



SEPTEMBER/OCTOBER 2006 - LEADERSHIP LETTER #11

Business Wit and Wisdom of Charles T. Munger
from *Poor Charlie's Almanack*, edited by Peter Kaufman

Hello Friends, Clients, and Colleagues ...

Around the holidays, our old friends and clients Bill and Jackie Lockwood gave us a copy of ***Poor Charlie's Almanack***. Edited by Peter Kaufman, it's a collection of the wit and wisdom of Charlie Munger, Warren Buffett's partner and Vice Chairman of Berkshire Hathaway.

Bill has started or helped to start three great firms ...

- LJB Inc. (engineers since 1966)
- Con/Span Bridge Systems
- BridgeTek (now part of CONTECH)

Long fans of Warren Buffett, Bill and I both appreciate his humor, honesty, practicality and business acumen.

Warren Buffett is long in his appreciation for his partner, Charlie Munger. I've tried to capture tidbits of Charlie's humor and insights on life, work, and philosophy, including business leadership.

I hope you enjoy these tidbits, and that they'll encourage you to get this well illustrated and most readable book!

Best wishes,

Mel

Mel Hensey, PE, F.ASCE
Management Consulting Engineer
Hensey Associates
8220 Riversedge Cir., Maineville, OH 45039
513/919-7672, MHensey@aol.com
www.henseyassociates.com

If you do not care to receive these Leadership Letters in the future, please simply send us an email to let us know and we'll remove you from the list. Thank you.

BUSINESS WIT & WISDOM OF CHARLES T. MUNGER
(Warren Buffet's Partner)
from the book *POOR CHARLIE'S ALMANACK*, edited by Peter Kaufman
PCA Publications, 2005

“I’ve gotten paid a lot over the years for just reading through newspapers.”
(Charlie studies everything!)

“I’m doing the best I can. But I’ve never grown old before. I’m doing it for the first time.”

Charlie continues to influence the law firm he helped found: “Choose clients as you would friends.”

He’s known for discussing his friends among the “eminent dead (like Ben Franklin) who had the right ideas.” Example ...

On helping society: *It is a grand mistake to think of being great without goodness and ... there was never a truly great man that was not ... truly virtuous.* (Ben Franklin)

To son Charlie on how to keep a friend: “Charlie, when you borrow a man’s car, you always return it with a full tank of gas.”

When discussing the efficiency of cost-plus contracts, he likes to say “even the mule knew when to slow down (Bill Gates).”

Business as an Ecosystem: *When we try to pick out anything by itself, we find it hitched to everything else in the Universe.* (John Muir)

Education: *Perhaps the most valuable result of all education is the ability to make yourself do the thing you have to do, when it ought to be done, whether you like it or not. It is the first lesson that ought to be learned and however early a man’s training begins, it is probably the last lesson that he learns thoroughly.* (Thomas Henry Huxley)

“A great business at a fair price is superior to a fair business at a great price.” (Charlie differing with Ben Graham)

What makes a great business model? Charlie’s recommended readings offer some clues: ***Guns, Germs and Steel, The Selfish Gene, Ice Age,*** and ***Darwin’s Blind Spot*** all seem to focus on “competitive destruction” and why a few entities adapt and thrive over time.

For example, General Electric is the lone survivor of the 50 most important stocks of a century ago.

*The man (or woman or child) who **doesn’t** read good books has no advantage over the many who **can’t** read them.* (Mark Twain)

Compound interest is the eighth wonder of the world. (Einstein). “Never interrupt it unnecessarily.”

“Be alert for the arrival of luck. When proper circumstances present themselves, act with decisiveness and conviction. Opportunity doesn’t come often, so seize it when it does.”

“It’s more important to have the discipline to **prepare**” he says, “than to have the will to win. When opportunity meets the prepared mind, that’s what’s best.”

Trickery and treachery are the practices of fools. Honesty is the best policy. (Ben Franklin)

“Today, it seems to be regarded as the duty of CEO’s to make the stock go up. This leads to all sorts of foolish behavior. We want to tell it like it is.”

Berkshire’s Acquisition Strategy: “Two-thirds of acquisitions don’t work. Ours work because we don’t try to do acquisitions—we wait for no-brainers.”

Avoid Debt: “Once you get into debt, it’s hell to get out. You can’t get ahead (or even survive) paying eighteen percent interest.”

Public Schools: “We took one of the greater successes in the history of the Earth and turned it into one of the greatest disasters in our history.”

On Improving Your Business with Technology: “Buffett learned in the textile business that people never do the second step of the analysis. That after you’ve made the investment (in technology), the benefit of the cost reductions don’t go to the guy who bought the equipment, but flow through to the firm’s **customers, not** to the firm.”

“The company that needs a new tool and hasn’t bought it, is already paying for it.”

“Then, you also get ‘competitive destruction’ when a new thing or way of doing something obliterates your product or service ... as no longer necessary.”

“You have to figure out what your own aptitudes are. If you play games where other people have the aptitudes and you don’t, you’re going to lose.”

“The iron rule of life is that only twenty percent of the people can be in the top fifth (of anything).”

On Incentives: “As usual in human affairs, what determines behavior are incentives for the decision maker, and ‘getting the incentives right’ is a very, very important lesson.”

“Many systems today reward people for being dishonest, and worse yet, teach them to be dishonest.”

On Investment Management: “I asked him, ‘Do fish really bite on those green and purple lures?’ And he said, ‘Mister, I don’t sell to fish.’”

“**Ideology** does strange things and distorts cognition even for very bright people. Any reasonable ‘position’ is OK, but being ‘totally sure’ turns you into a lousy thinker.”

What a man wishes, that also will he believe. (Demosthenes)

“Have a checklist and use it! And by the way, improve it based on your mistakes and other learnings. It’s very important to own up to and learn from mistakes!”

“Whether you’re an engineer, attorney, leader, owner, consultant, accountant, whatever, it’s extremely important to know what you know and **don’t** know.”

Reasons Charlie sees for the present sorry state of higher education:

- The balkanization of academia
- Departments are deficient in major ways
- Academia inertia, no desire to improve
- Certain tenured professors who are terrible
- Education schools are pervaded by psychology, much of which is wrong
- Deep-seated ideology keeps really bright people from learning and seeing past their prejudices
- Failure to know and use a wide range of mental models vs. those known to your profession

“It’s important for success, to master the best that other people have figured out. You cannot dream it all up by yourself.”

Expect your advisors’ opinions to be unhelpful due to their subconscious biases:

- 1) “They lean toward what is good for **them** ahead of what is good for you.
- 2) “To a man with a hammer, every problem looks like a nail.”

(My own observations in life suggest that this is often as true for attorneys, physicians, and dentists as it is for financial consultants, plumbers and shopkeepers! —*Mel*)

In Talks Four and Five, Charlie discusses the necessity of **multi-disciplinary thinking**. He notes that it more often occurs in the “hard sciences” (math, physics, chemistry, and engineering) ... because it’s practical and effective. Other “soft sciences” such as economics, philosophy, education, psychology, business, law, etc. **also need multi-disciplinarity**. However, they get away without it, to the detriment of their students.

(That reminds me of the observation by civil engineering pioneer, teacher and consultant Hardy Cross: Engineering is thought to be a technical discipline, but actually it requires a combination of science and technology with an understanding of people and economics. —Mel)

Charlie's discussion of Coca-Cola is refreshing! Its success is due to ...

- “a good-tasting, energy-giving, stimulating, cold, wine-colored, effervescent beverage with no after taste.
- “pavlovian conditioning (a man yearns for the beverage held by a pretty woman he can't have).
- “operant conditioning through flavor, stimulus (sugar, caffeine), coolness, lack of competitors.
- “brand, marketing, distribution (fountain syrup, bottled variously), pricing such that competitors are few.”

Thoughts about Investing:

“Opportunities come along very infrequently. But when they do, and you've studied them carefully for the long term, be prepared to make a big investment.”

I could improve your investing performance by giving you a card with say 20 boxes to represent all the investments you can make the rest of your life. (Warren Buffett)

The first principle is that you must not fool yourself, and you're the easiest person to fool. (Richard Feynman)

“In the US, a person with almost all their wealth invested long-term in just three fine domestic corporations, is securely rich; his long-term results will be superior.” (I'm sure he's thinking of GE, P&G, Berkshire Hathaway, J&J, etc.)

“I think that one should recognize reality even when one doesn't like it, indeed, especially when one doesn't like it.”

We frequently make mistakes by **over**-counting that which **can** be measured and **under**-counting what **can't** be measured.

“Incentives are difficult but important to ‘get right.’” Carelessly done, incentives create all sorts of problems, from the practice of medicine (drugs and surgeries) to government (DoD procurement, wage, and hour laws) to business (mergers, stock price).

“People tend to ‘game’ all human systems with great ingenuity; build systems that aren't easily faked.”

“**Other human tendencies** can interfere with good judgment:

- “**Liking or loving** an individual or group.
- “**Disliking or hating** an individual or group.
- “**Quickly resolving doubt** by a ‘too-fast’ decision (for comfort).
- “**Inconsistency avoidance** can lead to dumb decisions.
- “**Curiosity** can provide both fun and wisdom, and occasionally trouble.
- “**Fairness and helping others** is a widespread tendency.
- “**Envy and jealousy** can be more dangerous than greed.
- “**Reciprocity** tendency can work both ways, good and bad.
- “**Influence-from-mere-association** can lead to foolishness whether the association is with a person, a product, a feature or an event. Example: Kill the messenger.
- “**Pain-avoidance**, physically, but also emotional pain.
- “**Excessive self-regard** can get us into lots of troubles.
- “**Over-optimism** can blind us to problems.
- “**Loss-reaction** can lead to ridiculous actions.
- “**Social-proof tendency**: If it’s OK with others, it must be OK.
- “**Misjudging differences**, both great and small, can hurt.
- “**Stress-reaction** can lead to actions regretted later.
- “**Over-weighting** the data that’s easily available.
- “**Use it or lose it**: Underused skills go away.
- “**Drugs and alcohol** impair judgment without awareness.
- “**Authority influence**: Authorities are often wrong!
- “**Twaddle tendency**: ‘Man is born to prattle and pour out twaddle’ that can interfere with serious work.”

*Summary and excerpts by Mel Hensey
April 2006*