

Buffett bought Mrs B's store without an audit. Her record was the audit

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Maxim: *Back honest, capable managers.* — Warren Buffett, in substance

When you buy a share, you hand your money to people you will never meet. How they behave matters as much as what they sell.

A cheap share in a business run by the wrong people is not a bargain; it is a bet on strangers you have no reason to trust.

In 1983 Warren Buffett bought 90% of an Omaha furniture store, leaving the rest with the family that ran it. By his own account in Berkshire Hathaway's [1983 letter](#), the founder, Rose Blumkin, had sold used clothing for years and in 1937 opened the store with \$500 she had saved. Nearly half a century later, Nebraska Furniture Mart was selling more than \$100 million of furniture a year from a single store.

What Buffett did not do is the striking part. He did not audit the inventory or the books; the deal was a one-page handshake agreement, according to [Wikipedia's account of the company](#). He relied instead on what he had seen of the business as a shopper and on decades of the family's record. "They buy brilliantly, they operate at expense ratios competitors don't even dream about," he wrote, adding that he would "rather wrestle grizzlies than compete with Mrs. B and her progeny."

Mrs B was then about 90. The story had one more turn. In 1989, at 95, her family eased her into retirement; three months later she opened a rival outlet across the street, because Buffett had never asked her to sign a non-compete. The outlet was soon profitable, and Berkshire ended up buying that business too. She died in 1998, aged 104.

Few investors will ever shake hands with a founder. But the principle behind the handshake applies to anyone who buys a share: the record of the people in charge is often the most important document you can read.

Buffett's four tests, and why the third matters most

Buffett set out his checklist plainly in his 1977 letter, as quoted by [The Motley Fool](#). Berkshire wanted a business "(1) that we can understand; (2) with favorable long-term prospects; (3) operated by honest and competent people; and (4) available at a very attractive price."

The third test is the hardest to measure and the easiest to skip. Price is on the screen. Prospects can be argued over. Honesty and competence must be inferred from behaviour over years. Yet it is the test that protects the other three: an attractive price is worthless if the numbers behind it are false, and good prospects are worthless if the gains are diverted.

Honesty and competence are also different things, and an investor needs both. A capable manager without integrity can be the most dangerous combination, because the numbers will look good until the day they don't. An honest manager without ability will simply lose the money more slowly.

What the warning signs looked like

Indian markets have a well-documented case of what happens when the third test fails. In May 2018, Deloitte quit midway through its audit of Manpasand Beverages, a listed juice maker, citing transparency issues, and the stock fell 20% to its lower circuit, [The Quint](#) reported.

A year later, in May 2019, GST officials searched the company over an alleged network of about 30 dummy firms used to claim fraudulent tax credit, with evasion put at ₹40 crore. A whole-time director, his brother and the chief financial officer were held in judicial custody, and the shares again hit the lower circuit. The next auditor, Mehra Goel & Co, also resigned in the light of the investigation, [Moneylife](#) reported.

The point is not hindsight. The point is that the first public warning came a full year before the arrests, and it came from the one outsider with access to the books. An auditor walking away is not proof of fraud, but it is a signal no investor should explain away.

That signal is now easier to read. Since a [Sebi circular](#) of 18 October 2019, an auditor of a listed company who resigns must, in most cases, first finish the pending quarterly review, raise concerns with the audit committee, and give detailed reasons that the company must disclose to the stock exchanges within 24 hours.

How to judge people you will never meet

You cannot interview the chairman, but you can read what management has written and done. Five questions do most of the work:

1. **Do they explain bad news plainly?** Read two or three years of annual reports and results commentary. Honest managers describe mistakes and weak quarters in the same voice as good ones; evasive ones bury them in adjectives.
2. **Did they do what they said?** Compare targets and promises from earlier years with what happened. A record of missed guidance with new excuses each time tells you more than any presentation.
3. **Who else gets paid from the company?** Check related-party transactions in the annual report. Large, growing payments to firms owned by promoters or their relatives deserve a clear explanation.
4. **How secure is their own stake?** Look up promoter holding and pledged shares in the quarterly shareholding pattern on NSE or BSE. A rising pledge can force sales at the worst moment.
5. **What do the gatekeepers say?** Read the auditor's report for qualifications, and treat any auditor resignation, and the reasons now disclosed with it, as a reason to stop and investigate.

A simple decision rule. Treat management as a filter, not a factor to be traded off against price. If the answers to these questions leave you uneasy, no valuation should be low enough to tempt you, because the numbers you would be valuing may not be reliable. If the answers are reassuring, you still need Buffett's other three tests. Revisit the questions every results season, because people and incentives change, and the first warnings usually arrive quietly, in a footnote or a short exchange filing, long before the headlines.

Buffett could skip the audit with Mrs B because her record had already done the auditing for him: decades of low prices, satisfied customers and plain dealing. Ordinary investors do not get

handshakes, but they do get the record, in annual reports, filings and the behaviour of the people who sign them. Read it as carefully as the balance sheet. The business you buy is only as trustworthy as the people who run it.

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