EMERGING MARKETS JOURNAL
ISSN 2159-242X (print) ISSN 2158-8708 (online)

Book Review of "The Real Warren Buffett - Managing Capital, Leading People"

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Volume 6 No 2 (2016) | ISSN 2158-8708 (online) | DOI 10.5195/emaj.2016.117 | http://emaj.pitt.edu |

Abstract

This paper reviews and discusses the book titled "The Real Warren Buffett – Managing Capital, Leading People" by James O'Loughlin. The mentioned book details the managerial skills, financial expertise and leadership approach of Warren Buffett. Practical lessons of Warren Buffett are also included in "The Real Warren Buffett – Managing Capital, Leading People" and how he became the second richest man in United States are mentioned.

Keywords: Warren Buffett, Managing Capital, Leading People, James O'Louglin, Book Review, Finance

Volume 6 No 2 (2016) | ISSN **2158-8708** (online) | DOI 10.5195/emaj.2016.117 | http://emaj.pitt.edu

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Reviewed Publication Details:
O'Louglin, J. O. (2004). "The Real Warren Buffett: Managing Capital, Leading People", Nicholas Brealey.

Review

The book titled "The Real Warren Buffett – Managing Capital, Leading People" by James O'O'Louglin starts with a famous quote from Warren Buffet, the second richest man in the U.S. He says "We're only responsible for two functions… First, it's our job to keep able people who are already rich motivated to keep working at things… they don't need to do for financial reasons. It's that simple. Secondly, we have to allocate capital" (O'Louglin, 2004). As you can easily see, Warren Buffett emphasizes the importance of motivation here and implies that money may not let us to solve all the problems in every situation. Then, it's stated in the book that Buffett has not achieved his successes by simply being a stock picker. He is a very good Chief Executive Officer (CEO) who knows how to lead people and manage the capital, that's the key of his victory.

After that, the book says Warren Buffett learned from his mistakes as years passed, he discovered the errors in his decision making and he understood how to change behavior of the people, although it was very challenging. According to Warren Buffett, establishing loyalty among employees who work for him is also very important. Next, it's underlined in the book that leadership is not forcing, dragging, kicking and pushing; it's to know how to efficiently lead people. By the way, attracting the right employees to the organization is also crucial according to Warren Buffett. Additionally, he informs managers that mistakes are not tombstones, but they are stepping stones to better decision making.

In the following section, the book also discusses the leadership of Jack Welch, who retired in 2001 after 17 iconoclastically successful years at General Electric (GE), one of United State's most admired firms (Slater, 1998). According to the book, the success of Jack Welch comes from his eye-catching ability to get the teams he formed under him to pull together and perform. From Jack Welch's viewpoint, passion and desire are also critical for organizational achievement. Moreover, instead of being reactive to change, Welch anticipated it and then engaged on a personal crusade to adapt the company to his vision.

However, there are also some differences between the philosophies of Jack Welch and Warren Buffett. For example, Jack Welch likes reinventing the organization at every turn and strives to deliver a consistent and above-average return which is a risky strategy for Buffett that he rejects. Also, Buffett is extraordinary careful in selecting with whom to associate, seeking out those managers who "relish the thrill of outstanding performance". Furthermore, concerning motivation, Buffett chooses the hands-off route and sets managers free. According to him, this refers to setting minimum rules of behavior, which tap into a form of motivation that comes from within. The mentioned leadership rule is founded on his confidence in that immutable tanet of human behavior which informs him that trust will be reciprocated with compliance and effort. The following quote by Warren Buffet clearly explains this philosophy: "I found in running businesses that the best results come from letting high-grade people work unencumbered" (Loomis, 2012). It's also a form of leadership which realizes that, if it's not within the nature of a manager to reciprocate trust, no amount of management of the person will engender the expected behavior. On the other hand, Jack Welch's leadership style is different compared to that of Warren Buffett. The reason is that, Welch has the command-and-control style (O'Louglin, 2004).

The book mentions the leadership style of Jack Welsh with the following words: "By alternately hugging and kicking… setting stretch goals and relentlessly following up on people to make sure things get done", which speaks of a distrust of that part of human nature which is selfish and will attend to its own interests if left unattended. Because of this reason, the author criticizes the leadership style of Jack Welch, but he also adds that neither solution is free from error. According to the author, the positive inattention of Warren Buffet's leadership style to people management is sometimes costly, although it's a favorable and appreciated one. Similarly, Jack Welch's leadership style of control and command is also costly and has caused some serious losses to Welch until this time (O'Louglin, 2004). At last, the author finalizes this section by expressing that Buffett's leadership style is the more robust. Plus, according to Warren Buffett, all CEOs should make their employees believe in themselves and they don't need independent directors, oversight committees or auditors absolutely free of conflicts of interest. In other words, from Warren Buffett's point of view, conflict is a natural thing. Following that, the book also mentions Berkshire Hathaway, where Warren Buffett had worked as a chairman and chief executive officer (CEO) and had increased the market value of this firm at a compound growth rate of over 25% per year (Buhayar, 2016). In this firm, Buffett had learned that managers had to be motivated so well that they should be committed to the organization like the owners. The author of the book provides his comments then and says that managing is the integration of several components.

Lao Tzu, Chinese Taoist Philosopher is also mentioned in the book with his following quote: "Intelligent control appears as uncontrol or freedom. And for that reason it is genuinely intelligent control. Unintelligent control appears as external domination. And for that reason it is really unintelligent control." (O'Louglin, 2004). The author of the book provides this quote to the readers, because Lao Tzu's words are strictly related to leadership and control.

According to the book, the relationship between strategic plan and leadership is very important too. For example, the author talks about Stephen Schneider of CPS Company who indicates that strategic plans and leadership are tightly linked. Mr. Schneider explains strategy as "process of positioning an organization for future advantage," which necessities a deep understanding of the internal and external elements which affect a company. "Leadership", Stephen Schneider states, "is the weapon that provides strategic impact," demanding "the articulation of an argument so compelling that other people see its merits and are prepared to act on it." (O'Louglin, 2004).

Controls and Leadership Relationship is also analyzed in the book. For example, some famous words of Dr. Robert Cialdini is provided concerning this issue: "One problem with controls… is that when people perceive of themselves performing the desirable monitored behavior, they tend to attribute the behavior not to their own natural preference for it, but to coercive presence of the controls. As a consequence, they come to view themselves as less interested in the desirable conduct for its own sake… and they are more likely to engage in the undesirable action whenever controls cannot detect the conduct." (O'Louglin, 2004).

Later, the book focuses on the fact that leadership should not involve forcing and fearing the employees. At this point, Jonathan Freedman's experiment is mentioned. It's said that, Jonathan Freedman had run an experiment in which he first instructed a group of boys, on pain of punishment, not to play with a toy robot out of a selection of toys made available for them. As a result, the boys didn't play with the toy robot while he was present. On the other hand, six weeks later, back in the same room but this time when Freedman was absent, the majority of the boys played with the robot. As you can clearly see from this example, externally imposed rules did not work as well as forcing and fearing (Marshall, 2002).

In fact, the book says that, good leaders always know how to communicate well and explain the details. For instance, Freedman had done a second experiment and this time he had worked on another group who were warned against playing with the robot. However, this time Freedman had included a reason: "It is wrong to play with the robot". Again, the majority obeyed the rule. However, the difference here is that, with this group, six weeks later a great majority of boys were still following the rule. But what is the reason? Definitely, it's because the rule now came from the inside – the boys had decided that they would not play with the robot because this time that was their own decision. In other words, they had taken inner responsibility for their actions and it was not required for Freedman or anyone else to be present to monitor their behavior with outside pressures. Experiment designers could trust the boys since they had explained why they did not want the boys to play with the robot. Besides, the book links the importance of communication and explanation features of good managers to a quote of Charlie Munger, Vice President of Berkshire Hathaway: "Just as you think better if you array knowledge on a bunch of models that are basically answers to the question why, why, why, if you always tell people why, they will understand it better, they will consider it more important and they will be more likely to comply" (O'Louglin, 2004).

Rewarding as a motivational tool is also very important for Warren Buffett. For example, he implements a compensation scheme which rewards correct behavior appropriately. According to Warren Buffett, employees should get paid based on the performance of the part of the firm that they can affect. The book even provides a quote of Buffett related to this issue: "Arrangements that pay off in capricious ways, unrelated to a manager's personal accomplishments, may well be welcomed by certain managers… But such arrangements are wasteful to the company and cause the manager to lose focus" (O'Louglin, 2004).

Actually, Warren Buffet has deeper opinions on incentive compensation systems. As an example, I believe that the following sentences will help you to understand his philosophy on this subject: "We employ an incentive compensation system which rewards key managers for meeting targets in their own bailiwicks. If See's does well, that does not produce incentive compensation at the News – nor vice versa… In setting compensation, we like to hold out the promise of large carrots, but make sure their delivery is tied directly to results in the area that a manager controls… We believe further, that such factors as seniority and age must not affect incentive compensation… a 20-year-old who can hit .300 is as valuable to us as 40-year-old performing as well." (Connors, 2010).

After that, the book expresses the fact that leaders should highly value intellectual capital which should never be underestimated. A quote of Jack Welch related to this issue is even presented: "My gut told me that compared to the industrial operations I did know, this business (GE Capital) seemed an easy way to make money. You didn't have to invest heavily in R&D, build factories, and bend metal day after day. You didn't have to build scale to be competitive. The business was all about intellectual capital." (Choo and Bontis, 2002). According to the book, like Jack Welch, Warren Buffett also highly values intellectual capital as a leader and his competitive advantage comes from appreciating this factor which sets him apart.

Moreover, the book underlines the fact that Warren Buffett as a manager does not favor lay-offs. In relation with this, a comment of him is provided: "We don't engage in layoffs when we experience a cyclical slowdown at one of our generally profitable insurance operations. This no-layoff policy is in our self-interest. Employees who fear that large layoffs will accompany sizeable reductions in premium volume will understandably produce scads of business through thick and think (mostly thin)" (O'Louglin, 2004).

After that, the book argues that all leaders should have confidence for achievement, but overconfidence can be dangerous. For instance, some words of Charlie Munger take place in the book related to this issue: "Smart, hard-working people aren't exempt from professional disasters from overconfidence. Often they just go around in the more difficult voyages they choose, relying on their self-appraisals which they have superior talents and methods." (O'Louglin, 2004; Lowe, 2000). Thus, Charlie Munger thinks that the majority of individuals consider themselves to be above-average performers, although this is not the case in aggregate. The lesson which we should learn from this point is that we must always trust ourselves, but being too optimistic can also be harmful.

Warren Buffett also has some opinions and suggestions on change. As an example, according to him, managers should react to change instead of anticipating it. In other words, he says that managers should affect the change.

Then, Mr.Buffet makes clear that gathering feedback, eliminating stereotypes and identifying the truths are extremely significant. For this purpose, he has a "Circle of Competence" in place. For example, he establishes what he knows by determining truths, the dynamics which sit behind them, and their links to each other. Then, he makes sure that he knows by a process of inversion whereby he tries to disprove his previous conclusions. This way, he tries to eliminate stereotypes. Plus, he checks that he knows by looking for feedback from the results of his decisions (Flores, 2016). Following that, communication and asking for the opinions of others are also critically important according to Warren Buffett. For example, he says: "As you are acquiring knowledge about industries in general and companies specifically, there isn't anything like first doing some reading about them and then getting out and talking to competitors and customers and suppliers and past employees and current employees and whatever it may be. Virtually everything we have done has been by reading public reports and then maybe asking questions and ascertaining trade positions and product strengths or something of that sort." (O'Louglin, 2004).

Another fundamental characteristic of a leader should be to learn from his mistakes. Again, I will provide a quote from the book to better explain this issue. These are the words from a speech of Warren Buffett directed to his shareholders: "I want to be able to explain my mistakes… If we are going to lose your money, we want to be able to get up there next year and explain how we did it." (O'Louglin, 2004).

Besides, a good manager should also implement empathy according to the book. For instance, Warren Buffett also emphasized this important point and said that: "Managers frequently have trouble putting themselves in the shoes of their shareholder-owners". (Labitan, 2011).

Among all other things, Warren Buffet says that managers should always consider the long-run and must care for all stakeholders, including the investors. Regarding this subject, the book provides a quote of Warren Buffett: "If companies 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". (O'Louglin, 2004).

Finally, in Warren Buffett's opinion, when an organization gains a success, it should be celebrated with the whole stuff including all employees. He states that victories must always be remembered, no matter how big or small they are. On the opposite side, according to Warren Buffett, failures of organizations and their competitors are much more important and several lessons can be learned from these failures. For example, he says: "I have often felt there might be more to be gained by studying business failures than business successes… my partner, Charles Munger, says all he wants to know is where he's going to die – so he won't ever go there." (O'Louglin, 2004).

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