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In Tough Times for CEOs, They Head to Warren Buffett's Table

Billionaire Investor's Counsel Influences Pay, Reforms; Berkshire's Low Grade

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When General Electric Co. Chief Executive Officer Jeffrey Immelt needed advice on a thorny pay problem a few months back, he got it at Gorat's Steak House in Omaha, Neb.

That's where Warren Buffett likes to hold court, usually over his standard meal of a rare T-bone steak, double order of hash browns and a Cherry Coke. Mr. Immelt had sought out the 73-year-old billionaire investor for feedback on a new plan for executive pay. With steak sauce dripping on his papers, Mr. Immelt says he laid out an alternative to stock options -- a new stock award based on performance. "How would the average investor view this?" Mr. Immelt says he asked.

Mr. Buffett said the award should be based on simple targets, Mr. Immelt recalls. He says Mr. Buffett told him: "Delivery of carrots should be tied directly to results in the area that a manager controls." In other words, forget basing it on a stock price. Mr. Immelt listened, and in September announced a change in his own pay, calling it a first step to reshape GE's executive-compensation policies. He didn't mention the plan was shaped with Mr. Buffett's counsel.



Warren Buffett

the situation.

In recent months, prominent CEOs including Xerox Corp.'s Anne Mulcahy and Walt Disney Co.'s Michael Eisner, have all made the pilgrimage to Omaha, seeking Mr. Buffett not for stock tips, but for business advice. Microsoft Corp. Chairman Bill Gates came to Omaha and talked about stock options over T-bones and hot-fudge sundaes.

Martha Stewart, who faces a criminal trial in January for securities fraud and obstruction, made the trek last month. "People will come from anywhere" to see Mr. Buffett, she says, adding that the two chatted, in part, about the furniture business. She had wine with her dinner instead of Cherry Coke, she adds. Certain New York Stock Exchange insiders are consulting Mr. Buffett about possible contenders to take over the scandal-plagued Big Board, according to a person knowledgeable about

Mr. Buffett is widely recognized as a top investor. But his growing role as guru to top executives is more far-reaching, with potentially wide implications for how companies operate. He often tells corporate chiefs to end practices ranging from huge CEO pay to incomprehensible financial reports.

Mr. Buffett won't name his dinner guests or details of their chats. "Part of the reason people talk to me is I keep my mouth shut," he says. "If a guy has flown 500 miles to see me, it's his agenda." While he was seen by some as too conservative during the tech boom of the 1990s, these days executives are beating a path to his door. With corporate scandals and fat executive paychecks continuing to roil many U.S. companies, Mr. Buffett quips: "Lately I've been feeling like a priest."

The role of a behind-the-scenes governance consigliere is a bit odd for Mr. Buffett. For one thing, some say he doesn't always practice good governance himself. Berkshire Hathaway Inc., the investment company he heads, has a board that includes Mr. Buffett's friends and family. It hasn't publicly named a successor. One governance-rating firm, Institutional Shareholders Services Inc., rated Berkshire Hathaway a paltry 1.5 points out of a possible 100.

Mr. Buffett acknowledges that rating and the fact that he has friends on the board of his company. But he says that his directors are "very significant and long-term shareholders," who give the board an "owner orientation." The board's "most important topic is succession," he says, adding that Berkshire Hathaway does have succession plans but hasn't made them public.

Mr. Buffett's past efforts to push for Main Street values on Wall Street haven't always succeeded. Mr. Buffett was credited with saving Salomon Inc. after a Treasury-auction scandal in 1991 by stepping in as interim chief. But key defections occurred at the bond-trading firm in 1995 when a strict new pay plan that he endorsed backfired and had to be rolled back.

"It's very telling that CEOs are insecure enough to need validation, and Buffett's the closest thing to God in the corporate world," says Sarah Teslik, executive director of the Council of Institutional Investors, a Washington group that represents more than 130 pension funds with about \$3 trillion in assets. "But there's a big risk when a large percentage of American capital is following one person's view. They better pray Buffett doesn't have a blind spot or lose his marbles."

A look at some of the CEOs who have met with him in Omaha recently shows a pattern of change in line with Mr. Buffett's philosophies. Perhaps the clearest example is Mr. Buffett's push for a shift in the area of stock options. For years, he worried that options -- awards given to executives and employees to buy their company's stock at a fixed price at a future date -- were being "misused" because companies aren't required to show such compensation as an expense. Stock options created windfalls when the stock price went up, acting as an incentive for employees to hype short-term performance.

Mr. Buffett has long urged companies to treat options as an expense, even though that would

FOOD FOR THOUGHT	
CEOs who have recently met with Warren Buffett at Gorat's Steak House in Omaha, Neb.	
Jamie Dimon	Bank One
Michael Eisner	Disney
Bill Gates	Microsoft
Jeffrey Immelt	General Electric
Robert Lipp	Travelers
Anne Mulcahy	Xerox
Martha Stewart*	Martha Stewart Living
*Dined at Happy Hollow Country Club in Omaha	

reduce reported earnings. Last year, under mounting pressure from investors, CEOs began listening. Coca-Cola Co. and Washington Post Co., both companies in which Mr. Buffett has a large stake and a board seat, announced they would begin expensing options. Bank One Corp. Chairman and CEO Jamie Dimon followed suit, as did others, some of whom have made visits to Omaha since.

"I've been a student of Warren's my whole business career," says Mr. Dimon, 47. He says he has spent dozens of hours reading every word ever written by Mr. Buffett. "I even tracked down his old partnership papers back to 1960, before his business went public," he says.

Before Mr. Dimon took the helm at Bank One, then the nation's fifth-largest bank, he flew to Omaha two years ago for advice. He recalls asking Mr. Buffett, "How do I manage, for Wall Street -- or not?"



Courtesy of Martha Stewart
Warren Buffett and Martha Stewart, seated on the back of Mr. Buffett's Lincoln Town Car last month.

He says Mr. Buffett replied, "Give investors the good, the bad and the ugly." Mr. Dimon recalls that Mr. Buffett also cautioned that Bank One's 19-member board would be unwieldy. Soon after, Mr. Dimon gave brutal assessments of the Bank One's condition to analysts and investors, and shrunk its board to 13.

Last year, Mr. Dimon's friend Robert Lipp assumed the helm of Travelers Corp. Soon afterward, Mr. Dimon and Mr. Lipp were on the Travelers' jet to Omaha. Mr. Lipp, 65, says he was astonished that Mr. Buffett picked up the pair himself and showed them around his modest office. At dinner at Gorat's, the men talked about the "capricious" nature of stock

options. Mr. Lipp, acknowledging Mr. Buffett's influence, later announced Travelers would expense options beginning this year.

Sitting at a corner table against a windowless back wall, Mr. Lipp also asked Mr. Buffett how he approached his letters to shareholders, which have become widely quoted.

"I literally write 'Dear Doris and Bertie' to my sisters," Mr. Lipp recalls Mr. Buffett saying. He says Mr. Buffett explained that he doesn't write "super technical stuff, but I don't talk down to them either. They don't want pictures or public-relations; they want to know what the hell is going on in the business."

After Mr. Immelt drafted his first annual report as GE's chairman and CEO last year, he flew to Omaha where Mr. Buffett reviewed the chairman's letter. Munching on his steak, Mr. Immelt says he noticed Mr. Buffett grimacing as he read.

"You're writing for the wrong audience," he recalls Mr. Buffett telling him. Mr. Buffett, with his comments jotted in the margins, zeroed in on certain paragraphs. "A group of GE insiders would get this, but investors won't." Mr. Immelt says he reworked the passage to make it easier to understand.

When Microsoft made a momentous move this summer to eliminate stock options, Mr. Buffett's behind-the-scenes blessing proved instrumental. Mr. Gates and Mr. Buffett -- the nation's two richest men, valued at \$46 billion and \$36 billion respectively -- talk business a lot, and also play online bridge together a couple times a month (Mr. Buffett plays as "T-Bone," while the Microsoft founder uses the name "Challenger X.")

The pair have talked about compensation issues many times in the past couple of years, says Mr. Gates. As they entered Gorat's last spring, Mr. Gates wanted Mr. Buffett's input on whether to drop options in favor of restricted stock at Microsoft. He recalls asking: "How will employees respond to getting a lottery ticket that gives them a definite amount instead of one that could amount to nothing or a ridiculous sum?"

Mr. Buffett's reply, according to Mr. Gates, was: "My wife would rather have a ticket for one fur coat, than a ticket that gave her two or nothing."

Over a dessert of hot-fudge sundaes, the two discussed the impact on earnings of such a monumental compensation switch. Mr. Gates says he wanted to account for the change all at once, which would mean a big, one-time hit on income. Mr. Buffett agreed, according to Mr. Gates.

After paying \$35 in cash for the two dinners, Mr. Buffett prepared to drive his fellow billionaire back to the airport. But his first new car in 10 years, a Lincoln Town Car whose license plate says "THRIFTY," wouldn't start. Mr. Gates says despite their best efforts, neither he nor Mr. Buffett could unlock the steering wheel. So the two richest men in the U.S. were stranded in Gorat's parking lot, until they called a taxi to pick them up.

When Mr. Gates got back to Microsoft's headquarters in Redmond, Wash., he says he and CEO Steve Ballmer had a detailed conversation about the move to drop options and how to account for it. "Warren supports my approach," Mr. Gates says he told Mr. Ballmer. The change was announced in July.

Media mogul Barry Diller recently invoked Mr. Buffett's name as well. On a management retreat with 200 senior executives two weeks ago, Mr. Diller, chief executive of InterActiveCorp, a big e-commerce company, says he told them: "I'm sorry I keep using Warren Buffett's name for how this company should be run."

Mr. Diller, who also sits on the board of Coca-Cola and the Washington Post, has adopted several of Mr. Buffett's ideas. For example, Mr. Diller has stopped providing earnings guidance to investors because he contends it fosters a focus on short-term targets. Mr. Buffett urged him and others to refrain from making quarterly predictions.

Not all Buffett admirers follow his advice. Disney's Mr. Eisner says he often consults Mr. Buffett, once a major Disney shareholder, about big decisions. "But some of his advice -- as in options -- just won't work in the entertainment and creative fields," Mr. Eisner says.

Through his counseling, Mr. Buffett says he's following the practice of his mentor, the late Benjamin Graham, one of the last century's great investors who pioneered modern securities analysis. Mr. Buffett's professor at Columbia University, Mr. Graham shared his methodology and stock picks with his students.

But that's where Mr. Buffett draws the line between teacher and Berkshire Hathaway CEO: "I'm not going to tell anyone what we're buying today, but I'm perfectly willing to pass along what I've learned."

While executives must trek to Omaha, Mr. Buffett travels for periodic meetings with college and business-school students. Earlier this year, a group of students at the University of Tennessee brought him the idea of having Berkshire buy Clayton Homes Inc., a mobile-home giant based in the Knoxville area. Mr. Buffett eventually made an offer for the company, and Berkshire acquired it last month for \$1.7 billion.

Shortly after the deal closed, Mr. Buffett dreamed up a mock graduation ceremony for the students. Donning a cap with a tassel, he handed each of the 40 students a Ph.D. -- "phenomenally hardworking dealmaker" diploma from the "University of Berkshire Hathaway." Attached was another certificate: a share of Class B Berkshire Hathaway stock valued at about \$2,700. (He says the shares represented his cheapest ever investment-banking fee.)

"I prefer them to business people," Mr. Buffett says. "Students aren't fully formed and are often more willing to listen and learn."