

The Bill & Warren Show

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What do you get when you put a billionaire buddy act in front of 350 students? \$84 billion of inspiration In a meeting of incomparable minds (and unspendable net worth), Buffett and Gates muse about taking risks, motivating employees, confronting mistakes, and giving back. The result: something pretty darn close to wisdom.

The queue of students stretched through the lobby and out the door of the University of Washington's Husky Union Building in Seattle on a balmy Friday afternoon in late May. You could tell by the abundance of pressed chinos and dress shirts (and the shortage of nose rings) that this wasn't the ticket line for a Phish concert. Instead, the well-groomed group was staking out prime seats for, of all things, a lecture--albeit a very special lecture. The students and a few lucky guests were to be treated to a rare, public dialogue between the two richest businessmen in the solar system: Microsoft founder and CEO Bill Gates and Warren Buffett, chairman of Berkshire Hathaway Inc.

The billionaire buddies conceived the event to coincide with Buffett's weekend visit to Gates' home, following Microsoft's annual summit meeting for CEOs. The superinvestor and the cybertycoon asked some 350 business school students to participate in the session and invited the Public Broadcasting System and FORTUNE to document the affair. (PBS filmed the interchange and will offer copies to its affiliates for broadcast during pledge drives this fall.)

While the students milled downstairs, Gates and Buffett bantered with their wives and a small group of friends that included, among others, Katharine Graham, the former CEO of the Washington Post Co., and Bill's dad and sister. They noshed on fresh fruit in a makeshift greenroom while a makeup artist powdered Bill's nose and trimmed Warren's unruly eyebrows, much to Susie Buffett's amusement. At one point the Oracle of Omaha entertained the group with a goofy imitation of Richard Nixon's "V for victory" sign.

As showtime approached, the two gamely posed for photos and traded barbs like old college roomies. The other guests' main concern was that the titans not be too long-winded, so everyone could get back to Gates' house in time to play bridge. It felt like a convivial family reunion--granted, of one very high-powered family.

For a guest in that greenroom, perhaps the most lasting impression was the cross-generational affection between America's best-known billionaires. (For the record, on that day the 42-year-old Gates' net worth hovered around \$48 billion, compared with Buffett's \$36 billion. Buffett, who only a few years ago was considerably richer than Gates, has managed to remain 25 years older, though.) Buffett's presence seemed to calm Gates, who acted loose and gregarious despite Microsoft's legal fisticuffs with federal trustbusters and the stress of hosting several dozen prominent CEOs for the previous two days. Although Bill has finally begun to look his age--nascent crow's-feet now crease the

corners of his eyes, and he's no longer the beanpole he was--the Buffetts and Graham still dote on him like a wunderkind. He, in turn, treats them with a warm hint of deference, quite a contrast to his usual debater's demeanor.

Finally the two made their way to the stage, pausing in the wings for University of Washington Business School dean Bill Bradford's introduction. Unfortunately, the dean's remarks, which mainly praised Microsoft for hiring University of Washington students, missed the point. The funny, philosophical, extraordinary conversation that followed would be much more than a pep talk from a local employer and his pal. See for yourself.

--Brent Schlender

1. How We Got Here Warren and Bill explain how they became richer than God.

BUFFETT: I thought I ought to start this off by announcing that Bill and I have a small bet as to who would get the most applause. I suggested that I bet my house against his. We settled on a small sum, but evidently it isn't such a small sum to Bill, because just before we came out he gave me this Nebraska Cornhusker shirt to wear, and then he puts on this purple University of Washington shirt himself.

They've asked us to start out talking, the two of us, about what got us here, but then it's on to your questions. How I got here is pretty simple in my case. It's not IQ, I'm sure you'll be glad to hear. The big thing is rationality. I always look at IQ and talent as representing the horsepower of the motor, but that the output--the efficiency with which that motor works--depends on rationality. A lot of people start out with 400-horsepower motors but only get a hundred horsepower of output. It's way better to have a 200-horsepower motor and get it all into output.

So why do smart people do things that interfere with getting the output they're entitled to? It gets into the habits and character and temperament, and behaving in a rational manner. Not getting in your own way. As I said, everybody here has the ability absolutely to do anything I do and much beyond. Some of you will, and some of you won't. For the ones who won't, it will be because you get in your own way, not because the world doesn't allow you.

So I have one little suggestion for you: Pick out the person you admire the most, and then write down why you admire them. You're not to name yourself in this. And then put down the person that, frankly, you can stand the least, and write down the qualities that turn you off in that person. The qualities of the one you admire are traits that you, with a little practice, can make your own, and that, if practiced, will become habit-forming.

The chains of habit are too light to be felt until they are too heavy to be broken. At my age, I can't change any of my habits. I'm stuck. But you will have the habits 20 years from now that you decide to put into practice today. So I suggest that you look at the behavior that you admire in others and make those your own habits, and look at what you

really find reprehensible in others and decide that those are things you are not going to do. If you do that, you'll find that you convert all of your horsepower into output.

GATES: I think Warren's absolutely right about habit. I was lucky enough when I was quite young to have an exposure to computers, which were very expensive and kind of limited in what they could do, but still they were fascinating. Some friends of mine and I talked about that a lot and decided that, because of the miracle of chip technology, they would change into something that everybody could use. We didn't see any limit to the computer's potential, and we really thought writing software was a neat thing. So we hired our friends who wrote software to see what kind of a tool this could really be--a tool for the Information Age that could magnify your brainpower instead of just your muscle power.

By pursuing that with a pretty incredible focus and by being there at the very beginning of the industry, we were able to build a company that has played a very central role in what's been a pretty big revolution. Now, fortunately, the revolution is still at the beginning. It was 23 years ago when we started the company. But there's no doubt that if we take the habits we formed and stick with them, the next 23 years should give us a lot more potential and maybe even get us pretty close to our original vision--"a computer on every desk and in every home."

I was wondering how you define success, personally?

BUFFETT: I can certainly define happiness, because happy is what I am. I get to do what I like to do every single day of the year. I get to do it with people I like, and I don't have to associate with anybody who causes my stomach to churn. I tap-dance to work, and when I get there I think I'm supposed to lie on my back and paint the ceiling. It's tremendous fun. The only thing in my job that I don't like--and this just happens every three or four years--is that occasionally I have to fire somebody.

They say success is getting what you want and happiness is wanting what you get. I don't know which one applies in this case, but I do know I wouldn't be doing anything else. I'd advise you that when you go out to work, work for an organization of people you admire, because it will turn you on. I always worry about people who say, "I'm going to do this for ten years; I really don't like it very well. And then I'll do this...." That's a little like saving up sex for your old age. Not a very good idea.

I have turned down business deals that were otherwise decent deals because I didn't like the people I would have to work with. I didn't see any sense in pretending. To get involved with people who cause your stomach to churn--I say it's a lot like marrying for money. It's probably a bad idea under any circumstances, but it's absolutely crazy if you're already rich, right?

GATES: I agree that the key point is that you've got to enjoy what you do every day. For me, that's working with very smart people and it's working on new problems. Every time we think, "Hey, we've had a little bit of success," we're pretty careful not to dwell on it

too much because the bar gets raised. We've always got customer feedback telling us that the machines are too complicated and they're not natural enough. The competition, the technological breakthroughs, and the research make the computer industry, and in particular software, the most exciting field there is, and I think I have the best job in that business.

BUFFETT: Don't you think Dairy Queen is more important than that? [Berkshire Hathaway bought International Dairy Queen last fall, for \$585 million.]

GATES: You can manage Dairy Queen, Warren. I'll go and buy the Dilly Bars.

BUFFETT: We'll raise the price when you come.

Starting a new company is very risky. How do you determine when is the best opportunity to start a new company?

GATES: When I started Microsoft, I was so excited that I didn't think of it as being all that risky. It's true, I might have gone bankrupt, but I had a set of skills that were highly employable. And my parents were still willing to let me go back to Harvard and finish my education if I wanted to.

BUFFETT: You've always got a job with me, Bill.

GATES: The thing that was scary to me was when I started hiring my friends, and they expected to be paid. And then we had customers that went bankrupt--customers that I counted on to come through. And so I soon came up with this incredibly conservative approach that I wanted to have enough money in the bank to pay a year's worth of payroll, even if we didn't get any payments coming in. I've been almost true to that the whole time. We have about \$10 billion now, which is pretty much enough for the next year.

Anyway, if you're going to start a company, it takes so much energy that you'd better overcome your feeling of risk. Also, I don't think that you should necessarily start a company at the beginning of your career. There's a lot to be said for working for a company and learning how they do things first. In our case, Paul Allen and I were afraid somebody else might get there before us. It turned out we probably could've waited another year, in fact, because things were a little slow to start out, but being on the ground floor seemed very important to us.

How do you get people to support you?

GATES: At first you'll run into some skepticism. If you're young, it's hard to go lease premises. You couldn't rent a car when you were under 25, so I was always taking taxis to go see customers. When people would ask me to go have discussions in the bar, well, I couldn't go to the bar.

That's fun, because when people are first skeptical, they say, "Oh, this kid doesn't know anything." But when you show them you've really got a good product and you know something, they actually tend to go overboard. So, at least in this country, our youth was a huge asset for us once we reached a certain threshold.

2. The World Is Our Oyster Why Warren is sure everyone in China will want to drink Coke.

How do you as businessmen take your companies global?

BUFFETT: [At Berkshire Hathaway] we don't take our businesses global directly. Our two largest commitments are Coke and Gillette. Coke has 80% of its earnings coming from abroad, and Gillette has two-thirds of its earnings coming from abroad. So they are participating in a worldwide improvement in living standards, and we go global by piggybacking on them. I can sit in Omaha and let Doug Ivester [CEO of Coca-Cola] fly all over the world.

GATES: Our business is truly global. The PC standard is a global standard. What you need in a spreadsheet in Korea or Egypt is about the same as what you need in the U.S. We have to do some adaptation for the local languages, and that's a fun part of our business--understanding bi-directional languages and the large alphabets that you have in Chinese, Japanese, and Korean.

In fact, our market share is much higher outside the U.S. than it is inside, because it's relatively hard to set up local subsidiaries and to understand local conditions, local distribution and relationships. Since most of our competitors are from the U.S. and aren't as good at doing international business, we thrive even better in these other countries.

Most of our growth will come from outside the U.S. Here it will get to the point where it is largely a replacement market. Now, that doesn't mean U.S. customers don't want better software that can see, listen, and learn. But outside the U.S. we still have that early-growth-slope phenomenon.

What impelled you to make a trip together to China in 1995, and how has that trip affected your global business decisions since?

GATES: We went to China for a lot of reasons. Partly to relax and have fun. We found a few McDonald's there, so we didn't feel too far away from home. It was also exciting to go and see all the changes taking place, to see different parts of the country, and to meet some of the leaders.

China is a market that Microsoft had already been investing in. We've upped that a lot since then. As a percentage of our sales, though, it's tiny--well under 1%--and so even though it will double every year for the next five years, it's really only by taking a ten-year view that we can say it's worth the emphasis we're putting on it.

Although about three million computers get sold every year in China, people don't pay for the software. Someday they will, though. And as long as they're going to steal it, we want them to steal ours. They'll get sort of addicted, and then we'll somehow figure out how to collect sometime in the next decade.

BUFFETT: My family was amazed that I went. I never traveled beyond the outer reaches of the county in Nebraska. I had a terrific time and also confirmed my feeling that there's going to be a lot of Coca-Cola sold there in the future. I told everyone over there that it acts as an aphrodisiac.

3. Innovations "r" Us Warren ponders Internet chewing gum.

Both of you are innovators in your given industries. I was wondering what your definition of innovation is?

BUFFETT: I don't do a lot of innovating in my work. I really have just two functions: One is to allocate capital, which I enjoy doing. And the second one is to help 15 or 20 senior managers keep a group of people enthused about what they do when they have no financial need whatsoever to do it. At least three-quarters of the managers that we have are rich beyond any possible financial need, and therefore my job is to help my senior people keep them interested enough to want to jump out of bed at six o'clock in the morning and work with all of the enthusiasm they did when they were poor and starting. If I do those two things, they do the innovation.

GATES: The technology business has a lot of twists and turns. Probably the reason it's such a fun business is that no company gets to rest on its laurels. IBM was more dominant than any company will ever be in technology, and yet they missed a few turns in the road. That makes you wake up every day thinking, "Hmm, let's try to make sure today's not the day we miss the turn in the road. Let's find out what's going on in speech recognition, or in artificial intelligence. Let's make sure we're hiring the kinds of people who can pull those things together, and let's make sure we don't get surprised."

Sometimes we do get taken by surprise. For example, when the Internet came along, we had it as a fifth or sixth priority. It wasn't like somebody told me about it and I said, "I don't know how to spell that." I said, "Yeah, I've got that on my list, so I'm okay." But there came a point when we realized it was happening faster and was a much deeper phenomenon than had been recognized in our strategy. So as an act of leadership I had to create a sense of crisis, and we spent a couple of months throwing ideas and E-mail around, and we went on some retreats. Eventually a new strategy coalesced, and we said, "Okay, here's what we're going to do; here's how we're going to measure ourselves internally; and here's what the world should think about what we're going to do."

That kind of crisis is going to come up every three or four years. You have to listen carefully to all the smart people in the company. That's why a company like ours has to attract a lot of people who think in different ways, it has to allow a lot of dissent, and then it has to recognize the right ideas and put some real energy behind them.

Which countries and companies are best prepared to take advantage of the information age that is revolutionizing society?

BUFFETT: When you think about it, 15 years ago this country almost had an inferiority complex about its ability to compete in the world.

GATES: Everybody was talking about how the Japanese had taken over consumer electronics and that the computer industry was going to be next, and that their system of hard work somehow was superior, and that we had to completely rethink what we were doing. Now, if you look at what's happened in personal computers or in business in general, or at how we allocate capital, and how we let labor move around, the U.S. has emerged in a very strong position. And so the first beneficiary of all this information technology has been the U.S.

In places like Singapore, Hong Kong, and the Scandinavian countries, people are adopting the technology at basically the same rate that we are. And there are a few countries that, relative to their level of income, are going after the technology at an even higher rate than we are because they believe so much in education. In Korea and in many parts of China we see incredible penetration of personal computers even at very low income levels, because people there have decided it's a tool to help their kids get ahead.

The whole world is going to benefit in a big way. There will be this shift where, instead of your income level being determined by what country you are from, it will be determined by your education level. Today, a Ph.D. in India doesn't make nearly as much as a Ph.D. in the U.S. When we get the Internet allowing services and advice to be transported as efficiently as goods are transported via shipping, then you'll get essentially open-market bidding for that engineer in India vs. an engineer here in the U.S. And that benefits everyone, because you're taking better advantage of those resources. So the developed countries will get the early benefit of these things. But in the long run, the people in developing countries who are lucky enough to get a good education should get absolutely the biggest boost from all this.

BUFFETT: I didn't grasp it at first, but it's huge. The technological revolution will change the world in dramatic ways, and quickly. Ironically, however, our approach to dealing with that is just the opposite of Bill's. I look for businesses in which I think I can predict what they're going to look like in ten or 15 or 20 years. That means businesses that will look more or less as they do today, except that they'll be larger and doing more business internationally.

So I focus on an absence of change. When I look at the Internet, for example, I try and figure out how an industry or a company can be hurt or changed by it, and then I avoid it. That doesn't mean I don't think there's a lot of money to be made from that change, I just don't think I'm the one to make a lot of money out of it.

Take Wrigley's chewing gum. I don't think the Internet is going to change how people are going to chew gum. Bill probably does. I don't think it's going to change the fact that Coke will be the drink of preference and will gain in per capita consumption around the world; I don't think it will change whether people shave or how they shave. So we are looking for the very predictable, and you won't find the very predictable in what Bill does. As a member of society, I applaud what he is doing, but as an investor, I keep a wary eye on it.

GATES: This is an area where I agree strongly with Warren. I think the multiples of technology stocks should be quite a bit lower than the multiples of stocks like Coke and Gillette, because we are subject to complete changes in the rules. I know very well that in the next ten years, if Microsoft is still a leader, we will have had to weather at least three crises.

4. See You in Court! Bill and Warren talk about tangling with trustbusters.

What is the appropriate role for antitrust law in American business?

BUFFETT: We had one civil antitrust case at the Buffalo Evening News in 1977. And believe it or not, in the Salomon situation in 1991, in addition to having problems with the Federal Reserve in New York, and the SEC, and the U.S. Treasury, and the U.S. Attorney for the Southern District of New York, we also had the Department of Justice antitrust division after us. I don't know what happened to the Bureau of Indian Affairs. They missed us for some reason. Those are the only two experiences I had, and in neither case did I feel that we had done anything wrong. I might add that there was never any adjudication against us either time.

I am no antitrust scholar. I met Bill eight years ago, and he's a terrific teacher. He spent six or seven hours explaining Microsoft to me. Here I am the world's biggest dummy on technology, and he explained it to me pretty darn well. When he got through with it, I bought a hundred shares of stock so I could keep track of it. That shows two things: One is that I've got an IQ of about 50, and the second is that I didn't think he had any monopoly.

GATES: The key role of competition law is to protect consumers and to make sure that new products get created and that those products are very innovative. And you can look at different sectors of the economy and ask, "where is that happening very well?" No matter how you score it, there's no doubt that one sector of economy would stand out as absolutely the best, and that's the personal computer industry. I don't say the computer industry at large, because you have to remember that before personal computers came along, the structure was very different. People were stuck. Once you bought a computer from Digital or IBM or Hewlett-Packard or anyone else, the software that you created only ran on that computer.

The vision of Microsoft was that all of these computers would work the same. The reason for that is that if you want to get a lot of great software, you have to have a lot of

computers out there--millions and millions of them. So you've got to make them cheap, and make them so you don't have to test the software on all the different ones. The goal of the PC industry was to have every company competing to make the most portable one, or the fastest one, or the cheapest one. That would be great for consumers, and it would spark a big software market.

The price of computing before the PC came along was going down at a certain rate, and since the PC came along it's gone down at an incredible rate. The variety and quality of software has also increased at a phenomenal rate. We're absolutely at the peak of that today. The number of new software companies being started, the number of new jobs being created, the level of investment, the number of companies going public, you name it. It's way beyond even what it was three years ago. So consumers are doing very well.

Part of the PC dynamic is that instead of asking software developers to duplicate one another's work, we take anything that's typical in all those applications and put those features in Windows. So for things like connecting to the Internet, instead of everybody having to do that themselves, we put that in. That's been the evolution--graphical user interfaces came in, hard-disk support, networking support, now Internet support, including the browser.

I think antitrust laws as written are fine. There are people who will debate whether they should be weaker, but that's of academic interest. When I come in to do business, I'm very careful to check with our lawyers to be sure we're steering a hundred miles away from anything that would be questionable. So it is somewhat of a surprise to find ourselves in an antitrust controversy. Thank goodness for the judiciary, which is an environment in which facts are tested and people can see if competition worked in the way it should and has been beneficial to consumers. There's no doubt in our minds where that is going to come out.

In the meantime, we're going to be the focus of a lot of controversy because the filing of a lawsuit is a very big deal. You've got the government taking on that challenge and saying a lot of righteous things, and that's just something we'll have to be sure doesn't distract us from what we're really all about.

5. What's a Company Really Worth? Warren explains why Berkshire stock costs more than a Lexus.

Mr. Buffett, I was told that you have a policy against splitting stock, and I wondered if you might comment on Microsoft's history of splitting stock?

BUFFETT: I've never really felt that if I went into a restaurant and said, "I want two hatchecks instead of one for my hat," I'd really be a lot better off. But I also don't have any quarrel with companies that do split their stock, and I don't think Microsoft's been hurt by it.

I think that our policy fits us very well. There's nothing in my religious upbringing that causes me to recoil from stock splits. I'm on the boards of three companies, two of which have split their stock in the last couple of years. I happen to think that by not splitting Berkshire stock, we attract a slightly more long-term-oriented group of investors. What you want to do is attract shareholders that are very much like you, with the same time horizons and expectations. We don't talk about quarterly earnings, we don't have an investor relations department, and we don't have conference calls with Wall Street analysts, because we don't want people who are focusing on what's going to happen next quarter or even next year. We want people to join us because they want to be with us until they die.

If I were to split the stock dramatically, would I change that shareholder composition much? No, but I'd change it just a little. And remember, all the shareholder seats are filled, just like this auditorium. If I say something that offends all of you, and you all leave and another group comes in, am I better off or worse off? Well, that depends upon what they're like and what you're like. But I think I already have a very good group of shareholders who are attracted to these policies, and I think this policy reinforces it slightly.

GATES: Warren has done something admirable by signaling to people that it's a "different stock" and that they ought to think of Berkshire Hathaway as being a little different from your typical company. Having that unusual stock price is probably a good thing, as long as the newspaper doesn't screw it up. He's caused a lot of problems, you know, with the widths of those columns in the stock tables.

Mr. Buffett, what's your response to those who say that traditional methods for valuing companies are obsolete in this market?

BUFFETT: I think it's hard to find companies that meet our tests of being undervalued in this market, but I don't think that the methods of valuation have changed. It's just that in some markets, like in the mid-1970s, every security you looked at was really dramatically undervalued.

I once ran an investment partnership for about 13 years, ending in 1969, and closed it up because I couldn't find anything. I hadn't lost the ability to value companies; there just weren't any left that were cheap enough, and I wasn't in the business of shorting stocks.

But I think that there's no magic to evaluating any financial asset. A financial asset means, by definition, that you lay out money now to get money back in the future. If every financial asset were valued properly, they would all sell at a price that reflected all of the cash that would be received from them forever until Judgment Day, discounted back to the present at the same interest rate. There wouldn't be any risk premium, because you'd know what coupons were printed on this "bond" between now and eternity. That method of valuation is exactly what should be used whether you're in 1974 or you're in 1998. If I can't do that, then I don't buy. So I'll wait.

Would you look for a higher price-to-earnings ratio at this point than you did in 1969?

BUFFETT: That ratio would be affected by interest rates. The difference between now and 1969 or any other time, in terms of calculating a valuation, wouldn't be affected by anything else. Now, if you looked at the overall market, returns on equity are much higher than they were in 1969 or 1974, or any other time in history. So if you're going to say you're going to value the overall market, the question becomes: "Do you crank in the present 20% returns on equity for American business in aggregate, and say that's a realistic figure to stick on for this future that runs out until eternity?" I'd say that's a fairly reckless assumption and doesn't leave much margin of safety. And I would say that present market levels discount a lot of that, and so that makes me quite cautious.

Do you feel that technology has made businesses more efficient to the point that you can pay more for them?

GATES: There's definitely a one-time lift when you start using technology, and particularly if U.S. companies are using it better than their competitors outside the U.S. You get the ability to communicate better, and you get global scale in a lot of businesses that wouldn't have had it before.

When you look at the really big earners, the ones generating this 20% return on equity and going to that worldwide marketplace--companies like Coca-Cola or Microsoft or Boeing or GE--I know that every one of those has been helped by technology. But that cannot explain why ten years from now they'd be getting that kind of return on equity. Almost certainly there's something ephemeral about current conditions.

BUFFETT: I'm sure technology has made companies more efficient, and if I thought otherwise, I'd be afraid to say so with Bill sitting right here beside me. But the question you might ponder is this: Let's just say that I found a way to clone Jack Welch, and ran off 499 clones of him. Jack continued to run General Electric, and these other 499 ran the rest of the FORTUNE 500. Is the FORTUNE 500 going to have a higher return on equity five years from now or not?

I don't think the answer to that is easy. Because if you get 500 Jack Welches out there, they are going to be doing things in a competitive way that may well produce lower returns for American business than if you've got a bunch of clods out there and a guy like Jack competing with them. If you've got great variation in the quality of management, it improves the chances enormously of a relatively significant number getting terrific returns.

So I would say that a lot of things in business, including technology, really have the same effect as if you went to a parade and the band started coming down the street and all of a sudden you stood up on tiptoe. In another 30 seconds everybody else is on tiptoe, and it would be hell on your legs and you still wouldn't be seeing any better.

Capitalism tends to be self-neutralizing like that in terms of improvements. That's marvelous because it means we have better everything than otherwise. But the real trick is to stand up on tiptoe and not have anyone notice you.

The recent wave of mergers has been staggering. Could you comment on how any of these mergers will create value for shareholders?

BUFFETT: Actually, the two of us have a small announcement we would like to make... [laughter].

It won't stop. Mergers will be motivated by very good considerations. There truly are synergies in a great many mergers. But whether there are synergies or not, they are going to keep happening. You don't get to be the CEO of a big company by being a milquetoast. You are not devoid of animal spirits. And it gets contagious. I've been a director of 19 different public companies over the years, and I can tell you that the conversation turns to acquisitions and mergers much more when the competitors of the particular company are engaging in those. As long as our economy works the way it does--and I think it works very well--you're going to see a lot of it. A generally buoyant market tends to encourage mergers, because everybody's currency is more useful in those circumstances. [A few weeks later, Berkshire Hathaway agreed to pay \$23.5 billion in stock to acquire General Re, the world's third-largest reinsurance company.]

GATES: I think it's good to have a healthy skepticism. But General Motors was created out of a restructuring of the automobile industry from a specialized orientation to companies that did the whole job. And anybody who missed that was basically wiped out.

We've bought a lot of small companies, and I'd say that's been vital to us. These are companies that on their own probably wouldn't have made it, but when their abilities are combined with ours, both of us were able to create a much better set of products than we could've otherwise.

I think in banking today, if you're a medium-sized bank, you're probably going to need to participate in all this stuff that's going on. It doesn't make that much sense to have so many banks in this country, and so there will be certain ones going after scale. But there are a lot of silly mergers too.

At the end of the day, is the shareholder better off after a merger?

BUFFETT: In most acquisitions, it's better to be the target than the acquirer. The acquirer pays for the fact that he gets to haul back to his cave the carcass of the conquered animal.

I am suspicious of people who just keep acquiring almost by the week, though. If you look at the outstanding companies--say, a Microsoft or an Intel or a Wal-Mart--their growth overwhelmingly has been internal. Frequently, if some company is on a real acquisition binge, they feel they're using funny money, and it has certain aspects of a chain-letter game.

Beyond that, I'd like to see a period where merged companies just run by themselves after a deal, rather than moving around the accounting and putting up big restructuring charges. I get suspicious when there's too much activity. I like to see organic growth.

6. Aw, Shucks! Warren and Bill muse on their mistakes, their business partners, and managerial succession.

What was the best business decision you made?

BUFFETT: It was just jumping in the pool, basically. The nice thing about the investment business is that you don't need very many deals to succeed. In fact, if when you got out of business school here, you got a punch card with 20 punches on it, and every time you made an investment decision you used up one punch, and that's all you were going to get, you would make 20 very good investment decisions. And you could get very rich, incidentally. You don't need 50 good ideas at all.

I hope the one I made yesterday was a good one. But they've always been kind of simple and obvious to me. The truth is, you know them when you see them. They're so cheap. When I got out of Columbia University, I went through the Moody's manuals page by page--the industrial manual, the transportation manual, the banks and finance manual--just looking for things. And I found stocks at one times earnings. One was Genessee Valley Gas, a little tiny company up in upstate New York, a public utility selling at one times earnings. There were no brokerage reports on it, no nothing, but all you had to do was turn the page. It worked out so well I actually went through the book a second time. Bill was reading the World Book at that time. He's since put it out of business.

GATES: We were talking at breakfast this morning about which of all Warren's investment decisions was the worst one. They're tough to find because his track record is unbelievable. But we decided that, by some metric, buying the one that his company is named after--Berkshire Hathaway--was probably his worst investment decision.

BUFFETT: That's true. We went into a terrible business because it was cheap. It's what I refer to as the "used cigar butt" approach to investing. You see this cigar butt down there, it's soggy and terrible, but there's one puff left, and it's free. That's what Berkshire was when we bought it--it was selling below working capital--but it was a terrible, terrible mistake.

I've made all kinds of bad decisions that have cost us billions of dollars. They've been mistakes of omission rather than commission. I don't worry about not buying Microsoft, though, because I didn't understand that business. And I didn't understand Intel. But there are businesses that I did understand--Fannie Mae was one that was within my circle of competence. I made a decision to buy it, and I just didn't execute. We would've made many billions of dollars. But we didn't do it. Conventional accounting doesn't record that, but believe me, it happened.

GATES: In my case, I'd have to say my best business decisions have had to do with picking people. Deciding to go into business with Paul Allen is probably at the top of the list, and subsequently, hiring a friend--Steve Ballmer--who has been my primary business partner ever since. It's important to have someone who you totally trust, who is totally committed, who shares your vision, and yet who has a little bit different set of skills and who also acts as something of a check on you. Some of the ideas you run by him, you know he's going to say, "Hey, wait a minute, have you thought about this and that?" The benefit of sparking off somebody who's got that kind of brilliance is that it not only makes business more fun, but it really leads to a lot of success.

BUFFETT: I've had a partner like that--Charlie Munger--for a lot of years, and it does for me exactly what Bill is talking about. You have to calibrate with Charlie, though, because Charlie says everything I do is dumb. If he says it's really dumb, I know it is, but if he just says it's dumb, I take that as an affirmative vote.

It seems that in both of your companies, your success is driven by yourselves and your leadership skills. What will happen when you're gone?

BUFFETT: Your assumption is wrong. I will keep working until about five years after I die, and I've given the directors a Ouija board so they can keep in touch. But if the Ouija board doesn't work, we have outstanding people who can do what I do. People are not going to stop drinking Coca-Cola if I die tonight, they're not going to quit shaving tonight, they're not going to eat less See's candy, or fewer Dilly Bars, or anything of the sort. Those companies have terrific products, they've got outstanding managers, and all you'll need at the top of Berkshire is someone who can allocate capital and make sure you have the right managers down below. We've got the people identified to do that, and the board of directors of Berkshire knows who they are.

In fact, I've already sent out a letter that tells what should be done, and I've got another letter that's addressed that will go out at the time, and it starts out, "Yesterday I died," and then tells what the plans of the company are.

GATES: My attitude is a lot like Warren's. I want to keep doing what I'm doing for a long, long time. I think probably a decade from now or so, even though I'll still be totally involved with Microsoft because it's my career, I will pick somebody else to be CEO.

BUFFETT: I see some hands in the audience here.

GATES: That's a long time hence, and our top managers are always sitting down and talking about succession in general, because we want to make sure that we're giving people the opportunity to move up. We don't want to ever create a situation where they feel like it's clogged and they have to go off somewhere else to get big challenges. Our growth helps a lot. We're able to spawn off very, very big jobs for people. Picking that next person is something I give a lot of thought to, but it's probably five years before I have to do something very concrete about it. If there was a surprise, well, there's a contingency plan.

7. Charity Begins When I'm Ready Bill and Warren explain why they'll give away 99% of their wealth... someday.

As two of the world's most successful business people, what role do you see for yourselves in giving back to your communities? And how do you use your influence to get others to give back as well?

BUFFETT: We both have a similar philosophy on that. I know in my own case that 99%-plus will go back to society, just because we've been treated extraordinarily well by society.

I'm lucky. I don't run very fast, but I'm wired in a particular way that I thrive in a big capitalist economy with a lot of action. I'm not adapted for football, I'm not adapted for violin playing. I happen to be in something that pays off huge in this society. As Bill says, if I had been born some time ago I would've been some animal's lunch.

I do not believe in the divine right of the womb. Frankly, I don't think it's right that the quarterback of the Nebraska football team next year should be the eldest son of the quarterback of the Nebraska football team of 22 years ago. Nor do I think that our Olympic team in 2000 should be chosen from the same family that was on the Olympic team in the various respective sports in 1976.

We believe in a meritocracy when it comes to athletics and all sorts of things. Now, why not have a meritocracy in terms of what you go out into the world with in terms of the productive goods? Let the resources flow to those who use them best, and then I believe they should give them back to society when they get through.

GATES: That's a great philosophy, not to mention that passing along a lot of money can be bad for the people who receive it.

BUFFETT: You'd better not put it to a vote.

How do you use your role as successful businessmen in influencing others, even those who are not as successful, to give back?

BUFFETT: Let me suggest another way to think about this. Let's say that it was 24 hours before you were born, and a genie appeared and said, "You look like a winner. I have enormous confidence in you, and what I'm going to do is let you set the rules of the society into which you will be born. You can set the economic rules and the social rules, and whatever rules you set will apply during your lifetime and your children's lifetimes."

And you'll say, "Well, that's nice, but what's the catch?"

And the genie says, "Here's the catch. You don't know if you're going to be born rich or poor, white or black, male or female, able-bodied or infirm, intelligent or retarded." So all

you know is that you're going to get one ball out of a barrel with, say, 5.8 billion balls in it. You're going to participate in what I call the ovarian lottery. It's the most important thing that will happen to you in your life, but you have no control over it. It's going to determine far more than your grades at school or anything else that happens to you.

Now, what rules do you want to have? I'm not going to tell you the rules, and nobody will tell you; you have to make them up for yourself. But they will affect how you think about what you do in your will and things of that sort. That's because you're going to want to have a system that turns out more and more goods and services. You've got a great quantity of people out there, and you want them to live pretty well, and you want your kids to live better than you did, and you want your grandchildren to live better than your kids. You're going to want a system that keeps Bill Gates and Andy Grove and Jack Welch working long, long after they don't need to work. You're going to want the most able people working more than 12 hours a day. So you've got to have a system that gives them an incentive to turn out the goods and services.

But you're also going to want a system that takes care of the bad balls, the ones that aren't lucky. If you have a system that is turning out enough goods and services, you can take care of them. You don't want people worrying about being sick in their old age, or fearful about going home at night. You want a system where people are free of fear to some extent.

So you'll try to design something, assuming you have the goods and services to solve that sort of thing. You'll want equality of opportunity--namely a good public school system--to make you feel that every piece of talent out there will get the same shot at contributing. And your tax system will follow from your reasoning on that. And what you do with the money you make is another thing to think about. As you work through that, everybody comes up with something a little different. I just suggest you play that little game.

How do you see yourselves as leaders in facets of human experience other than business?

GATES: You have to be careful, if you're good at something, to make sure you don't think you're good at other things that you aren't necessarily so good at. I come in every day and work with a great team of people who are trying to figure out how to make great software, listening to the feedback and doing the research. And it's very typical that because I've been very successful at that, people come in and expect that I have wisdom about topics that I don't.

I do think there are some ways that we've run the company--the way we've hired people, and created an environment and used stock options--that would be good lessons for other businesses as well. But I always want to be careful not to suggest that we've found the solutions to all problems.

BUFFETT: You can learn a lot by studying Microsoft and Bill. And you can learn the most by studying what it is he does year after year. But if he devoted 5% or 10% to what

he's now doing, and then spread the remainder of his attention over a bunch of other things, well, society would be worse off, in my view.

Bill's right, occasionally there are things--like campaign finance reform--that he may want to take a position on. But you still don't want to say that the whole world ought to follow you on it. I'm very suspect of the person who is very good at one business--it also could be a good athlete or a good entertainer--who starts thinking they should tell the world how to behave on everything. For us to think that just because we made a lot of money, we're going to be better at giving advice on every subject--well, that's just crazy.

Having fielded their last question, the two billionaires briefly acknowledged the applause and bolted off the stage, leaving behind an audience that clearly would have relished another two hours of them. But no. Practically before the applause had died down, the two had jumped into Gates' Lexus and sped off. After all, they had a bridge game to play.