? Above all, Berkshire's ownership remains dominated by individuals, not institutions. In 1965, 80 percent of American corporate equity was owned by individuals and 20 percent by institutions; today those figures for large public companies are reversed. At

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Welcome to Berkshire Hathaway weekend. Why come? It's Buffett, yes. But also the people. And Omaha.

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Berkshire, in contrast, the figures remain closer to what they were in 1965. On top of Buffett's bloc — 32 percent of the voting power and 17 percent of the economic interest — individuals control another 40 percent of both, making institutional investors far less important at Berkshire.

At most big companies today, a changing cast of financial giants each owns large blocs — more than 5 percent — that, in aggregate, swamp the ownership of others. At Berkshire, only Buffett owns more than 5 percent of the premium Class A and just one giant comes close (Fidelity at 4 percent). For Class B, while three giants surpass 5 percent, aggregating 23.2 percent, this confers only 3.5 percent of the voting power, given the B's low vote. Their investment rationale is also formulaic: Blackrock, State Street and Vanguard run S&P index funds that necessitate holding the Class B.

Berkshire's more important institutional owners are boutique firms that have owned Berkshire for decades. They have reputations tied to Berkshire's identity and many cater to families. From the 1970s, this has included Davis Funds, First Manhattan, and Ruane Cunniff's Sequoia Fund — all led by Buffett's friends and Berkshire aficionados. Since the 1980s, renowned value investors such as Akre Capital, Gardner Russo & Gardner, and Markel Corp. have also owned large stakes.

Dating to the 1990s, Berkshire has boasted high insider ownership, even beyond Buffett's. All fellow directors own meaningful stakes. Several add to billions of dollars and, counting shares of the Gates Foundation created by Berkshire director Bill Gates, represent 4 percent of Berkshire's voting power and economic interest. Most Berkshire managers have substantial portions of their net worth in Berkshire stock, running to many millions of dollars.

Berkshire's insiders not only "eat their own cooking," as Buffett quips, they acquire their stakes the old-fashioned way: They buy them. At most public companies today, insider ownership grows from stock options that became fashionable in the 1990s, but Berkshire rejects such devices. Managers who obtain stock by exercising options are owners, too, aligned with shareholder interests. But how a manager became an owner shapes corporate culture, and Berkshire's is distinctively one where, from the outset, managers "walk in the shoes of owners," to quote Buffett.

Most capital in the U.S. is controlled by institutions whose performance is measured pre-tax or which are tax-exempt, such as foundations and pension funds (like Berkshire shareholders CalPERS, a California public employees' pension fund, and the states of Ohio, Tennessee and Wisconsin). The typical Berkshire shareholder, however, including all directors and managers, is both taxable and tax-conscious. The difference helps explain Berkshire's unusual dividend history.

While most big public companies pay regular dividends that shareholders welcome, Berkshire has not paid one since 1967 and the shareholders in 2014 overwhelmingly voted against another.

Why? For one, Berkshire has been able to reinvest each dollar of earnings to generate corresponding gains in market value. But as important, dividends increase the taxable income of most Berkshire shareholders. By Berkshire reinvesting the pre-tax dollars, after-tax returns grow — galactically in earlier decades, but still significantly today despite the anchor of Berkshire's enormous size. When continued for years on end, capital compounds at much higher rates, accumulating far greater wealth for shareholders than if Berkshire paid dividends.

Institutional investors avoid concentrating portfolios in the stock of one or a few companies, in order to spread out their risk. Among holders who publicly disclose stakes, for instance, few of the largest hundred shareholders of blue chip companies like Apple, ExxonMobil or General Electric allocate more than 5 percent of their portfolios to that company's stock.

In contrast, many Berkshire shareholders concentrate in its shares. To illustrate, half of the hundred largest publicly disclosed Class A owners hold more than 5 percent of their portfolio in the stock, starting with Buffett and several other notable individuals and boutique firms. A dozen more of the largest such Class B holders are so concentrated. Indeed, many Berkshire shares are owned by people for whom Berkshire is among their largest holdings.

Today's institutional investors challenge managers to divest subsidiaries and focus on a single business. That contrasts with the Berkshire acquisition model and commitment to hold subsidiaries forever. The Berkshire shareholder embraces the diverse and permanent conglomerate, where divestitures are repugnant.

At most public companies, the annual letters to shareholders are ghostwritten and aptly ignored. Buffett personally pens his missives; they are edited by an unpaid but dedicated writer friend, Carol Loomis; and Berkshire shareholders devour them. Parents send copies to their children to provide business and financial education. Buffett's letters are often more valuable than Berkshire's formal disclosures mandated by law.

With a few exceptions, corporate annual meetings are time drains and few shareholders attend, while Berkshire's is a packed intellectual, cultural and social extravaganza. Typical Berkshire shareholders have read Buffett's letter before the ensuing meeting and discuss it together in breakout sessions.

Most people posing questions from the meeting floor show knowledge based on the letter. Fellow owners cheer astute queries and hiss or boo when ignorance is shown. Many shareholders — such as Mark Hughes, Shane Parrish, Dan Pecaut and Charlie Tian — take copious notes of the meeting for friends, family and clients.

Numerous events occur throughout the weekend of the Berkshire annual meeting, scattered all over Omaha. Thousands of shareholders attend conferences at the University of Nebraska arranged by Robert Miles; panel discussions at Creighton University led by John Wingender; and a dinner hosted by Columbia University and Gabelli Co., another distinctive Berkshire shareholder. There's even another shareholder meeting — of Markel, whose decades emulating Berkshire yields overlapping owners.

The Warren Buffett shareholder is an avid reader. For the past two decades, Buffett has designated a few dozen books for sale at each annual meeting, adding to 120 different titles. Guidance is especially helpful in categories of special interest to Berkshire shareholders, including on the 331 book titles that feature the word Buffett. Authors range from public figures such as Vanguard founder Jack Bogle and Wall Street Journal columnist Jason Zweig to Berkshire's owner-operators, such as Jim Clayton and Barnett Helzberg, reflecting on their business experience.

Dozens of these books are written by Berkshire shareholders. Perennial best-sellers are the magisterial biography by Roger Lowenstein, "Buffett"; an exemplary treatment of his investing philosophy by Robert Hagstrom, "The Warren Buffett Way"; and Andy Kilpatrick's hefty corporate history, "Of Permanent Value."

Berkshire's shareholders are part of the company's culture, which adds to its value. In my new book, "The Warren Buffett Shareholder: Stories from Inside the Berkshire Hathaway Annual Meeting," 43 distinguished meeting veterans tell short stories of their experiences. I explain that the Warren Buffett shareholder is "interested yet patient, skeptical yet faithful, and serious yet fun." Culling the experience of this seasoned group, who've collectively attended the meeting 750 times, I add:

Berkshire's family of subsidiaries is often likened to an art collection, with Buffett the curator. It's not a stretch to portray Berkshire shareholders, at the meeting, as the visitors, patrons and, yes, lovers of the curation, as well as the guides, docents and tutors for newcomers and recurring visitors alike.

These shareholders will play a continuing role in Berkshire's prosperity, which dovetails with its broader succession plan. After all, Buffett has been Berkshire's managing partner since 1965. Berkshire will certainly need talented successors to invest its capital (as Todd Combs and Ted Weschler have begun to do), oversee its operations (like Greg Abel and Ajit Jain were tapped this year to begin), and provide board guidance (from Howard Buffett to Bill Gates). But along with all of that, this unique company will need continuity of ownership quality.

To paraphrase Buffett, companies usually get the shareholders they deserve. Berkshire has attracted more and more of them over the decades and their values deepen, despite radical shifts in the rest of corporate America's ownership. It becomes easy to explain why throngs return to Omaha every spring: to meet, reconnect and exchange ideas with some of the most interesting shareholders in the world, from Buffett on down.

Let's hope that continues for decades to come.

Lawrence Cunningham, a professor at George Washington University, has published extensively on Berkshire and Buffett, including a new book co-edited with his wife, Stephanie Cuba, "The Warren Buffett Shareholder: Stories from Inside the Berkshire Hathaway Annual Meeting," on sale at the Berkshire annual meeting.