Pegasus

A newsletter for the Caux Round Table Network
looking at business above the clutter and confetti

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Moral Capitalism At Work

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Pegasus

INTRODUCTION

In this issue of *Pegasus*, we bring you two items. First are some excerpts from Warren Buffet's summary of why he was successful over the last 50 years. Secondly are some comments of mine on ethics and family companies written for the Hong Kong publication of the Chartered Company Secretaries association.

The Economist reports that more than 90% of the world's businesses are family managed or controlled. This makes family businesses very important to wealth creation, capitalism, and corporate social responsibility. The Boston Consulting Group calculates that, even in the United States, the noted home for publicly traded ownership shares in corporations, 33% of companies with revenues of more than $1 billion per year are family owned or controlled. In France and Germany, the percentage of such family dominated companies is 40%of large enterprises.

I submit there is a similarity between family companies and Warren Buffet's Berkshire-Hathaway conglomerate, even though Berkshire-Hathaway is publically owned. Berkshire-Hathaway is, for all practical purposes, a company run by Buffet and his colleague Charles Munger. Shareholders are passive and let Buffet have his way, as if the company were his alone.

Both Buffet and family companies share a common feature – in the main, they seek wealth through capital appreciation of the value of an enterprise. They do not seek short–term gains from financial intermediation, which are then "banked" as cash investments to become financial capital only.

In these excerpts, Buffet goes to the heart of why he was successful, which validates Caux Round Table Principle for Business #1: "The value of a company to society is the wealth and employment it creates and the marketable products and services it provides to consumers at a reasonable price commensurate with quality."

As he describes with his purchase of See's Candy, Buffet found the right way to make a lot of money in buying companies or stock in companies which sold credible products and services and so brought to themselves reliable cash flow year in and year out. This strategy aligns with the Caux Round Table approach to sustainability in business enterprise. Buffet does not discuss this next point, but it has to apply in his case for him to have made so much money over the past 50 years. His companies are successful because they take stakeholders and intangible assets like quality management and quality culture into their algorithm for making profits. Without such reliance on being worthy, trusted and responsible, his companies would not have been so profitable. Thus, Warren Buffet, in his own way, has demonstrated the viability in the marketplace of a "moral" capitalism.

Stephen B. Young
Global Executive Director
Caux Round Table

BERKSHIRE - **PAST, PRESENT, AND FUTURE**

Warren Buffett
Chairman & CEO
Berkshire Hathaway

Berkshire's Performance vs. the S&P 500 Annual Percentage Change Year in Per-Share Book Value of Berkshire, in Per-Share Market Value of Berkshire, in S&P 500 with Dividends Included:

Compounded Annual Gain – 1965-2014
- 19.4%, 21.6%, 9.9%

Overall Gain – 1964-2014
- 751,113%, 1,826,163%, 11,196%

In the Beginning On May 6, 1964, Berkshire Hathaway, then run by a man named Seabury Stanton, sent a letter to its shareholders offering to buy 225,000 shares of its stock for $11.375 per share.

I had expected the letter; I was surprised by the price. Berkshire then had 1,583,680 shares outstanding. About 7% of these were owned by Buffett Partnership Ltd. ("BPL"), an investing entity that I managed and in which I had virtually all of my net worth.

Shortly before the tender offer was mailed, Stanton had asked me at what price BPL would sell its holdings. I answered $11.50, and he said, "Fine, we have a deal." Then came Berkshire's letter, offering an eighth of a point less. I bristled at Stanton's behavior and didn't tender.

That was a monumentally stupid decision. Berkshire was then a northern textile manufacturer mired in a terrible business. The industry in which it operated was heading south, both metaphorically and physically. And Berkshire, for a variety of reasons, was unable to change course.

That was true even though the industry's problems had long been widely understood. Berkshire's own Board minutes of July 29, 1954, laid out the grim facts: "The textile industry in New England started going out of business forty years ago. During the war years this trend was stopped. The trend must continue until supply and demand have been balanced."

About a year after that board meeting, Berkshire Fine Spinning Associates and Hathaway Manufacturing – both with roots in the 19th Century – joined forces, taking the name we bear today. With its fourteen plants and 10,000 employees, the merged company became the giant of New England textiles. What the two managements viewed as a merger agreement, however, soon morphed into a suicide pact.

During the seven years following the consolidation, Berkshire operated at an overall loss, and its net worth shrunk by 37%.

Meanwhile, the company closed nine plants, sometimes using the liquidation proceeds to repurchase shares.

And that pattern caught my attention. I purchased BPL's first shares of Berkshire in December 1962, anticipating more closings and more repurchases. The stock was then selling for $7.50, a wide discount from per-share working capital of $10.25 and book value of $20.20. Buying the stock at that price was like picking up a discarded cigar butt that had one puff remaining in it. Though the stub might be ugly and soggy, the puff would be free.

Once that momentary pleasure was enjoyed, however, no more could be expected.

Berkshire thereafter stuck to the script: It soon closed another two plants, and in that May 1964 move, set out to repurchase shares with the shutdown proceeds. The price that Stanton offered was 50% above the cost of our original purchases. There it was – my free puff, just waiting for me, after which I could look elsewhere for other discarded butts.

Instead, irritated by Stanton's chiseling, I ignored his offer and began to aggressively buy more Berkshire shares. 24 By April 1965, BPL owned 392,633 shares (out of 1,017,547 then outstanding) and at an early-May board meeting we formally took control of the company. Through Seabury's and my childish behavior – after all, what was an eighth of a point to either of us? – he lost his job, and I found myself with more than 25% of BPL's capital invested in a terrible business about which I knew very little. I became the dog who caught the car.

Because of Berkshire's operating losses and share repurchases, its net worth at the end of fiscal 1964 had fallen to $22 million from $55 million at the time of the 1955 merger. The full $22 million was required by the textile operation: The company had no excess cash and owed its bank $2.5 million.

For a time I got lucky: Berkshire immediately enjoyed two years of good operating conditions. Better yet, its earnings in those years were free of income tax because it possessed a large loss carry-forward that had arisen from the disastrous results in earlier years. Then the honeymoon ended. During the 18 years following 1966, we struggled unremittingly with the textile business, all to no avail. But stubbornness – stupidity? – has its limits.

In 1985, I finally threw in the towel and closed the operation.

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From my perspective, though, Charlie's most important architectural feat was the design of today's Berkshire. The blueprint he gave me was simple: Forget what you know about buying fair businesses at wonderful prices; instead, buy wonderful businesses at fair prices.

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The year 1972 was a turning point for Berkshire. We had the opportunity then to buy See's Candy for Blue Chip Stamps, a company in which Charlie, I and Berkshire had major stakes, and which was later merged into Berkshire.

See's was a legendary West Coast manufacturer and retailer of boxed chocolates, then annually earning about $4 million pre-tax while utilizing only $8 million of net tangible assets.

Moreover, the company had a huge asset that did not appear on its balance sheet: a broad and durable competitive advantage that gave it significant pricing power. That strength was virtually certain to give See's major gains in earnings over time. Better yet, these would materialize with only minor amounts of incremental investment. In other words, See's could be expected to gush cash for decades to come.

The family controlling See's wanted $30 million for the business, and Charlie rightly said it was worth that much. But I didn't want to pay more than $25 million and wasn't all that enthusiastic even at that figure. (A price that was three times net tangible assets made me gulp.) My misguided caution could have scuttled a terrific purchase. But, luckily, the sellers decided to take our $25 million bid.

To date, See's has earned $1.9 billion pre-tax, with its growth having required added investment of only $40 million. See's has thus been able to distribute huge sums that have helped Berkshire buy other businesses that, in turn, have themselves produced large distributable profits. (Envision rabbits breeding.) Additionally, through watching See's in action, I gained a business education about the value of powerful brands that opened my eyes to many other profitable investments.

BERKSHIRE TODAY

Berkshire is now a sprawling conglomerate, constantly trying to sprawl further.

Conglomerates, it should be acknowledged, have a terrible reputation with investors. And they richly deserve it.

Let me first explain why they are in the doghouse, and then I will go on to describe why the conglomerate form brings huge and enduring advantages to Berkshire. Since I entered the business world, conglomerates have enjoyed several periods of extreme popularity, the silliest of which occurred in the late 1960s.

The drill for conglomerate CEOs then was simple: By personality, promotion or dubious accounting – and often by all three – these managers drove a fledgling conglomerate's stock to, say, 20 times earnings and then issued shares as fast as possible to acquire another business selling at ten-or-so times earnings.

They immediately applied "pooling" accounting to the acquisition, which – with not a dime's worth of change in the underlying businesses – automatically increased per-share earnings, and used the rise as proof of managerial genius.

They next explained to investors that this sort of talent justified the maintenance, or even the enhancement, of the acquirer's p/e multiple. And, finally, they promised to endlessly repeat this procedure and thereby create ever-increasing per-share earnings.

Wall Street's love affair with this hocus-pocus intensified as the 1960s rolled by. The Street's denizens are always ready to suspend disbelief when dubious maneuvers are used to manufacture rising per-share earnings, particularly if these acrobatics produce mergers that generate huge fees for investment bankers.

Auditors willingly sprinkled their holy water on the conglomerates' accounting and sometimes even made suggestions as to how to further juice the numbers. For many, gushers of easy money washed away ethical sensitivities.

Since the per-share earnings gains of an expanding conglomerate came from exploiting p/e differences, its CEO had to search for businesses selling at low multiples of earnings. These, of course, were characteristically mediocre businesses with poor long-term prospects. This incentive to bottom-fish usually led to a conglomerate's collection of underlying businesses becoming more and more junky. That mattered little to investors: It was deal velocity and pooling accounting they looked to for increased earnings.

The resulting firestorm of merger activity was fanned by an adoring press. Companies such as ITT, Litton Industries, Gulf & Western, and LTV were lionized, and their CEOs became celebrities. (These once-famous conglomerates are now long gone. As Yogi Berra said, "Every Napoleon meets his Watergate.")

Back then, accounting shenanigans of all sorts – many of them ridiculously transparent – were excused or overlooked. Indeed, having an accounting wizard at the helm of an expanding conglomerate was viewed as a huge plus: Shareholders in those instances could be sure that reported earnings would never disappoint, no matter how bad the operating realities of the business might become.

In the late 1960s, I attended a meeting at which an acquisitive CEO bragged of his "bold, imaginative accounting." Most of the analysts listening responded with approving nods, seeing themselves as having found a manager whose forecasts were certain to be met, whatever the business results might be.

Eventually, however, the clock struck twelve, and everything turned to pumpkins and mice. Once again, it became evident that business models based on the serial issuances of overpriced shares – just like chain-letter models – most assuredly redistribute wealth, but in no way create it.

Both phenomena, nevertheless, periodically blossom in our country – they are every promoter's dream – though often they appear in a carefully-crafted disguise. The ending is always the same: Money flows from the gullible to the fraudster. And with stocks, unlike chain letters, the sums hijacked can be staggering.

At both BPL and Berkshire, we have never invested in companies that are hell-bent on issuing shares. That behavior is one of the surest indicators of a promotion-minded management, weak accounting, a stock that is overpriced and – all too often – outright dishonesty.

So what do Charlie and I find so attractive about Berkshire's conglomerate structure?

To put the case simply: If the conglomerate form is used judiciously, it is an ideal structure for maximizing long-term capital growth.

One of the heralded virtues of capitalism is that it efficiently allocates funds. The argument is that markets will direct investment to promising businesses and deny it to those destined to wither. That is true: With all its excesses, market-driven allocation of capital is usually far superior to any alternative.

Nevertheless, there are often obstacles to the rational movement of capital. As those 1954 Berkshire minutes made clear, capital withdrawals within the textile industry that should have been obvious were delayed for decades because of the vain hopes and self-interest of managements.

Indeed, I myself delayed abandoning our obsolete textile mills for far too long. A CEO with capital employed in a declining operation seldom elects to massively redeploy that capital into unrelated activities. A move of that kind would usually require that long-time associates be fired and mistakes be admitted.

Moreover, it's unlikely that CEO would be the manager you would wish to handle the redeployment job even if he or she was inclined to undertake it.

At the shareholder level, taxes and frictional costs weigh heavily on individual investors when they attempt to reallocate capital among businesses and industries. Even tax-free institutional investors face major costs as they move capital because they usually need intermediaries to do this job.

A lot of mouths with expensive tastes then clamor to be fed – among them investment bankers, accountants, consultants, lawyers and such capital-reallocators as leveraged buyout operators. Money-shufflers don't come cheap.

In contrast, a conglomerate such as Berkshire is perfectly positioned to allocate capital rationally and at minimal cost.

Of course, form itself is no guarantee of success: We have made plenty of mistakes, and we will make more. Our structural advantages, however, are formidable. At Berkshire, we can – without incurring taxes or much in the way of other costs – move huge sums from businesses that have limited opportunities for incremental investment to other sectors with greater promise.

Moreover, we are free of historical biases created by lifelong association with a given industry and are not subject to pressures from colleagues having a vested interest in maintaining the status quo. That's important: If horses had controlled investment decisions, there would have been no auto industry.

Another major advantage we possess is the ability to buy pieces of wonderful businesses – a.k.a. common stocks.

That's not a course of action open to most managements. Over our history, this strategic alternative has proved to be very helpful; a broad range of options always sharpens decision-making. The businesses we are offered by the stock market every day – in small pieces, to be sure – are often far more attractive than the businesses we are concurrently being offered in their entirety.

Additionally, the gains we've realized from marketable securities have helped us make certain large acquisitions that would otherwise have been beyond our financial capabilities. In effect, the world is Berkshire's oyster – a world offering us a range of opportunities far beyond those realistically open to most companies.

We are limited, of course, to businesses whose economic prospects we can evaluate. And that's a serious limitation: Charlie and I have no idea what a great many companies will look like ten years from now.

I mentioned earlier that See's Candy had produced huge earnings compared to its modest capital requirements. We would have loved, of course, to intelligently use those funds to expand our candy operation. But our many attempts to do so were largely futile. So, without incurring tax inefficiencies or frictional costs, we have used the excess funds generated by See's to help purchase other businesses.

If See's had remained a stand-alone company, its earnings would have had to be distributed to investors to redeploy, sometimes after being heavily depleted by large taxes and, almost always, by significant frictional and agency costs.

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Berkshire has one further advantage that has become increasingly important over the years: We are now the home of choice for the owners and managers of many outstanding businesses. Families that own successful businesses have multiple options when they contemplate sale. Frequently, the best decision is to do nothing.

There are worse things in life than having a prosperous business that one understands well. But sitting tight is seldom recommended by Wall Street. (Don't ask the barber whether you need a haircut.) When one part of a family wishes to sell while others wish to continue, a public offering often makes sense.

But, when owners wish to cash out entirely, they usually consider one of two paths. The first is sale to a competitor who is salivating at the possibility of wringing "synergies" from the combining of the two companies. This buyer invariably contemplates getting rid of large numbers of the seller's associates, the very people who have helped the owner build his business.

A caring owner, however – and there are plenty of them – usually does not want to leave his long-time associates sadly singing the old country song: "She got the goldmine, I got the shaft."

The second choice for sellers is the Wall Street buyer. For some years, these purchasers accurately called themselves "leveraged buyout firms." When that term got a bad name in the early 1990s – remember RJR and Barbarians at the Gate? – these buyers hastily relabeled themselves "private-equity."

The name may have changed but that was all: Equity is dramatically reduced and debt is piled on in virtually all private-equity purchases. Indeed, the amount that a private-equity purchaser offers to the seller is in part determined by the buyer assessing the maximum amount of debt that can be placed on the acquired company.

Later, if things go well and equity begins to build, leveraged buy-out shops will often seek to re-leverage with new borrowings. They then typically use part of the proceeds to pay a huge dividend that drives equity sharply downward, sometimes even to a negative figure.

In truth, "equity" is a dirty word for many private-equity buyers; what they love is debt. And, because debt is currently so inexpensive, these buyers can frequently pay top dollar. Later, the business will be resold, often to another leveraged buyer. In effect, the business becomes a piece of merchandise. Berkshire offers a third choice to the business owner who wishes to sell: a permanent home, in which the company's people and culture will be retained (though, occasionally, management changes will be needed). Beyond that, any business we acquire dramatically increases its financial strength and ability to grow. Its days of dealing with banks and Wall Street analysts are also forever ended. Some sellers don't care about these matters. But, when sellers do, Berkshire does not have a lot of competition.

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Today Berkshire possesses (1) an unmatched collection of businesses, most of them now enjoying favorable economic prospects; (2) a cadre of outstanding managers who, with few exceptions, are unusually devoted to both the subsidiary they operate and to Berkshire; (3) an extraordinary diversity of earnings, premier financial strength and oceans of liquidity that we will maintain under all circumstances; (4) a first-choice ranking among many owners and managers who are contemplating sale of their businesses and (5) in a point related to the preceding item, a culture, distinctive in many ways from that of most large companies, that we have worked 50 years to develop and that is now rock-solid.

These strengths provide us a wonderful foundation on which to build

GOVERNANCE AND **FAMILY COMPANIES**

Stephen B. Young
Global Executive Director
The Caux Round Table

There is a commonplace that family companies don't need much governance. Families provide their own governance for themselves and their businesses, especially in cultures with strong patriarchal patterns of family organization.

But this commonplace is superficial. Family authority patterns have their own place within the emotional bonds and stresses of often involuntary kinship relationships, gender tensions, generational differences, and disfavored in-laws. But such emotionalism is irrational within a business. Business rationality demands acting upon a strict means/ends causality with a view towards commercial success. Business success demands from those with positions in the company fidelity to role responsibilities and emotional self-control to serve as part of a team performing as expected for the common good of the group.

The culture of business rationality is very different from the more affective culture of patrimonialism and favoritism which constitutes the authority pattern in many families. Matriarchal authority patterns in families can come with their own dysfunctions as well.

If a family puts a priority on the business success of its company, it needs governance over the company appropriate to the roles and responsibilities of market focused, profit-focused decision-making.

What then is governance? How should families come to appreciate governance as a beneficial addition to their quest for happiness and wealth creation? Governance achieves two important tasks. First, it moves subjective values and other ethereal concepts from abstraction into material reality. Second, it provides control of outcomes through the selection of priorities and the imposition of accountability.

First governance transfers our ambitions, ideas, ideals, values, innovations, as well as fears, jealousies, and other normative constructs into social realities. Governance applies power and authority to people to influence their worldly actions according to chosen norms. Governance moves people from desire to outcome. Governance obtains conformity with the chosen vision and mission of those in authority. Or, people are given authority because they are trusted to be effective in achieving the chosen goals and objectives which arise from subjective preferences.

Since a business enterprise is a cooperative enterprise, organizing people to function as needed is essential. Business does not happen through spontaneity or serendipity but though planning and intentional decision-making in response to complex currents of people and circumstances. Business happens for better or worse through governance. Every business has goals and objectives. Some values must be chosen for implementation within the business if it is to be a self-sustaining organization and have an impact in the market.

Governance is needed to convert ambition into results.

A company run without governance runs the serious risk of being erratic, faddish, ad-hoc, wasteful, and irrelevant.

Second, governance selects among alternative courses of action in order to limit choices and impose discipline. Governance delivers control – control over self and control over others. This function aligns owners of a business with the rationality necessary to achieve business success. Governance enables family owners to control themselves as might be required to do what is in the best interest of the business and to control the people who serve the company and make its decisions.

Choosing between Dr. Jekyll and Mr. Hyde

But what values should a family choose to implement through government? Should the family seek to run its company as the good Dr. Jekyll or as horrific Mr. Hyde?

The challenge of governance for a family lies in choosing its goals and objectives. A family company could be socially responsible or it could be very irresponsible in extracting advantages for itself from society.

Depending ….

On the values that prevail in the family. Good values are contrasted with bad values.

In order to have governance of the family firm, a decision must be made as to what goals and objectives will be transferred to the vision and mission of the company. Will they be good values or bad values? The governance process will take whatever it is given by the family and bring it to life in the market.

Generally speaking, bad values in the context of a family company look towards money and power for the family. Selfishness in seeking to establish the social, cultural or political power of the family as a collective enterprise often demands that the company be run for the extraction of cash for transfer to family accounts. Then financial wealth can be used for the purchase of status goods through conspicuous consumption in the fashion of absentee landlords, feudal aristocrats, or demanding warlords shaking down their dependants and retainers. This is the family acting as rentiers, not as risk-taking capitalists creating new wealth for themselves and for society.

From the perspective of society, business should be part of Adam Smith's metaphoric "invisible hand" contributing to the general economic growth of the community. Rent extraction, living off a company only as a rentier, compromises the robustness of economic growth.

The Caux Round Table, therefore, developed a set of ethical principles to direct owners of private wealth away from rent seeking towards productive contributions to social prosperity.

These principles start from the premise that:

Wealth comes from earning a return on capital – human, financial, physical, reputational, social. Current wealth generates future wealth. A necessary use of wealth, therefore, is to ensure the creation of more wealth.

Wealth is a form of capital, constituting in particular the flexible ability to use and deploy finance capital. Both individual initiative and social institutions interact to produce all forms of capital, giving to capital a mixed character subject to the authorship claims of both individuals and society. Capital therefore arises out of kyosei, a process of living and working together for a common good. Ownership of shares in companies and corporations is, of course, a primary form of wealth in the global economy.

Further, the highest and best use of any form of capital is to generate additional capital. Capital should not be used to hinder society's ability to create more capital for the benefit of others. Consumption is not the most responsible use of capital.

Second, proper use of wealth is necessary for the achievement of more gentle and happy social circumstances, for improvement of the human condition. Possession of wealth generates envy in others, leading to cultural and social tensions. Unequal distribution of wealth further gives rise to resentment, alienation and political conflict.

Third, use of capital to abuse one's power and position or impose one's will on others is not compatible with a respect for human dignity.

The fundamental Principle for owners of wealth to acknowledge is:

The ownership of wealth entails stewardship. The ends of holding wealth encompass more than meeting self-centered desires for dominion and indulgence. There is a fiduciary aspect to the ownership of capital. Wealth is to be consciously devoted to meeting the needs of society, of others, and the challenges of the future. Wealth should be of benefit to society.

This fundamental principle is made more specific by these subsidiary principles:

1) **Wealth should be used to enhance other forms of capital: finance, physical, human, reputational, and social.**

First, wealth should be used to sustain and improve the institutions that permit the creation of wealth. Accumulated over time, wealth can influence the future. Wise use of wealth avoids immediate consumption and invests in the creation of better outcomes for future generations. When wealth is invested in the creation of additional finance capital, it should invest in those businesses and productive enterprises that adhere to the Caux Round Table Principles for Business. In particular, the current wealth of advanced industrial countries (some US$79 trillion) should be increasingly directed towards the creation of conditions for sustained economic growth in poor, developing and emerging market nations. Wealth should be used to enhance all forms of capital formation in nations that adhere to the Caux Round Table Principles for Governments.

2) **The desires of owners for self-satisfaction should be balanced against society's need for robust accumulation of new capital in all forms.**

Philanthropy is incumbent upon those who possess wealth. The social function of wealth is to finance a greater good. Those who are to inherit wealth should be expected to assume the fiduciary responsibilities of stewardship that accompany the possession of wealth.

3) **Wealth must support the creation of social capital.**

Social capital – the reality of the social compact incubating successful wealth creation and permitting the actualization of human dignity – is created over time by governments and civil society. From the rule of law to physical infrastructures, from the quality of a society's moral integrity and transparency of its decision-making to the depth and vitality of its culture, social capital demands investment of time, money, imagination and leadership. Wealth should pay its fair share in taxes to support public programs enhancing social capital and should invest in the private creation of social capital through philanthropy.

4) **Wealth should be invested in institutions enhancing human capital.**

Education and culture can be funded from public budgets on a consumption basis, but wealth should shoulder the principal responsibility in a society of providing permanent endowments for institutions of education and culture.

5) **Private wealth should supplement public expenditures for the social safety net.**

Private charity and philanthropy should respond to the health and human services needs of the less fortunate.

6) **No one is morally entitled to the use and enjoyment of wealth procured by fraud, corruption, theft, or other abuse of power.**

Those who control such wealth should make restitution of such wealth to public bodies or civil society. Use of private property rights to shelter such wealth is ethically suspect.

A simple and straightforward way for family companies to manage governance is to carry forward into the company the best family values. A family is a community which has a place for all its members and has expectations that its members will flourish and have happy lives.

Of course, many families are dysfunctional and don't act on the basis of love and kindness towards relatives. Families can be upsetting interpersonal fire pits of emotional dramas, power struggles, resentments, and other psycho-social neuroses.

But families should seek for the best, which is to experience mutual love and support in comfort and advancement.

Families can extend to their companies this sense of mutuality and reciprocal obligation. The family value most appropriate for setting company priorities would be to share beneficial outcomes with employees, customers and the community while living in harmony with the environment.

The family and its extended family – so to speak – of stakeholders in the family company come to share value produced by the business. The family business can be something of a social enterprise serving a variety of beneficiaries. As the company prospers, so will the family but the company cannot prosper well unless its employees, customers and suppliers share in what the company makes possible - its goods or services or its financial benefits.

In Japan a similar concept derived, I think, from Shinto naturalism with Buddhist overtones is called *Kyosei*. From this point of view, a company, like a family, is part of a wider environment which sustains it. By taking care of its environment – its customers, its employees, its creditors, its suppliers, its community – the company improves the odds of its own financial success. It creates through *Kyosei* favorable support structures which will feed its needs with quality inputs and resources.

In the United States, the tradition of Calvinism in the old families of New England provided a similar incentive to run family companies with regard for customers, employees and the community. The Dayton family in Minnesota became famous for not only its sound and successful business undertakings but as leaders in charity and community problem solving.

The honor and reputation of a family – its legacy over the generations – is built on how it lives up to values or not. Putting in place governance of a family company such that it acts responsibly promotes honor and a worthy reputation.

Honor and reputation may not be desired goods for investors in public companies, who most often conceptualize their relationship with the company as strictly financial, but they are frequently the psycho-social glue which holds families together. They set standards of high performance which family members come to accept as a birthright to live up to.

But on the purely financial side, a family company improves its long term value to be gifted down over the generations by paying attention to its stakeholders. Companies that exploit their stakeholders can profit in the short-run but often lose out in the long run. Financially, family companies are more likely to worry about long-term returns, the building of capital wealth that can sustain descendants. Family members should be reluctant to "take the money and run" for in taking the money out and away from the company, they are undermining the family's future well-being.

Governance in family companies, therefore, needs to constrain that narrowly focused impulse to profit at the expense of the family group. This is part of the second function of governance – providing discipline and rationality to promote the well-being of the business.

Thus, family companies have an inbred bias for sustainability of enterprise in order to serve the family's needs over time and through generations. To be sustainable, good governance is necessary. Poor governance adds risk and brings on difficulties and losses. Good governance foresees challenges and is responsive to demands for excellence. With good governance, family companies will prosper more and longer.

Once the first aspect of governance is at work, the second comes into play – exercising control through the selection of specific goals and objectives and holding those in positions of responsibility accountable for their actions.

But younger generations as they come to maturity may or may not be as committed as their parents and grandparents to personal governance of the family business. It is at this juncture between generations where governance can be most important for family companies. If the right values have been chosen by the founders and the right structures for rational priority setting have been put in place, the family company can continue to prosper with professional managers over time becoming incorporated into a family ethos of purpose and achievement.

In conclusion, governance is not in tension with family control of business but is a vital part of success in running such an enterprise.

Outro: Character and Governance

"Character development, like historic progress, best happens imperceptibly, through daily effort."

-- David Brooks
Author, New York Times Columnist

Steve stated in his piece on family businesses that there is a need for good governance within business in order for it to be successful. But how do we achieve this 'governance' and how is it viewed as legitimate? Legitimate governance, both political and societal, is contingent upon character and leadership. Good character is one of the primary building blocks of both legitimate governance and effective leadership.

As Steve points out in his introduction, Warren Buffet's companies would not have been so successful if they had not been trusted and responsible, two hallmarks of good character. In this day and age where companies have been afforded more and more rights of the person, it is inherently valuable to begin judging companies like persons as well. A successful person is one who is trusted and responsible – indeed one who can be said to possess good character. A business with the same types of characteristics - and, thus good character - will be equally successful.

New York Times Columnist David Brooks has recently published a book entitled, "The Road to Character." In a recent article he spoke about the "self-satisfied moral mediocrity" that has become pervasive in our culture today. According to Brooks, character is created (and revealed) not just through discomfort but through actual suffering, and using that suffering as a "moral moment." Our society, however, has done everything it can to reduce suffering and magnify comfort. This omnipresent pursuit of comfort denies us all something truly important, the building of character through self-confrontation.

In times of discomfort and suffering, individuals are forced to look within for validation. In this economy of 'likes' where everyone is attempting to get, in Brooks' words, "jolts of approval," this self-confrontation is difficult to uncover. Much like there is a necessity for individuals to learn from failures, it is essential that we learn from our situations when we are at our weakest points. By examining our weaknesses (uncovered through discomfort) we can ask ourselves, "What is my weakest spot?" and "How do I get better in my weakest spot?" Through this process, character is developed and unfortunately, in our modern society, we have been taught to trumpet our own success to the extent that any sign of weakness is completely drowned out.

What a society values in both people and corporations fluctuates throughout the years, however, in order to be truly successful, no matter the times, it takes a wealth of character. When Brooks speaks to the idea that there are 'Resume virtues' and 'Eulogy virtues' for us as individuals, the same could be said for corporations. The Resume virtues are outward facing and a means to an end. The Eulogy virtues are more contemplative, inward facing, and vastly more important to the building of character. It is unfortunate that modern society has cleaved virtues into two separate and distinct groups but it does appear that the modern definition of 'character' has shifted from a moral category to a workplace category. Indeed, in a recent interview, Brooks notes that we have all been a part of a perceived monetization of human traits and values. Now instead of being criterion for how to live a life -his 'Eulogy virtues' - morals are now viewed as currency; 'persistence' and 'grit' have become pieces of Resume virtues.

Instead of simply doing good and working to create some CSR program or a philanthropic arm of a company – Resume virtues, we should be striving to actually be good – Eulogy virtues.

We all know about 'character' and what makes up good character. We all understand concepts like the golden rule and the values inherent in the CRT's Principles for Ownership of Wealth. So why do we need to codify these principles? Why does Pegasus come out every month with varying content but with similar messages? It is because of a theme that was underlying Buffet's excerpts. He mentioned several instances when a distinct lack of character impedes ethical capitalism. Nearly once a decade (if not even more frequently) there are 'Barbarians at the Gate,' 'creative accounting methods,' or predatory lending. These issues repeatedly arise in the capitalist system as it currently operates and as it infects the entire economy, it does not matter whether the business is a conglomerate or a family-owned enterprise, it taints the system as a whole.

Because of these reoccurring instances of moral mediocrity, there will always be a need for the Caux Round Table. If for no other reason than the fact that moral capitalism and good corporate character should be more than just dreams but goals that we continue to strive for. Character, built through self-confrontation and daily effort, is exemplified in good governance, which in turn leads to business success and sustainability.

As always, I welcome your comments.

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