

Closing Down Buffett's Buffet

Berkshire Hathaway Ends Innovative Program of Shareholder-Designated Donations

by Patrick J. Reilly

Summary: The termination of Warren Buffett's shareholder giving program shows why corporate giving to political advocacy groups is risky business even when shareholders are put in charge.

Warren Buffett is known for many things:

He is a celebrated investment guru—the “Sage of Omaha”—who has helped others make millions while accumulating a reported \$49.3 billion himself.

He was Arnold Schwarzenegger's financial advisor in last year's high-profile race for California governor—and almost as polarizing for his views on taxes as the actor was for his alleged mistreatment of women.

To some, the second-richest man in the world is a generous philanthropist to charities in Omaha, Nebraska—where his Berkshire Hathaway holding company is based—and to leftist advocacy groups (like the Nuclear Threat Initiative) and population control efforts. To others he is a stingy billionaire holding on to most of his wealth until he dies, when his Buffett Foundation will become the largest and most powerful private foundation in the world.

But for more than two decades, Warren Buffett also has been known for the innovative corporate giving program he initiated at Berkshire Hathaway, which al-



In its 22-year history, Warren Buffett's shareholder giving program distributed \$197 million to about 3,500 charities.

lowed shareholders in the company to designate gift recipients. That program, which was frequently praised as a model for corporate philanthropy and even led one U.S. Congressman to try to mandate similar programs at other companies, was terminated last summer. One of Buffett's signature achievements came to an abrupt end.

The story of how a small boycott effort turned around one of America's most powerful businessmen is an interesting study of how thorny corporate giving programs can be when social and political advocacy groups are beneficiaries. A

closer look at the Berkshire Hathaway program also reveals flaws in its shareholder-

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controlled approach and in Buffett's views on corporate responsibility and philanthropy.

Let the Owners Decide

Berkshire Hathaway's unique giving program was not Buffett's idea. It was started in 1981 at the suggestion of Charles Munger, Buffett's longtime business partner and the vice chairman of Berkshire Hathaway.

In October 1981, Buffett sent a letter to shareholders criticizing other companies that "deplore governmental allocation of the taxpayer's dollar but embrace enthusiastically their own allocation of the shareholder's dollar" through corporate giving programs.

"What bothers me about ordinary corporate practice is the way gifts tend to be made based more on who does the asking and how corporate peers are responding than on an objective evaluation of the donee's activities," Buffett wrote. "Conventionality often overpowers rationality."

Buffett noted the irony that many major corporations matched gifts made by

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their employees, yet none had a matching gift plan for shareholders. This was perhaps understandable, Buffett wrote, for companies that have no long-term owner's perspective and consider shareholders to be temporary buyers and sellers of stock. But he noted that Berkshire Hathaway investors tended to stick with the successful company over time.

The rules for the designated-shareholder program never changed significantly from what Buffett announced in his 1981 letter. Class A shareholders, generally long-term owners of the company, were permitted to designate a per-share sum to no more than three charities of the shareholder's choice. Class A shares, representing most of Berkshire Hathaway's equity capital, are worth about 30 times the company's Class B shares which offer no rights to designate contributions.

The program was an immediate success. In 1981, shareholders each designated \$2 per share—a total of almost \$1.8 million—to 675 charities. By the end of its 22-year history, the program distributed about \$197 million, benefiting about 3,500 charities annually at \$18 per share. The clear favorites of shareholders were schools (about 800 benefited from the program) and churches and synagogues (more than 400).

The latter category of recipients was just one of the reasons shareholders loved the program. Whereas most American companies refuse to support religious organizations and activities—often for fear of controversy and religious disputes—Berkshire Hathaway's owners were given almost unlimited freedom in their selection of recipients as long as they were designated as tax-exempt. That same freedom enabled gifts to sometimes go to controversial groups, but the company was able to distance itself from the gifts, noting that funding decisions were out of management's control.

Devil in the Details

The idea was well-received, but its implementation was not so simple.

In 1981, the program's first year of

operation, trouble arose almost immediately with owners who owned stock through nominees (usually brokers). A Treasury Department ruling limited the program to shares registered in the owner's name. Berkshire Hathaway tried to inform ineligible shareholders of this and urged them to register their stock in their own name, but some brokers failed to pass on the communications or they forwarded messages too late. For major corporations with large numbers of shares, convincing owners to re-register their shares in their own name could be problematic.

A serious limitation on the program also surfaced. As a holding company that preferred not to mess with the management of subsidiaries that were successfully generating profits, Berkshire Hathaway didn't want to interfere with subsidiaries' giving programs already in place. So even though Berkshire Hathaway calculated the amount of profits designated each year for charity, and corresponding tax deductions, shareholders in the Berkshire Hathaway giving program controlled only a portion of that amount—the remainder was controlled by subsidiaries, whose style of corporate giving (e.g. matching employee gifts) had been publicly derided by Buffett. He and Munger were not using Berkshire Hathaway shareholder funds to support their own choice of charities, but subsidiary managers and employees were doing just that.

Did the program actually allow average investors to control corporate giving while keeping Berkshire Hathaway's directors out of the picture? Not exactly. Buffett and Munger are among the company's largest shareholders—Buffett reportedly owns 36 percent of the stock. Because both enjoyed the same rights as other owners to allocate a per-share amount to charity, Berkshire Hathaway's chairman/CEO and vice chairman in effect controlled much of the company's giving. The upshot? Instead of directly supporting needy charities, Buffett and Munger designated their own private foundations to receive—many of their company gifts. For instance, Berkshire Hathaway contributed \$9.2 million to the Buffett Foundation in 2002, according to the foundation's report to the IRS.

Probably the greatest flaw in Berkshire Hathaway's giving program was also its most attractive feature: It let shareholders exercise total control over designating gifts. While conventional corporate giving can be unimaginative and fail to support charities favored by a company's shareholders, it also can buttress company interests—assuming managers focus on corporate strategy and not on their personal interests or ideology. Many corporate managers are more likely than the average investor to keep the company's goals in mind when they make corporate charitable contributions.

That didn't happen at Berkshire Hathaway. Almost from the beginning of its giving program, the company was targeted by activists who were upset about grant recipients who received shareholder-designated gifts. In his 2002 letter to shareholders, Buffett admitted receiving "a few letters every week" complaining about the company's gifts to Planned Parenthood. Presumably the letters caused sufficient concern for Buffett to rebut them in his company's annual report.

"The letters are invariably polite and sincere, but their writers are unaware of a key point: It's not Berkshire, but rather its owners who are making charitable decisions—and these owners are about as diverse in their opinions as you can imagine," Buffett wrote. "For example, they are probably on both sides of the abortion issue in roughly the same proportion as the American population. We'll follow their instructions, whether they designate Planned Parenthood or Metro Right to Life...."

Buffett was correct, of course. But regardless of who decides how corporate gifts are designated, a company is identified with its gifts. Buffett failed to appreciate how quickly anger about corporate donations—usually to controversial social and political advocacy groups like Planned Parenthood—can affect sales and profits. Had Berkshire Hathaway made more strategic gifts consistent with the company's goals (such as supporting communities where employees live or where customers are concentrated) and needs

(such as protecting the company's public image by avoiding recipients that are highly controversial), it might have avoided the coming storm.

Abortion Controversy

Pro-life activists have long been upset not only by Berkshire Hathaway's gifts to Planned Parenthood and other advocates of legal abortion, but also by Buffett's personal philanthropy in support of population control. Roger Lowenstein writes in his book, *Buffett: The Making of an American Capitalist*, that while the charitable giving of Buffett's wife Susan is "largely inspired by the poor living conditions of people, and particularly women," Warren Buffett has "a Malthusian dread that overpopulation would aggravate problems in all other areas—such as food, housing, even human survival."

The Buffett Foundation has made significant grants to groups working to increase the availability of abortion, including the Center for Reproductive Law and Policy, NARAL, Planned Parenthood, the Population Council, and the Abortion Access Project. One \$4.7 million grant supported International Projects Assistance Services, which makes portable suction abortion devices. Other philanthropies and donors that have benefited from Warren Buffett's striking business success (see box on page 4) also have funded family planning and abortion-related groups or have transferred large sums to the Buffett Foundation:

- Charles Munger's foundation, the Alfred C. Munger Foundation in Los Angeles, has made grants to the Center for Reproductive Law & Policy, Planned Parenthood, and Population-Environment Balance.

- The Susan A. Buffett Foundation in Omaha, established by Buffett's daughter, has supported Omaha charities, including Planned Parenthood. In 2001, the Susan Buffet Foundation made a \$985,000 grant—more than two-thirds of the foundation's total grants—to the Buffett Foundation.

- The Spirit Foundation in Omaha, led by Buffett's son Peter, has made grants

to the NARAL Foundation and Planned Parenthood. In 2001, the foundation made grants totaling more than \$1 million—half the year's total grants—to the Buffett Foundation.

- The Sherwood Foundation in Omaha, established by Buffett for his children, a sister and a friend, has made grants to Planned Parenthood.

- Mildred Topp Othmer, an Omaha woman who made her fortune by trusting her investments to Buffett and Berkshire Hathaway, was a Planned Parenthood trustee and left the organization \$60 million upon her death in 1988.

Beginning in 1992 a pro-life group called Life Decisions International tried to rally consumers to boycott Berkshire Hathaway and its subsidiaries. As recently as May 2002, the boycott inspired a shareholder resolution to end the company's giving program. (The resolution was defeated by a 97 percent "No" vote.) But it was not until October 2002, when Berkshire Hathaway acquired a kitchen gadget retailer called Pampered Chef from its founder and chairman, Doris K. Christopher, and her family, that pro-life complaints seemed to have an impact.

Consistent with Buffett's style of hands-off ownership, the acquisition didn't appear to change anything about Pampered Chef—Christopher remained in charge, the management team stayed put at the company's Addison, Illinois headquarters, and business was conducted through more than 67,000 independent sales representatives. Christopher started the company in 1980 with \$3,000—the only money she ever invested in the company—and brought in \$50,000 that year by making in-home presentations of her kitchen products. By 2002, Pampered Chef was the nation's largest branded kitchenware company and largest direct seller of housewares, doing \$700 million of business annually.

But all that changed when the new Berkshire Hathaway subsidiary became the boycott target of Life Decisions International. Sales declined and many of Pam-

Berkshire Hathaway Philanthropies

The great success of Berkshire Hathaway and Warren Buffett has led to the creation of several private foundations. Although Buffett has already given away millions, the real impact of his philanthropy will be felt after his death, when the Buffett Foundation is fully endowed.

Some of the philanthropies tied to Berkshire Hathaway's success include:

- The Buffett Foundation had assets of \$25.3 million but made grants totaling \$33.4 million in 2002. It relies on annual gifts of Berkshire Hathaway stock. Buffett serves as vice president and his wife Susan is president. Most grants support abortion-related programs and population control.
- The Alfred C. Munger Foundation in Los Angeles, funded by Buffett's partner Charles Munger, primarily supports Los Angeles charities and other nonprofits. The foundation had assets of \$26.7 million in 2002.
- The Sherwood Foundation in Omaha, established by Warren Buffett, allows his children (Susan, Howard and Peter), his sister Doris Buffett Bryant and friend Astrid Menks to each make grants of up to \$100,000 a year. The foundation had assets of \$1.6 million in 1999, the latest year for which information is available.
- Buffett's daughter leads the Susan A. Buffett Foundation in Omaha, which had assets of \$35.3 million in 2001. Grants primarily support Omaha charities.
- Buffett's son leads the Howard G. Buffett Foundation in Decatur, Illinois, with assets of \$30.1 million in 2002. Grants primarily support environmental organizations.
- The Spirit Foundation in Omaha, led by Buffett's son Peter, primarily supports various environmental and Milwaukee charities. The foundation's assets in 2001 were \$33.8 million.

At the Sunshine Lady Foundation in Morehead City, North Carolina, Buffett's sister Doris Buffett Bryant makes small grants to help charities and people down on their luck. The foundation had assets of \$3.6 million in 2002.

pered Chef's sales associates quit the company to protest its gifts to Planned Parenthood. Less than nine months after acquiring Pampered Chef, Berkshire Hathaway announced that its corporate giving program would be terminated to protect Pampered Chef from further losses.

"The independent consultants that serve The Pampered Chef have no responsibility for what Berkshire Hathaway shareholders do, yet the careers of many of these consultants are now suffering because of the contributions program," la-

mented Berkshire Hathaway in a press release. Terminating the program was necessary to save their jobs—and the company's investment.

Uncertain Future

"It killed me," Munger told the *Washington Post* following the announcement. But he added that "controversial donations have never been big for companies. ... Maybe they should be left to individuals."

Did it have to end this way? The Berk-

shire Hathaway model had been popular with conservatives like Capital Research Center president Terrence Scanlon and Nobel laureate economist Milton Friedman. They saw shareholder designation as an improvement over manager-directed corporate giving. "Warren Buffett's policies of letting the shareholders decide which charities to support are an excellent model," Scanlon told the *Chronicle of Philanthropy* in 1997. "Shareholders should have more control over the philanthropic activities of a company."

Friedman agreed in the 1996 preface to *Patterns of Corporate Philanthropy*, Capital Research Center's directory of corporate giving to advocacy groups. "The social function of a business corporation...is not to serve as a philanthropic or charitable organization," Friedman wrote. However, because the law allows charitable contributions to be tax-deductible while it continues to tax dividends, Friedman concluded that a shareholder could benefit from corporate giving—"if and only if the contributions are to causes or organizations that he or she wishes to support...[T]he way to assure that outcome is one Warren Buffett adopted many years ago for Berkshire Hathaway."

In 1997, Rep. Paul Gillmor (R-OH) even went so far as to attempt to require all public companies to follow Buffett's lead. He tried and failed to convince Congress to pass legislation to this effect. (Buffett did not comment on the legislation; Scanlon opposed a legislative mandate; but Friedman supported the proposal as a way to undo Congress' original mistake of permitting tax deductions for corporate philanthropy.)

In hindsight, it doesn't seem that replicating the Buffett model of shareholder-designated giving is such a good idea. Given its recent troubles, most companies will not find it prudent to adopt a similar program. Still, is there a way to create a corporate giving program that gives shareholders more control while serving the goals and needs of the company?

Perhaps. The Berkshire Hathaway experience suggests that a similar program can work if it includes restrictions on recipient groups so as to avoid controversial gifts to political advocacy organizations. Shareholders could be directed to community charities and informed about ways that their gifts can support the company's strategic plan. And the amount of each shareholder's charitable allocation might be capped so that very large investors don't have a disproportionate control over the entire giving program.

Certainly the alternative of manager-directed giving is not the answer. As Capital Research Center's survey of corporate giving shows, the officials who control the philanthropy of large corporations frequently do not act in their companies' interests; too often they fund leftist political advocacy groups that hinder the free market and lobby for expanded government regulation and entitlements. (See www.corporatepatterns.org for the on-line successor to *Patterns of Corporate Philanthropy*.)

Wait-and-Die Philanthropy

The demise of Berkshire Hathaway's corporate giving program means fewer funds for the Buffett Foundation, which was often Buffett's designated recipient of company gifts tied to his stock.

But almost all of Warren Buffett's fortune—which now stands at \$49.3 billion—will go to the foundation when he and his wife Susan die, making the Buffett Foundation much larger than even the Ford Foundation (2002 assets \$9.3 billion). Buffett has no interest in devoting much of his own time to philanthropy, so he intends to multiply his fortune through investments and then allow his foundation's trustees to distribute the funds without restriction.

"I've told the trustees that they can do anything they think is the thing to do at the time," Buffett told the *Omaha World-Herald* in 1977. "I tell them that their decisions above ground will be a lot better than mine six feet underground." Nevertheless, Buffett's daughter Susie has said that she expects the foundation's emphasis to be on population control, consistent with her father's interests.

Aside from the foolishness of endowing an immense foundation without guidelines on the use of its funds, Buffett has been criticized for his "wait-and-die" approach to philanthropy.

"Warren Buffett, he's a decent human being, he said he's going to give his money away when he dies for population control," media mogul Ted Turner said during a 1997 speech. "He may live 20 more years.

By then, the world's population is going to double again."

In rare agreement with Turner, *Forbes* magazine also encouraged Buffett to give it all away during his lifetime. "Consider what's happened to three of the best-known and richest foundations—Ford, Carnegie and Rockefeller," the magazine said in 1997. "Their founders were exemplars of laissez-faire capitalism. They all had strong ideas about how the world worked, what virtue was and how it would be rewarded. Today, however, the liberal pooh-bahs who run their foundations waste much of the income on left-wing causes that would appall their original donors."

In 1999, Buffett was said to be the force behind a failed effort by Nebraska Senator Bob Kerrey, who introduced legislation to allow private foundations to accept more than 20 percent of a company's stock. The Kerrey bill would have let a foundation accept up to 40 percent of a company's stock in 2007 and 49 percent in 2008. Commentators observed that without a change of this type about half of Buffett's Berkshire Hathaway stock would be subject to taxes before the Buffett Foundation could get it. Why Buffett publicly opposed repeal of the federal estate tax in 2001 is anyone's guess.

Buffett has made clear that wherever his fortune goes when he dies, it won't go to his kids. The right amount to bequeath to your children, he has said, "is enough so they feel they could do anything, but not so much that they could do nothing." For Warren Buffett, that amount is "a few hundred thousand" for his daughter and two sons.

"Did I work harder because I wasn't going to get a billion bucks?" daughter Susan once asked. "Maybe. But it would have been fun to find out for sure."

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PhilanthropyNotes

Liberal groups are touting “**e-commerce**” as a better way to improve fundraising and mobilize activists. Under the strategy, organizations are urging supporters to buy gift certificates, clothing and mutual funds from them on-line. In 2003, the **Sierra Club** began offering mutual funds investing in environmentally-friendly corporations and launched men’s and women’s apparel lines that are now available online in hundreds of stores nationwide. Said Johanna O’Kelly, Sierra Club director of licensing, “Studies show that 67 percent of American adults consider themselves environmentalists, but how do you reach all those people? The clothing line reaches out to the everyday shopping audience.”

Conservative groups are also using the tool for fundraising. The **Christian Coalition** urges its 2 million members to buy gift certificates, redeemable at a variety of stores, and dedicates a percentage of the proceeds to Christian ministries, churches and schools. Holly Ross, director of programs for the **Non-profit Technology Enterprise Network**, which helps nonprofits use new technology, says, “Organizations are not just flat out asking for money anymore; they are tying [requests] to specific programs and outcomes.” Ross points to **Moveon.org**, the liberal internet advocacy network which has held fundraisers to pay for political ads, as a good example of how to creatively use technology to raise money. However, some experts warn nonprofits to be careful. Ken Gross, an attorney specializing in tax-exempt groups, says nonprofits risk losing their tax-exempt status by relying on sales profits to raise money.

The Pew Charitable Trusts has given state **Public Interest Research Groups (PIRGs)** and a network of activist groups a \$4 million grant to support an ambitious youth voter registration drive called the **New Voters Project**. PIRG officials claim the effort is nonpartisan despite PIRG connections to consumer activist and Green Party candidate Ralph Nader. Project coordinator Ivan Frishberg cites its bipartisan advisory board, which includes Gerald Ford, Walter Mondale and former Republican Committee chief Frank Fahrenkopf, Jr. The campaign aims to register 260,000 18-24 year-olds in six competitive battleground states: Colorado, Iowa, New Mexico, Nevada, Oregon and Wisconsin. All but Colorado decided their 2000 presidential election outcomes by less than 4 percent of the vote. PIRG and its allies plan to avoid television ad campaigns and focus on registering voters and getting them to the polls.

Charitable giving is on the rise this year. An October poll of 660 charities conducted by Guidestar, the online information clearinghouse for nonprofits, found that about 39 percent of charities reported an increase in contributions in 2003. In 2002, only 28 percent reported an increase in contributions. That year donations to the nation’s 400 largest charities fell for the first time in 12 years by 1.2 percent—in marked contrast to the previous five years when donations rose at an annual average of 12 percent. The Fidelity Charitable Gift Fund, one of the nation’s largest public charities with \$2.5 billion in assets, says its contributions are up 25 percent in the past seven months, despite a slow start at the beginning of the year. But other major charities are still experiencing serious funding shortfalls. The American Red Cross disaster-relief fund is empty. The fund tries to keep at least \$56 million on-hand, but its been depleted by a series of recent disasters, including the California wildfires.

The charitable response to 9/11 may have made Americans more skeptical of charity. An October survey conducted by Paul Light of New York University and the Brookings Institution found that only 18 percent of respondents had a “great deal” of confidence in nonprofits, below the 25 percent reporting high confidence prior to the attacks. Leading charities such as the Red Cross and United Way were strongly criticized for mishandling donations to the relief effort. Says Light, “The effect of September 11 and the events that followed have been much greater than we thought.”

