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Berkshire Hathaway's Massachusetts Roots

By Adam J. Mead

Warren Buffett has been the public face of Berkshire Hathaway for six decades, and Omaha has long since become the company's spiritual home. But the name on the letterhead, and the history underneath it, belongs to Massachusetts. Long before it was an insurance and investment conglomerate, Berkshire Hathaway was a New England textile company, and its predecessor mills trace back to the earliest days of American manufacturing.

What gave rise to those textile companies and the industry itself is fascinating and instructive. Samuel Slater brought the first water-powered textile mill to the United States in 1789. Slater snuck out of England with the know-how to build a viable water-powered mill and did so with financial backers in Pawtucket, Rhode Island. By 1809, there were 27 Slater-type mills in New England.

The next major innovation was financial and operational. Francis Cabot Lowell, a wealthy Boston merchant, used a joint-stock corporation to create the Boston Manufacturing Company in 1813. He was the first to integrate his mills, the first of which was in Waltham, Massachusetts. It housed all operations needed to turn raw cotton into finished cloth. The mills were profitable almost immediately. Lowell had thus discovered the optimal combination of size and integration to generate economies of scale out of the cotton mill. Not surprisingly, this innovation spread rapidly.

Having wrested all the power they could out of the Charles River in Waltham, the investors in the Boston Manufacturing Company, sometimes referred to as the Boston Associates, turned their sights on a new location. They chose a site on the Merrimack River in what was East Chelmsford, Massachusetts, and formed the Merrimack Manufacturing Company. In Lowell, the company was more than just mills; it was a company town that by the 1840s employed more than 8,000 people. They used the surrounding farmland to build boardinghouses, churches, company stores and other infrastructure for the many workers required to operate the mills. Many of the workers were women.

The early mills in the United States were thousands of miles from cotton fields, which raises a key question: why develop the textile industry in the North? In short, the South did not find it immediately economical to do so, and the North had some distinct advantages, at least at first. Two initial northern advantages were access to capital and a cheap power source.

Availability of capital was possibly the deciding factor as to why the textile industry first took hold in the Northeast. When Lowell formed the Boston Manufacturing Company, he was already a successful businessman. He and his Boston Associates had access to capital from the whaling business. By the mid-1800s, a large store of capital accumulated during the boom times of whaling was unleashed as whaling declined and the textile business grew.

Other early advantages of the North were geographic. New England has many strong-flowing rivers that unleashed vast

Textile worker in the Berkshire Cotton Mills, 1916.

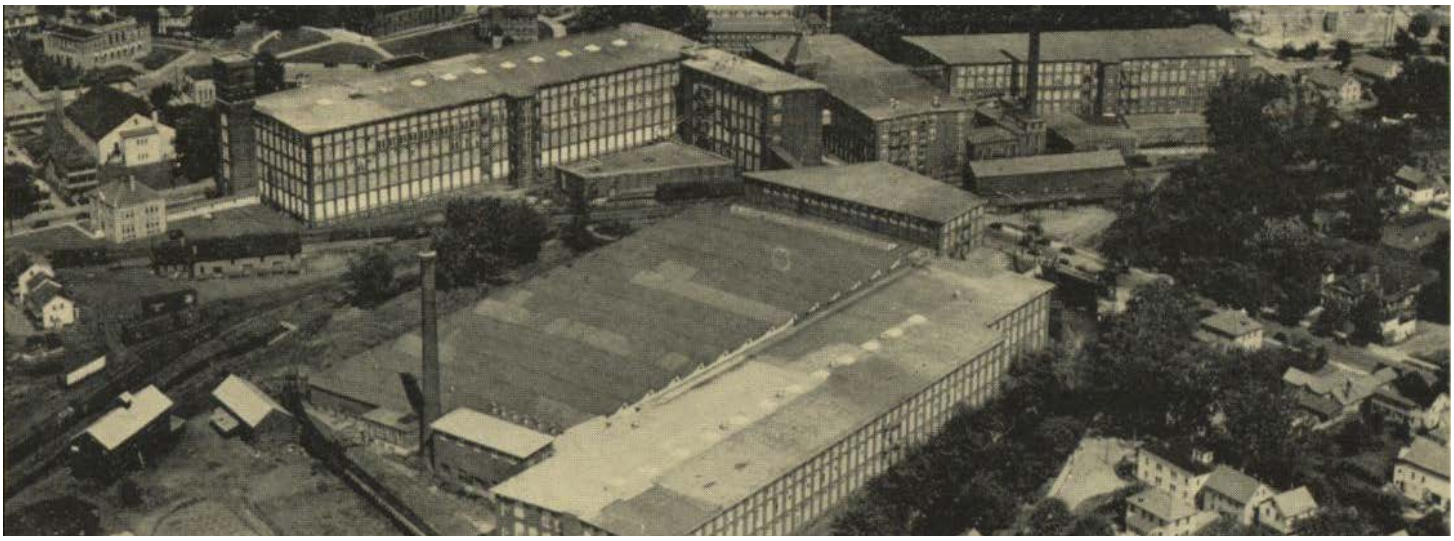


Photo of a Berkshire Fine Spinning Associates, Inc. factory in Adams, Massachusetts, from their 1944 annual report to shareholders.

amounts of power as they descended to the ocean. These rivers also provided a convenient means of transporting goods to and from the mills. The proximity to New York City, known as the fashion capital, may also have played a part, since the Northeast knew sooner which products were most popular. After all, information travelled much more slowly then.

According to *The Decline of a Textile City: A Study of New Bedford*, "the New England region obtained a virtual monopoly" in textiles, with 70% of the active spindles in the United States housed there. By 1880, New England boasted more than 80% of active spindles. This would prove to be the height of success for New England textile manufacturing. It would only go down from there.

The oldest predecessor company with identifiable direct connections to the Berkshire Hathaway of today is the Valley Falls Company, formed by Oliver Chace in 1839. The Chace family built a textile empire that brought prosperity to the villages of Cumberland and Central Falls, Rhode Island, as the family built and expanded its mills along the river.

In 1929, five companies, including Valley Falls, merged to form Berkshire Fine Spinning Associates, Inc. The other four were Coventry Co., formed in 1864 in Coventry, Rhode Island; Greylock Mills, formed in 1880 in Pittsfield, Massachusetts; Fort Dummer Mills, formed in 1910 in Brattleboro, Vermont; and Berkshire Cotton Manufacturing Company, formed in 1889 in Adams, Massachusetts. Berkshire Cotton Manufacturing was the largest of the five, so the new entity was named Berkshire Fine Spinning Associates, Inc.

The history of the Hathaway side of Berkshire Hathaway is more straightforward. It was formed in 1888 at the height of textile manufacturing in New England, incorporated in 1889 in New Bedford, Massachusetts, and operated independently until the 1955 merger with Berkshire Fine Spinning. Hathaway was formed with $400,000 of initial capital from Horatio Hathaway and several partners looking for their next business venture after the decline of New Bedford's sperm whaling industry, according to filings with the Massachusetts Secretary of State. One of those partners was Hetty Green, the rich heiress to a New Bedford shipping fortune.

The two Berkshire Hathaway predecessor companies, Berkshire Fine Spinning and Hathaway Manufacturing, operated on parallel tracks throughout the 1930s. They largely faced the same struggles as New England-based textile manufacturers, including the relentless march south and the growing influence of overseas competition.

The Great Depression in the 1930s acutely affected New England textile manufacturers. The mills that had survived that far had largely done so by shifting production away from coarser goods and toward the finer textiles that the South had not yet mastered. The Great Depression softened demand for these higher-priced discretionary fine goods. Many mills saw production of such fine goods fall by over 50%, while volumes of coarser-grade staples fell less than 1%.

Since material costs for cotton and its substitutes were largely market-driven, mill owners looked to the next largest cost: wages. Workers responded with strikes and walkouts, including the Uprising of '34, in which a general textile strike impacted the entire industry. During the uprising, 500,000 mill laborers walked off the job. With the implementation of the Fair Labor Standards Act of 1938, a standard uniform wage nationwide mitigated the labor differential between the North and the South. The North rejoiced, but it was bittersweet, since the legislation came too late. As described in *The Decline of a Textile City*, the new law could not "bring back mills which were already liquidated, whose machinery was sold at auction, and whose buildings had been torn down." Just in New Bedford, Massachusetts, 20 mills went out of business between 1930 and 1939.

The difficult operating conditions of the northern textile mills in the 1930s likely would have continued unabated throughout the 1940s if it weren't for one major event. World War II created a temporary boom for the entire textile industry and offered the remaining mills in the North a brief flash of extreme profitability. The war effort required an immense production of textiles for military use, including powder bags, camouflage cloths, ponchos and mosquito netting. The large-scale use of parachutes in the war required production of nylon, a relatively new material that was both lightweight and strong. The textile mills were initially hesitant to commit to large-scale production. It was only after Berkshire Fine Spinning made a large

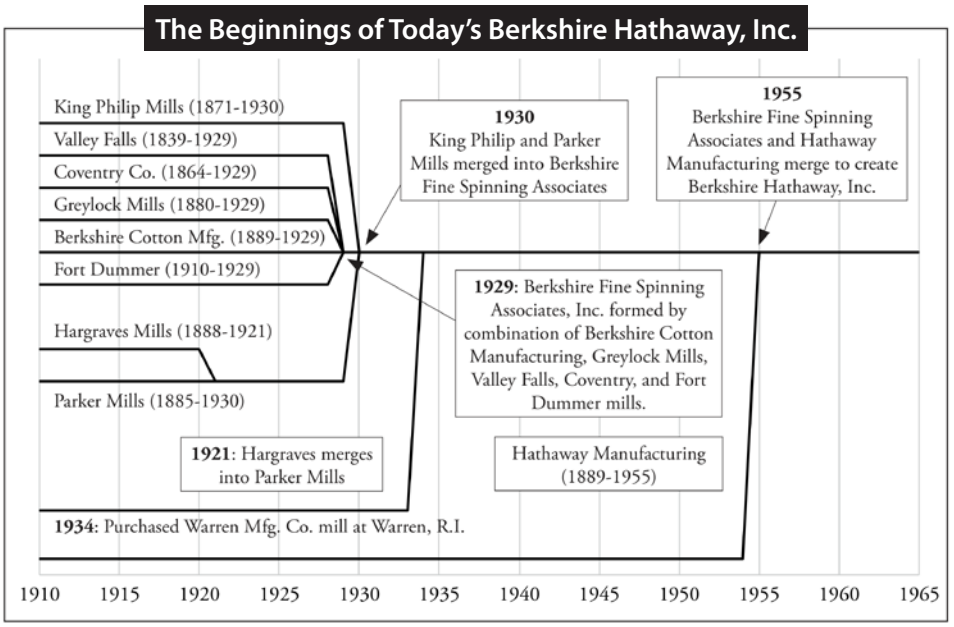
commitment that other mills followed suit. Berkshire Fine Spinning alone produced five million yards of nylon fabric for the war effort, and it and others found a new outlet for their many languishing spindles and looms.

The final merger that would impart the name on today's modern conglomerate occurred in 1955, when Berkshire Fine Spinning merged with Hathaway Manufacturing. The merger resulted primarily from continued relentless industry pressures. But it was set in motion by a flooding of the Hathaway Mill on Cove Street in New Bedford, Massachusetts, which was significantly damaged by Hurricane Carol in September 1954. Eager to remain in business, Seabury Stanton, Hathaway's leader, pursued a merger with Berkshire Fine Spinning. The merger was finalized on March 14, 1955.

Leading the new enterprise were John H. McMahon as chairman of the board, Seabury Stanton as vice chair and Malcolm G. Chace, Jr. as president. The managers were upbeat, writing in the first annual report in 1955, "The purpose of the combination of the two companies was to effect operating economies and greater diversification of products for each. The new Company can now supply the market not only with plain fine combed cotton goods, but also with fancy colored box loom fabrics and with rayon, nylon, dacron and other synthetic fabrics."

That optimism proved short-lived. Shortly after the merger, in July of that year, a strike caused a 13-week shutdown. The next month, Hurricane Diane severely damaged several plants in Rhode Island. These early episodes would set the stage for the many troubles and tough decisions that would be faced during the ensuing decade. The many corporate mergers that occurred prior to the formation of the combined Berkshire Hathaway, Inc. created a textile conglomerate. The business had locations throughout New England and was quite large, with combined revenues of over $65 million in 1955.

Aside from the acquisition of Bourne Mills in 1956, management acted rationally in shrinking the business over the following decade, rather than continuing to acquire other mills in hopes of finding ever-elusive synergies. Over the 10 years ended in 1964, a net of $22.3 million, or about 42% of shareholders' equity from the beginning of the period, was sent to shareholders in the form of dividends and share repurchases, leaving the company with $22.1 million of equity by 1964.



Sources: Moody's Manual reports and Massachusetts Corporate Card Files accessed via the Boston Public Library.

Warren Buffett gained control of Berkshire Hathaway a decade later, in 1965. Ten years after that, he made an addition to the textile group rather than another subtraction. During 1975, Berkshire acquired Waumbec Mills and Waumbec Dyeing and Finishing Co. in Manchester, New Hampshire. On April 28, 1975, Berkshire purchased the company for $1.7 million, partially funding the purchase with $1.15 million of promissory notes issued by Berkshire at the parent company level. This followed a decade where Berkshire reduced production or sold off certain textile manufacturing locations. So why buy Waumbec?

Buying a company in a dying industry doesn't make sense on the face of it, but a few factors likely influenced the decision. First, Waumbec was like Berkshire's existing Home Fabrics division and focused on the more profitable finished woven products, primarily drapery and apparel. Buffett thought it could complement Berkshire's existing operations. Next, the purchase appealed to Buffett's instinct to acquire bargains. The purchase price for Waumbec was below book value, reflecting its diminished economic position. In the notes to the financial statements in Berkshire's annual report for 1975, a disclosure is made: to balance the purchase price against the book value of the company, no net property, plant and equipment was carried on the consolidated financials.

The below-book value purchase price was a result of Waumbec's weak operating results. Waumbec was operating 55% of its looms at 50% of operating capacity.

There was a dark spot among the good news in 1976, and unsurprisingly, it was in textiles. Returns on revenues and on capital were back to trend and inadequate. The Waumbec Mill, acquired only a year earlier, was not pulling its weight. The entire group continued a long slide into economic oblivion. Still, Buffett believed "reasonable returns on average are possible." He told shareholders that the Textile Group was an important source of employment in New Bedford, Massachusetts and Manchester, New Hampshire.

By 1977, Berkshire remained in textiles despite its shrinking size and dismal prospects. Of its $379 million of identifiable assets at year-end 1977, just $22 million were in the textile division. Still, Buffett put himself in the shoes of a minority shareholder and asked the question: why was Berkshire continuing to operate the Textile Group when it seemed to present nothing but problems, and where opportunities clearly existed to redirect the capital elsewhere? Among his reasons: "Our mills in both New Bedford and Manchester are among the largest employers in each town, utilizing a labor force of high average age possessing relatively non-transferable skills. Our workers and unions



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Berkshire Hathaway specimen certificate. This zero-coupon convertible subordinated note raised $390 million, net, at an implied interest rate of 5.5%. The conversion implied a price-to-book ratio of 2.3x.

have exhibited unusual understanding and effort in cooperating with management to achieve a cost structure and product mix which might allow us to maintain a viable operation." The fate of textiles was coming, but not for several more years.

Reflecting on the past, Buffett considered buying control of Berkshire a colossal mistake. It led his original partnership investors, himself included, to give up a fraction of the ownership of much better businesses acquired through Berkshire, rather than buy them through another entity. And that was to say nothing of the now two decades of frustrations watching an industry decline into oblivion. As Buffett put it, the unpleasant job of shuttering the remnants of Berkshire's past was largely completed by July 1985. He was sympathetic to the managers and employees associated with the textile operations, but in the end economics won out. Berkshire couldn't remain in a competitively disadvantaged business that required ongoing capital investment at sub-par returns.

The figures were unambiguous. Over the nine years prior to Buffett's involvement, Berkshire Hathaway was entirely engaged in textile manufacturing. During that time, it lost $10 million on total revenues of $530 million. By comparison, See's Candies earned $2 million on revenues of $31 million the first year it was purchased.

Although textiles did deliver some profits in the 1960s, they were not adequate compared to the capital required to produce them. As the years wore on and the competitive disadvantages accrued, it became obvious that the business was not viable.

Buffett praised the division's managers, Ken Chace and Garry Morrison, as "resourceful, energetic and imaginative" in their efforts to operate the Textile Group profitably. The textile business failed not because of them, but despite their monumental efforts. Berkshire's employees and their unions were praised too, for accepting below-average wages and understanding the economic position of their employer. Even after the decision to liquidate the mills was made, both management and the employee base performed superbly, said Buffett.

Buffett summed up his predicament in allowing the mills to operate at sub-par levels for so long:

> I won't close down businesses of sub-normal profitability merely to add a fraction of a point to our corporate rate of return. However, I also feel it inappropriate for even an exceptionally profitable company to fund an operation once it appears to have unending losses in prospect. Adam Smith would disagree with my first proposition, and Karl Marx would disagree with my second; the middle ground is the only position that leaves me comfortable.

Buffett communicated his position to shareholders in the past by reminding them that Berkshire's textile workers were largely older and possessed almost no skills outside of textile manufacturing. Many were also foreign-born and spoke very little English and would have been severely hurt by closure of the mills. Many were hurt with the 1985 mill closure, but Buffett could at least point to efforts to cushion the blow. Equipment of enormous importance in prior years was rendered economically useless over time by the onslaught of competitive pressures. In the end it was sold for almost nothing: machinery that had originally cost $13 million, and that would have cost $30 to $50 million to replace in 1985, was carried on the books at a mere $866,000 and ultimately sold for liquidation proceeds of just $163,000.

Berkshire's shareholders would surely have faced the same agonizing decline if it weren't for the arrival of Warren Buffett and his capital allocation skills. With the aid of Chace, Morrison and the employees of the textile operations, Berkshire slowly reduced its investment in textiles. Monies raised by selling off plant and equipment, and shrinking investments in receivables and inventories, were recycled into more profitable investments in operating businesses—such as National Indemnity and Illinois National Bank—and into marketable securities.

The liquidation of the textile operations in 1985 and 1986 was the end of an era. What began as an association with the country's first mill operators and continued for almost two centuries in various forms ended with a money-losing fire sale. Although its original business of textiles was no longer part of the picture, the story of those who built Berkshire Hathaway will always have a place in history because of Warren Buffett, and because of the Massachusetts mills that gave the company its name. $

Adam Mead is the CEO and chief investment officer of Mead Capital Management and the founder of Watchlist Investing. He lives in Derry, New Hampshire. This article has been adapted and condensed, with the author's permission, from The Complete Financial History of Berkshire Hathaway *(Harriman House, 2026). The text has been lightly edited for length, clarity and continuity.*