Fall 1997

Wharton

ALUMNI MAGAZINE

THE BUSINESS OF BLOCKBUSTERS:

Hits and Misses in the Movie Industry

The Wharton School
University of Pennsylvania

global.wharton.connections

classes of

1993
1988
1983
1978
1973
1968
1963

Networks

Wharton #1

Executive Education Sessions
Alumni/Faculty Exchanges
The Dean's Wharton Town Meeting
Picnic on the Quad
Class parties

technologies

ideas

Wharton alumni reunion 98

Friday, May 15
Saturday, May 16
Sunday, May 17

fun

careers

You should have received your first Reunion information mailing. The Reunion Directory, a newsletter and additional Weekend scheduling will be sent to you this winter.

If you have not received any materials, please contact the Alumni Affairs office at 215.898.8478 or fax us at 215.898.2695.

Our e-mail address is *alumni.affairs@wharton.upenn.edu.* Look for our web site this fall at *http://www.wharton.upenn.edu*

5th Asian Regional Alumni Meeting

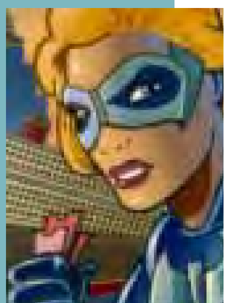
Taipei, Taiwan, R.O.C.
June 12-13, 1998

For preliminary information, contact
Injay W. Tai
B: 886.2.364.1960
F: 886.2.369.6780

Wharton
ALUMNI MAGAZINE

Fall 1997

Cover Article



Last summer, studios released close to a dozen films with budgets of $100 million or more. Is that too many movies at too high a cost? Grab your popcorn and settle back in your seats for our full-length feature, "The Business of Blockbusters."

Illustration by Michael Rogalski 8

Features

Departments

Editorial Staff

Editor
Robbie W. Shell

Staff Writers
Tom McMahon
Mike Baltes

Editorial Assistant
Dorothy Gillam

Design
Warkulwiz Design Associates

Editorial Office
344 Vance Hall, 3733 Spruce St.
Philadelphia, PA 19104 (215) 898-8478
Fax (215) 898-2695
alumni.affairs@wharton.upenn.edu
URL address: http://www.wharton.upenn.edu/alum_mag/alum_mag.html

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Dean and Reliance Professor of Management and Private Enterprise

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Partnering with the Community

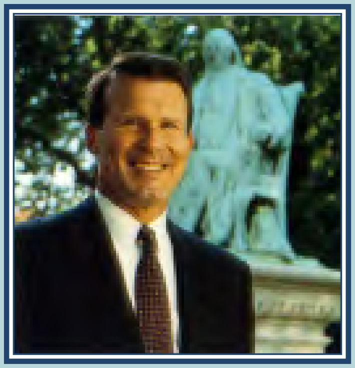
No business operates in a vacuum. It is part of a community that is home to its employees and its customers, and in which it has a meaningful stake. And as a result, business leaders have an important responsibility to their communities. The very best in business leadership today and in the future will be in those companies that devote their energy and resources – both human and financial – to making their communities better places to live, work and do business.

In Philadelphia and even in remote locations around the globe, Wharton students are already demonstrating this critical element of business leadership through a broad range of volunteer activities. And they do it with great vigor and enthusiasm. While carrying full course loads at the world's most demanding business school, Wharton students organize and manage dozens of projects that incorporate both business know-how and elbow grease. The impact they are having is very tangible:

- Nearly 50 MBA students spend an hour five days a week tutoring students in West Philadelphia's junior and senior high schools as part of the Say Yes to Education program. In the program's 10 years, the dropout rate for students has plummeted, and more than half have gone on to college. Wharton students have also helped their young proteges seek financial assistance from local sponsors for college tuition.
- Each year, more than 500 Wharton freshmen set out into the Philadelphia community in groups of 12 to 15 students for semester-long projects in team-building, communications and leadership skill development. Partnering with nonprofit agencies throughout Philadelphia, students learn firsthand the valuable lesson that business leadership is directly linked to community commitment.
- Wharton Community Consultants, a new student club, takes this lesson one step further. Knowing that sound management skills can help community organizations be more effective, the group offers management consulting services to Philadelphia nonprofits. Students get hands-on experience with the day-to-day challenges of running an organization, and the agencies get top-notch management advice.
- Wharton's Young Entrepreneurs Program matches Wharton MBAs with high school students who have an interest in starting their own businesses. The students work with their Wharton mentors to develop a business plan and make presentations to venture capital boards. Last year, nearly 30 high school students participated, and $2,500 was awarded in start-up capital.
- "Wharton into the Streets" is an annual event each fall that introduces students to the community service opportunities in Philadelphia. Working with the Peoples Emergency Center, Wharton students conduct a tutoring program, cook and serve meals to the shelter's residents and organize food, clothing and holiday gift drives. Other students work with the homeless and hungry through the University City Hospital Coalition, the Greater Philadelphia Food Bank, and MANNA (Metropolitan Area Neighborhood Nutrition Alliance).
- Our biggest outreach activity of all celebrates its 10th year this spring. Wharton's Christmas in April program rehabilitates homes for low-income families, the elderly and the disabled. Last year, more than 1,000 Wharton students helped to repair 31 houses in West and North Philadelphia. Students worked year-round to raise $130,000 to buy materials and supplies. Now a nationwide effort that involves business schools across the country, Wharton's program was the first in 1988 and remains the largest – proving once again the leadership impact of Wharton students among their peers across the nation.
- And recognizing that we are members of a global community, for the last 10 years Wharton International Volunteer Projects has taken MBA students to Third World locales as business consultants. Last summer, 31 students spent three to four weeks assisting the local economies in eight countries. Projects included developing marketing strategies to export hand-made sweaters from an Ecuadorian village to delivering computer training to entrepreneurs in The Gambia. (See story, page 23.)

WHARTON STUDENTS ORGANIZE AND MANAGE DOZENS OF PROJECTS THAT INCORPORATE BOTH BUSINESS KNOW-HOW AND ELBOW GREASE.

These student programs form the heart of a long-term commitment by Wharton and Penn to improve the quality of life of our community – both locally and globally. They are central to our educational mission of leadership. And arising as they do from the terrific spirit, creativity and energy of our students, these activities are a wonderfully encouraging sign for the future and for the kind of leadership these students will bring to their careers. Leadership that is good for business and good for our communities.



Thomas P. Gerrity

Goergen Gift Establishes Entrepreneurial Management Program

Goergen

Robert B. Goergen, WG'62, chairman and CEO of Blyth Industries, a leading manufacturer of candles, candle accessories and home fragrance products, has donated $10 million to create the Goergen Entrepreneurial Management Program. The gift, among the largest to support an entrepreneurial program at a U.S. business school, will endow the Goergen Program, building on the School's longstanding commitment to the teaching and study of entrepreneurship.

The gift establishes a Robert B. Goergen Professorship and will sponsor Goergen Fellowships for faculty to teach new courses needed to meet growing demand. A worldwide search will be conducted for a program director.

Goergen is a highly successful entrepreneur in his own right, transforming Blyth Industries from a regional $3 million manufacturer of grocery store and religious candles into a company that designs, manufactures and markets candles internationally. Blyth Industries, with revenues of $500 million in 1996, employs 2,200 at the parent company and two subsidiaries, Candle Corporation of America and Party Lite Gifts.

Before building Blyth Industries, Goergen held management positions at a number of leading organizations including McCann-Erickson, McKinsey & Co. and Donaldson, Lufkin & Jenrette.

"Wharton provided me with many of the tools and skills responsible for my business track record," says Goergen. "Moreover, I'm a strong supporter of the entrepreneurial spirit in America, which creates business growth and increases employment and prosperity. Given Wharton's unrivaled reputation in fostering this spirit, the gift is intended to help the School prepare the next generation of business leaders by adding depth and breadth to its entrepreneurial management faculty."

Among the five-year goals of the program:

• Increase faculty leadership by increasing the number of junior faculty and supporting tenure-track development; growing standing faculty to strengthen the identity of the entrepreneurial group with the School; and attracting more visiting scholars from abroad.

• Enhance curricular leadership by significantly increasing course offerings to include such topics as acquiring busi-

Continued on page 30

Record Increases for Admissions

The number of applicants to Wharton's MBA program increased 1.8 percent this year, from 7,329 in 1996 to a record 7,461 in 1997.

The new record reflects several factors, notes MBA admissions director Robert J. Alig, WG'87, including strong momentum in the international pool and a strong interest among corporate recruiters in students with MBA degrees.

"Our office visited close to 20 countries around the globe last year," notes Alig. "We are seeing more students from mainland China, Eastern Europe, the former Soviet Union and other areas where historically we had either no applicants or very few." At the same time, "we continue to do well in countries like Japan and India."

Meanwhile, MBA degrees are, according to several business publications, "back in vogue," Alig says. After a few lackluster recruiting years in the late 1980s and early 1990s, "investment banks, consulting firms, high-tech and entrepreneurial firms are all very interested in MBA students, not just here but at other schools as well."

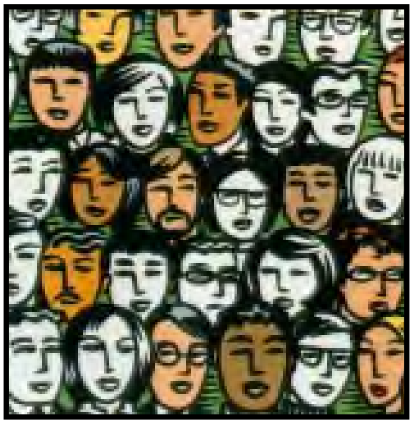


ILLUSTRATION / BURTON MORRIS

Of those who applied to the MBA program this year, 43 percent were international (compared to 37.4 percent last year), and 22.7 percent were women (compared to 22.6 percent last year).

The average GMAT score of the application pool increased over last year, indicating that "we are not only attracting more students, but stronger students," Alig notes. "The quality of the pool we have seen is outstanding."

Continued on page 7

Alumni Conferences: Reconnecting In Shanghai and Paris

New opportunities – for investments, for alignments, and for alumni networking – highlighted regional alumni conferences in Shanghai last May and in Paris last June.

The truly global nature of these forums was evident at both events:

- More than 250 alumni and guests representing 22 different countries attended the Paris conference, entitled Wharton European Forum ’97.
- The kickoff speaker in Paris was Kim Woo-Choong, founder and chairman of Korean-based Daewoo Group, who spoke about the company’s expansion into Eastern and Central Europe.
- The Dean’s Medal, the School’s highest honor, was presented in Shanghai to Wang Dao-Han, former mayor of Shanghai, chief adviser to the Shanghai Municipal People’s Government and one of China’s most prominent business and government leaders.

Wang Xi

The Asian Regional Alumni Meeting, held in Shanghai May 29-31 at the Shanghai Hilton, offered seminars on the development of stock markets in China, Shanghai’s leadership role in the Chinese economy, its partnership with Hong Kong, and the opportunities in Shanghai for strategic alliances. Guest speakers included Acting Mayor of Shanghai Chen Liangyu, a graduate of the first Wharton senior executive program taught in Shanghai in 1990, and Dean’s Medal recipient Wang Dao-Han.

In awarding the Dean’s Medal, Wharton Dean Thomas P. Gerrity cited Wang’s “service and contributions to economic advancement and world peace.” For example, as mayor of Shanghai from 1980 to 1985, “Mr. Wang created the long-range plan for the city, made Shanghai one of 14 Special Economic Development Zones in China, and gained approval for Shanghai to be the first city to utilize foreign capital.” Today, as a member of the Leading Group of Taiwan Affairs and as president of the Association for Relations Across the Taiwan Straights, “Mr. Wang will continue to be influential in guiding China’s future in the world economy,” the Dean noted.

Wang Xi, WG’67, president of the Wharton Club of Shanghai, helped to host the event’s 200 guests.

At the Wharton European Forum, held at the Automobile Club de France in Paris June 19-20, guests attended sessions on “Multimedia and Telecommunications in Europe,” “The Euro: On Target for 1999,” and “Emerging Markets of Eastern and Central Europe.” The keynote speaker was Herbert M. Allison, president of Merrill Lynch & Co., Inc.

Kim Woo-Choong

Alumni who were panelists during the Forum included Angel L. Corcostegui, WG’80, PhD’82, vice chairman and CEO of Banco Central Hispano; Michel Fleuriet, PhD’73, president du directoire, Merrill Lynch France; Jean-Yves Charlier, WG’91, president, International Telecommunications Services, SITA Group; David Coco, WG/SAIS’91, financial director, Hayes Wheels Autokola NH, Czech Republic; Rosalind Copisarow, WG’88, head of Fundusz Mikro in Warsaw, Poland, and Mark G. Speeckaert, AMP’92, CFO, Belgacom. Two Wharton faculty members, Richard Marston, professor of finance and director of the Weiss Center for International Financial Research, and Eric J. Johnson, professor of marketing and an organizer of the Wharton Forum on Electronic Commerce, also took part in the panel discussions.

“These alumni gatherings in Europe and Asia are extraordinary, high-impact events that are an important part of the School’s global outreach activities,” says Gerrity. “For our alumni around the world, they provide a unique opportunity to focus on the critical business issues of their regions and also to reconnect with each other and the School.”

Alumni at Paris reception

Campus NEWS

■ Wharton and the Pew Charitable Trusts have launched a new program designed to improve the management of cultural institutions in the Philadelphia region.

The program, funded by a three-year $1.4 million grant from Pew, offers local arts groups an array of courses, workshops and lectures focusing on fundraising, finance, marketing and professional development. The technical assistance is provided at no cost to participating groups.

Wharton and Pew will also jointly administer a $350,000 Innovation Fund offering grantees one-time support for entrepreneurial efforts, collaborative ventures or reorientation of services.

■ A new major – in technological innovation – designed to educate technological entrepreneurs and future leaders of technology-based companies is now available to MBA students, either as a stand alone major in the MBA program or as part of a dual degree program with the School of Engineering and Applied Science (MBA/MSE).

Requirements for the stand-alone major include "Managing the Innovation Process," "Innovation, Change and Entrepreneurial Management" and "Technology Policy."

■ The Aresty Institute of Executive Education is offering a program aimed at administrators and faculty of colleges and universities. Led by management professor Peter Cappelli, the four-day course focuses on organizational change, decision making and leadership.

Participating teams, from such institutions as Cornell, Middlebury, the University of Connecticut and Arizona State, among others, have already tackled projects ranging from introducing a new computer system and revising curricula to changing a school-wide budget system.

■ Wharton's Emerging Technologies Management Program co-sponsored two workshops during the past year:

The first, entitled "Managing Uncertainty Through Scenario Thinking," included participants from McKinsey & Co., AT&T Universal Card Services and Merck & Co. in addition to Wharton researchers. The workshop was part of the School's initiative to identify and develop best practices and competitive strategies for firms competing in emerging technologies.

The second workshop, "Alliances in Transition: Progress, Problems, Prospects," examined current practice in developing and managing individual alliances and networks of alliances.

Participants included Rhone-Poulenc Rorer, SAP Inc., Corning Inc., and Chrysler Corp.

Both workshops were co-sponsored by the SEI Center for Advanced Studies in Management.

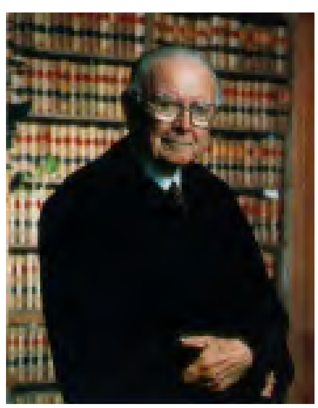
■ A $500,000 gift establishing a program to examine diversity in the workplace has been given to Wharton by Pitney Bowes. The donation – the first and largest of its kind awarded to a business school – creates the George Harvey Program in Redefining Diversity in honor of George Harvey, W'54, former chairman, president and CEO of Pitney Bowes.

The program will support research to examine a variety of perspectives on diversity and its importance to today's employees, managers, customers, stakeholders and society as a whole.

Harvey, who retired from Pitney Bowes in 1996, is a member of Wharton's Board of Overseers.

A JUSTICE FOR ALL: Retired Supreme Court Justice William J. Brennan, W'28, a judicial activist and staunch civil libertarian, died at age 91 on July 24, 1997.

In a tenure that spanned nearly 34 years, Justice Brennan wrote landmark opinions enforcing desegregation of schools, upholding affirmative action plans for minority groups, protecting freedom of the press and striking down state aid to religious schools. He opposed the death penalty and supported a woman's right to an abortion as outlined in *Roe v. Wade*. In all, he participated in more than 1,200 opinions.



BRENNAN

During an interview with the *Wharton Alumni Magazine* shortly before his retirement from the court in 1990, Brennan noted at one point: "There should be an appreciation that ours is a self-governing society. How terribly important it is that able people help run it."

The Class of W'01: An Enterprising Group

This year's class of incoming freshmen – members of W'01 – includes the following:

- The founder of a nonprofit company, Adopt-A-Bike Foundation, which rehabs donated bicycles and gives them as holiday gifts to area children
- The founder/president of an investment club who invests on the NYSE and worked as a marketing intern at Merrill Lynch
- One of Malaysia's top chess players and a participant in international chess olympiads
- The founder of a golf program for inner-city kids.

Also on campus this fall is Michael Billings, one of 20 African-American high school students selected nationwide as a Ron Brown Scholar. The award, which honors the U.S. Secretary of Commerce who died last year in a plane crash in Croatia, provides recipients with a four-year $40,000 grant.

Billing's credentials are impressive. He is a member of the National Honor Society, the Mayor's Youth Community Service Council, the varsity baseball and basketball teams at Rowland Hall-St. Marks high school in Salt Lake City and associate editor of the school newspaper.

Billings

"I wrote one column on how the Utah Jazz wouldn't get very far in the playoffs. (They went pretty far.) I wrote another on Jackie Robinson and the 50th anniversary of major league baseball's integration. And I wrote a third on the school's decision to eliminate the honors diploma," notes Billings. "My point was that the honors diploma wasn't really too full of honor because you could get it just by taking one more credit. Most of the class was graduating with the diploma, so it had no real meaning."

Billings was born in Salt Lake City and raised by his great grandmother. When she passed away during his eighth grade year, he asked a friend if he could move in with his family. Another friend's father helped get him a scholarship at Rowland Hall-St. Marks.

He found mentors at Rowland Hall, including the school pastor. "He gave me a perspective that had to do with living life to its fullest and not worrying about materialistic goals."

During the summer of 1996 Billings went to the University of Arizona at Tucson to attend the LEAD program – an intensive month-long business course offered to talented minority students at 10 U.S. business schools, including Wharton. "That helped me see what undergraduate business school would be like," says Billings, who was accepted at Yale, Princeton, Stanford and Duke in addition to Wharton. "I came here because the curriculum is broad enough that you can use what you learn in any field that you decide to enter."

HOLD THESE DATES...

for upcoming MBA student conferences on:

October 24: European Conference

October 31: Asian Finance Conference

October 31: Wharton Women in Business Conference

January 16 & 17: Whitney M. Young, Jr. Conference

Contact the Office of Student Affairs at 215.898.4968 for more information and/or registration

New Faculty Join Wharton This Fall

Ho

Teck H. Ho, who earned his PhD in operations and information management at Wharton, has returned here this fall as an associate professor of marketing.

He has taught most recently at UCLA and before that was a lecturer at the National University of Singapore where he received degrees in electrical engineering and computer and information sciences.

Ho's research looks at group decision making and competition, specifically in such areas as new product development, market entry and exit, and cross cultural negotiations.

Ho joins 15 other new faculty members at Wharton: They include:

ACCOUNTING: Assistant professors Marguerite Bishop, (assistant professor, NYU Stern School of Business), Wayne Guay (PhD, University of Rochester) and Philip Stocken (PhD, Penn State University)

FINANCE: Assistant professors Michael Brandt (PhD, University of Chicago), William Dupor (PhD, University of Chicago), Christopher Geczy, (PhD, University of Chicago), Joao Gomes (PhD, University of Rochester), Patrik Sandas (PhD, Carnegie Mellon University) and Amir Yaron (assistant professor of economics and finance, Carnegie Mellon)

HEALTH CARE MANAGEMENT: Assistant professor Sean Nicholson (PhD, University of Wisconsin, Madison)

LEGAL STUDIES: Assistant professor Edward Swaine (associate at Cleary, Gottlieb, Steen & Hamilton; research fellow, Katholieke Universiteit, Leuven, Belgium)

MARKETING: Assistant professor Christophe Van den Bulte (PhD, Penn State)

PUBLIC POLICY AND MANAGEMENT: Associate professor Joel Waldfogel (associate professor, economics, Yale University)

REAL ESTATE: Assistant professor Todd Sinai (PhD, MIT)

STATISTICS: Assistant professor Jianhua Huang (PhD, UC Berkeley)

Record Increases for Admissions *Continued from page 3*

This year's yield – the number of students who accept Wharton – is 73.0 percent, compared to 70.9 percent last year. That translates into 792 first-year students here on campus, of whom 30.6 percent are international, 27.4 percent are women, 4.8 percent are African American, 8.5 percent are Asian American, 3.8 percent are Hispanic American and 0.1 percent are Native American.

On the undergraduate level, despite a national trend showing decreasing interest in a business major, applicants to the class of 2001 totaled 3,464, 1.2 percent higher than last year. The joint-degree Huntsman Program in International Studies & Business (IS&B) showed a particularly strong increase, with 573 applicants for 40 places, a 38 percent increase over last year's 410 applicants. Applicants for the 45 places in the joint-degree Jerome Fisher Program in Management & Technology totaled 499 this year, a 2.2 percent decline from last year's 510 applicants. For the new nursing and health care management program there were 28 applicants for six places.

In the single degree program, the yield was up significantly, 74.5 percent compared to just under 70 percent in 1996.

The overall increase, notes Richard Herring, vice dean and director's of Wharton's undergraduate division, "reflects the exciting opportunities students find at Wharton. We have dual-degree programs, joint-degree programs and the ability to minor in subjects in the College [of Arts and Sciences]. We also have a new program with the Penn Law School in which Wharton undergraduates can get their BS and their law degree in six years. And we have revived and expanded the MBA submatriculation program as well.

"We are working against the stereotype that business education is narrow and limited ... What our program offers is the ability to structure and analyze problems that have to do with organizations and society."

The average SAT scores for all undergraduate matriculants was 1404 compared to 1400 last year. Matriculants in the IS&B and M&T program had scores of 1517 and 1483 respectively, compared to last year's scores of 1472 and 1492.

Matriculants for the single degree program include 131 women out of the 417 total. Minority students total 188, including 126 Asians, 27 African-Americans, 6 Chicanos, 20 Latinos, 6 Puerto Ricans and 3 Native Americans.

101997

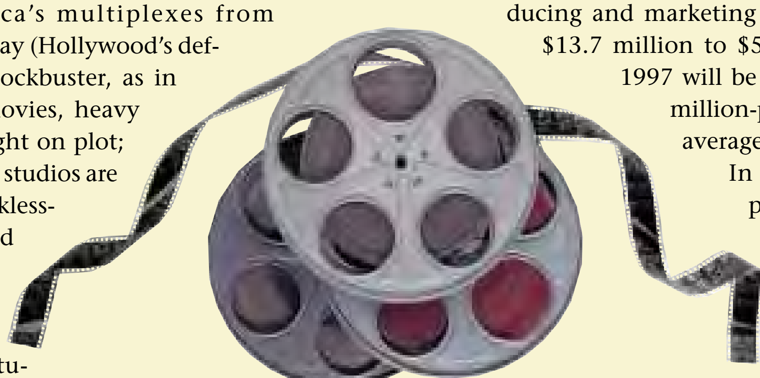
The Business of BLOCKBUSTERS:

ADMIT ONE

Movies That Become Megahits Are Money Machines for Their Studios. When They Fail, It's a Whole Different Script

An ad last July for *Ulee's Gold*, the Peter Fonda movie about a beekeeper trying to raise his grandchildren in a small town in Florida, described the film as "an antidote to the mindless mayhem of the summer blockbusters and busts … In its own quiet, intelligent manner, the movie will blow you away."

The promoters of *Ulee's Gold* were clearly banking on movie goers' dissatisfaction with one of summertime's most sacred rituals – the parade of blockbuster movies that glut the screens of America's multiplexes from May 10 through Labor Day (Hollywood's definition of summer): blockbuster, as in male-oriented action movies, heavy on special effects and light on plot; as in the megabucks that studios are spending – some say recklessly – on producing and promoting what they desperately hope will be hit shows.



The stakes for the studios are enormous. A hit movie is like a multi-million dollar ATM – churning out revenues from U.S. audiences, international audiences, video rentals, video games, licensing fees, merchandising fees, restaurant tie-ins, theme parks, soundtracks and so forth. Everyone with a cut of the action – from the studios and theaters to the actors and directors – stand to reap huge rewards. Conversely, if a film tanks, the studio is hung out to dry, 100 percent responsible for the losses which can also be in the tens of millions.

It's a risky business that gets more volatile each year. This summer, studios released a record number of blockbuster films – at least 10 – with budgets of $100 million or more. Studios that spend millions on production costs justify those expenditures by spending additional millions on marketing.

Indeed, average marketing costs alone are more than $17 million per film (with a few movies in the $25 to $30 million range) all in an effort to create that important pre-release buzz that can make or break a movie. Between 1980 and 1996, according to industry sources, the average cost of producing and marketing a Hollywood film rose from $13.7 million to $59.7 million. The figures for 1997 will be higher (the oft-delayed $200 million-plus *Titanic* alone will raise the average.)

In this pressure-cooker atmosphere, the boiling point is opening weekend: movies that do well continue to get promoted. Those that don't are shoved aside by the next blockbuster hovering just around the corner.

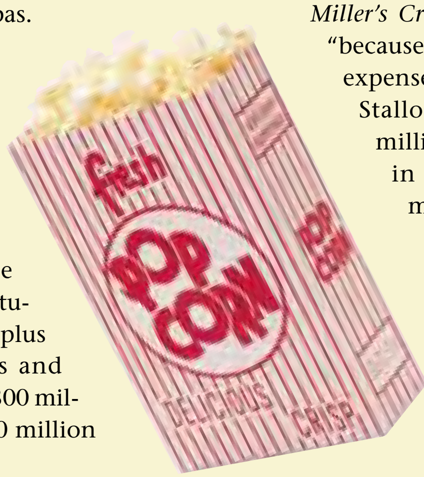
Then there's the question of public taste. While the film business is financially risky, it's also fickle. Audiences that gloried in special effects movies one summer may, the next year, start demanding better plots and more character development. Right about now, for example, some are wondering if the special effects genre, for one, may simply be wearing itself out.

As Stanley R. Jaffe, W'62, president of Jaffilms, a feature film production company in New York, puts it: "Just how many exploding buildings can you look at?"

BLOCKBUSTERS I: THE BRIGHT SIDE

On or about July 2, once it was clear that *Men in Black* – a $90 million science fiction-adventure comedy – was going to be a blockbuster, stories about the movie's studio (Columbia Pictures, part of Sony), its stars (Tommy Lee Jones and Will Smith) and director (Barry Sonnenfeld) appeared everywhere. Opening on 5,000 screens in 3,000 theaters around the U.S., *Men In Black* grossed $130 million during its first week. (By contrast, Disney's *Con Air*, considered a successful movie in its own right, brought in $90 million in the first six weeks.)

A huge hit. But blockbusters don't necessarily have to be megahits to justify their existence, says Michael H. Mendelsohn, W'84, who owns a production company called Patriot Pictures (a partner and financier of the hit Harrison Ford movie *Air Force One*) and is entertainment finance portfolio manager/adviser to Banque Paribas. Take Warner Bros.' *Batman & Robin*, the fourth of the *Batman* series that opened last June and – despite costs estimated at between $100 million and $160 million – wasn't quite the megahit that observers had predicted.



But look at it this way, Mendelsohn says. "If *Batman* does $100 million in the U.S., that will return $50 million to the studio [theaters take the other $50 million], plus money from videos, international sales and licensing. That could be another $250 to $300 million in revenues. Who cares if it cost $100 million to make …

"People mock these big budget movies but a lot of their criticism is misplaced," Mendelsohn adds. "Will all of them work? No. If a $100 million movie only takes in $70 million, you lose $30 million, not a big deal for major studios. But if it's a blockbuster and brings in $500 million, that more than takes care of any problems."

In one sense, the economics of the film industry make blockbusters a strategic necessity. Hits become valuable franchises that collect revenues from multiple sources, help support a studio's ongoing operations and also allow studios the opportunity to branch out and experiment with other types of films. Last summer's *Independence Day* has made more than $1 billion for Twentieth Century Fox in worldwide ticket sales, merchandise tie-ins and other ancillary revenues. This summer's *The Lost World: Jurassic Park* had grossed $227 million for Universal by Labor Day.

Nicholas Wodtke, WG'95, who was senior manager of motion picture finance and corporate development at Sony Pictures before moving to Singapore in May to help Sony launch an action adventure television channel, agrees that blockbusters make economic sense in part because of "the prestige involved. Blockbusters are like a flagship for the studio, and they help support a lot of lesser products as well," notes Wodtke, who prepared financial analyses for movies like *Jumanji, Jerry Maguire, My Best Friend's Wedding* and the upcoming summer 1998 release *Godzilla*. "When you have a flagship blockbuster you might be able to secure a lot of screens for your other movies too." *Jerry Maguire*, he adds, "was a blockbuster in that it earned more than $150 million in domestic box office receipts, but it was also an exception to the rule. It was a romantic comedy and its theme was football," hardly the usual stuff of which blockbusters are made.

Foreign sales are a vital part of the blockbuster equation. "Studios will tell you not to go by how well their films do in the domestic market," notes Theodore C. Pedas, WG'54, president of Circle Management Company in Washington D.C. who has produced such films as *Barton Fink, Miller's Crossing, Blood Simple* and *Raising Arizona*, "because they know they can recoup a lot of their expenses internationally." *Daylight*, a Sylvester Stallone movie that cost MCA/Universal $70 million to produce, "did less than $50 million in the States, but video was another $20 million and foreign sales another $175 million," notes Mendelsohn. (It helps that foreign audiences haven't yet lost their appetite for special effects extravaganzas or Rambo-type films.)

Sushil Tyagi, WG'96, a consultant in Price Waterhouse's strategy consulting group in Los Angeles who works mainly with media and entertainment clients, sees two different strategies when it comes to the search for successful blockbusters. The first is for studios to make a large number of movies and hope that one will succeed. "That one success will pay for the others," says Tyagi. "If the buzz in the business is that one of the movies looks like it will be a hit, then the studio will start putting more and more money into marketing it, which leads to further exaggeration of the cost."

The wiser strategy is to cut back on the number of movies. The logic here, Tyagi says, "is that too many films are coming out too close together and therefore don't give each other any time to generate money. Studios aren't saying they will stop trying to produce blockbusters. They are saying they will make fewer of them, plan them more carefully, do a better job of timing their releases and possibly co-finance with another studio to share risks and rewards."

Part of that strategy, says Tyagi, includes the decision not to get the best, highest-priced talent, "but to look instead at the elements that make a hit, such as special effects, and then spend the money there. It's a reallocation rather than a reduction of costs."

BLOCKBUSTERS II: THE DARK SIDE

Stanley Jaffe, who has produced such hits as *Kramer Vs. Kramer, Fatal Attraction, Bad News Bears* and *Goodbye Columbus* during a 30-year career in the film business, sums up the recent blockbuster phenomenon as "a disaster for the industry."

To begin with, he notes, "it's an extremely risky financial strategy, not so much because of what these pictures gross as what they net." Once a studio pays production costs, advertising costs and distribution costs, and once the directors/producers and/or stars take their percentage from the gross, "you would be surprised at how many of these big pictures either don't make much money or lose it."

In many cases involving recent blockbusters, notes Wendy Finerman, W'82, who produced the Oscar-winning hit film *Forrest Gump* in 1994 and now runs her own production company, "the costs, including promotional expenses, can be astronomical. And there is also the cost of the use of the studio's money, which is something people don't always factor in. Meanwhile, a lot of talent also has a piece of the movie ... The return on investment for the studio might not be that huge."

Studios, Jaffe adds, have become "dependent on the big title, which has raised the stakes exponentially. Nobody in the industry sneezes if a picture costs $100 million. But if General Motors had a $100 million R&D project that didn't work out, the company would be embarrassed. In our business it's just on to the next picture."

Wodtke, while he sees blockbusters as generally good economic strategy, also speaks of the escalating risks involved in their production. "Those risks are getting bigger every day because so much more money is being spent on advertising, a big part of which is getting prime time TV spots. Everyone is trying to chase after a little bit of ad time. Meanwhile on the production side the costs of talent and special effects are going through the roof. It's all a gamble in which you are no longer putting $100 on the table, you are putting $1,000."

Then there is the cannibalization factor. It's not only that studios are spending enormous amounts of money encouraging viewers to see their pictures, it's also that wannabe blockbusters are now being released every two to three weeks, rather than every five to six.

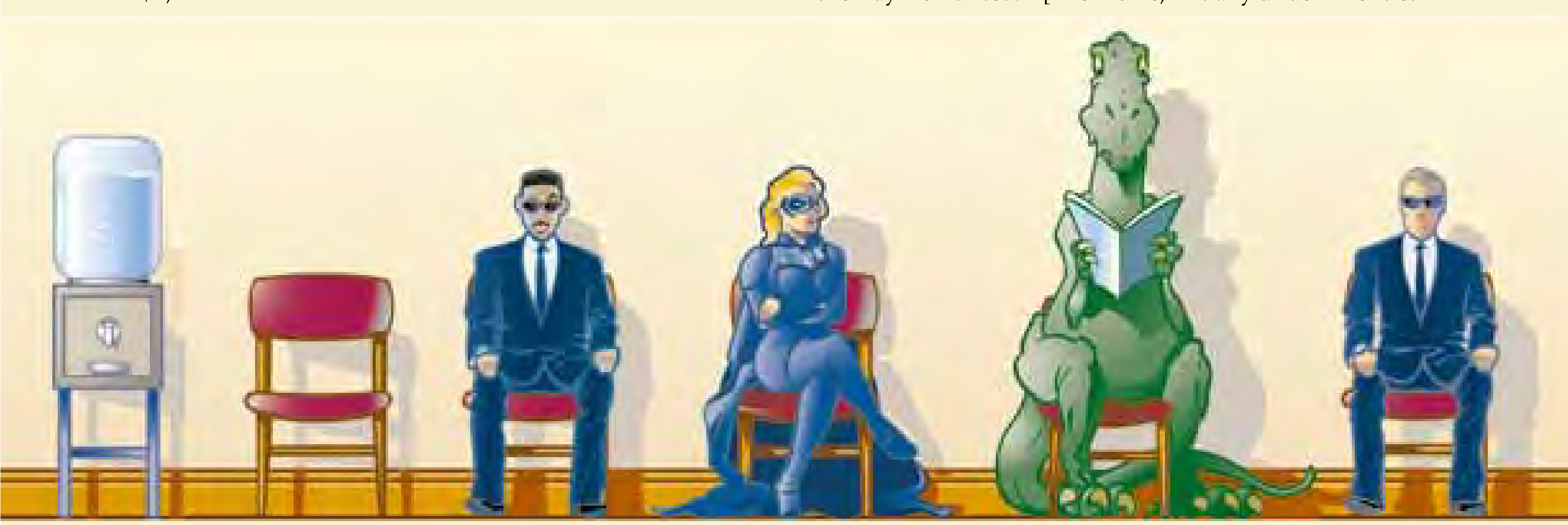
"There were too many big movies last summer opening one after the other," notes Paul Zaentz, W'72, a producer in the Saul Zaentz Film Center which had such hits as *The English Patient, Amadeus* and *One Flew Over the Cuckoo's Nest*. "It doesn't give them much of a chance. These days if a film is not a success the first weekend, that's the end." With so many summer movies out there, adds Mendelsohn, "studios only have one or two or three weeks to draw big crowds before two more huge blockbusters are rolled out."

Movies, notes Finerman, "are chosen for development for many reasons. First and foremost is how commercial the idea or project appears. The second is whether the material will attract talent, meaning a director and actors/actresses. However, in recent years, movies that were expected to be blockbusters didn't live up to their expectations and offbeat films that people didn't think would be hits – like *The English Patient* and *Pulp Fiction* – were, in fact, major hits. A lot of times it's the smaller movies that can be more financially successful and give a greater return to the studio than the blockbuster.

"The most important fact to keep in mind about this industry," adds Finerman, whose movie *Fairy Tale ... A True Story* is being released this fall, "is that nobody knows for sure what will be successful."

INDEPENDENTS' DAY

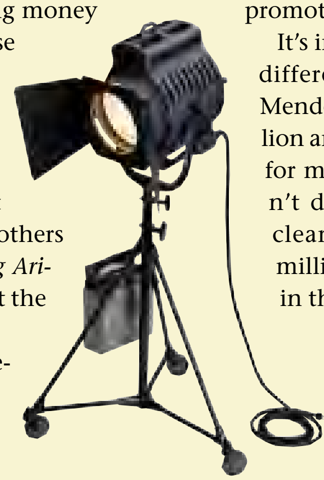
"*The English Patient* was a huge hit," says Zaentz, "because there are people out there who want to see a movie that makes them think, that is built on interesting characters and good acting, and that does not have the Hollywood happy ending. But we had to fight the studios to get it made the way we wanted." [The movie, initially under Twentieth



Century Fox, was financed and distributed instead by Miramax, which has since been bought by Disney.]

In fact, four of the five pictures nominated for best picture at last spring's Academy Awards – *The English Patient, Shine, Secrets & Lies* and *Fargo* – were made by independent producers. One might be tempted to conclude that the smaller, independent filmmakers – and "art house" films – are alive and well and clearly a match for the action-oriented, special-effects movie genre.

Yes and no. "There are producers and directors who will make small films, and actors who will give up big money to do roles they believe in," notes Zaentz, whose next movie will be based on *Lies of the Night*, a book that takes place in the mid 19th century in a dungeon in Sicily. "But as far as single companies making small films, it's very difficult. I don't think there are independent companies but there *are* independent film makers. The Coen brothers [Ethan and Joel, who wrote and directed *Raising Arizona, Fargo* and *Blood Simple*, among others] are at the top of the list."



Indeed, what some see as a resurgence in independent and art house movies is evidenced by both the number and quality of recent releases – such as *Sling Blade, Swingers, Chasing Amy* and *Brothers McMullen* – and the fact that some of the major studios have started or acquired independent arms. Disney owns Miramax; Universal – where Kevin Misher, W'87, is executive vice president of Universal Pictures Production – has a majority stake in October Films; Sony has Sony Classics, and New Line is owned by Turner which is owned by Time-Warner – where Lorenzo di Bonaventura, WG'86, is co-president of production for Warner Bros. In most cases, the consensus is that these independent arms are truly independent, able to retain their artistic autonomy but also able to take advantage of their studios' distribution systems.

There is clearly an audience for art house movies, notes Mendelsohn, whose co-production credits also include *Box of Moonlight* released in August, *One Tough Cop* to be released this winter, and such previous films as *The Madness of King George, Reservoir Dogs, Nobody's Fool* and *My Life*, among others. "That's why we continue to finance them. Women are tired of hardware action, killing aliens, male testosterone-based pictures. There is counterprogramming going on – i.e. more comedies, romantic comedies, epic love stories and so forth."

Provided, of course, that people have the time to see them. "It all comes down to marketing," says Tyagi. "Some movies are advertised through national networks TV buys to such a degree that we are made to feel it's un-American not to see the film ... If a good creative film that is only niche-marketed opened on the same weekend as a broadly promoted one, it could die."

It's important to remember that corporations have different profit motivations than independents, Mendelsohn notes. "If I make a movie for $2 million and sell it for $5 million, that is significant profit for me. For someone like Disney, $3 million doesn't dent their bottom line ... Their emphasis is clearly going to be on pictures that make $50 million - $100 million and have an evergreen value in the film library. If I hit a single or double, that's good for me. I don't have to hit a homerun."

"Studios want to adopt a high-low strategy," adds Wodtke. "They want the blockbuster and also the lower budget films ... There is a different market for each. And the rule of thumb is that any hit – whether it's a blockbuster or an art house film – is good for business in general because it promotes the movie experience overall."

In fact, it's the mid-range movies – those costing between $25 million and $40 million to produce – that tend not to be made. "The question is, if you think the movie is going to have very broad appeal and be a hit, why aren't you spending $100 million on it?" asks Tyagi. Conversely, if it is a "niche story" with more narrowly-defined appeal, "why spend $25 million making it? Why not spend $1 million to $3 million? In any case, don't be in the middle of the road. Either go for the low-cost game or don't."

Mendelsohn makes another point. "Mid-sized movies are difficult to make because of the cost of talent. When a Tom Cruise or Harrison Ford or Sylvester Stallone costs $20 million, and a production involving special effects might be

anywhere from $30 million to $50 million, plus your print and advertising costs, then already you have moved beyond the $25 million to $40 million film. That's why you see fewer studio pictures in that range."

★

Even though marketing independent films is more difficult these days because of the consolidation of the smaller art houses, more independent films are being made than ever before, says Pedas. "Fifteen years ago when you had an independent film you would play at certain houses and then be finished with it. Now you have a lot of suburban theaters doing very well with these films," some of which, Pedas adds, are grossing huge sums at the box office. "If you have a really good story to tell," Pedas says, "you will find the financing."

"I've never had a picture that anybody thought was going to be a blockbuster and yet I have had some pictures that were among the most successful ever," notes Jaffe, who is now making a movie for Tristar based on Madeline, the sprightly French heroine of a series of children's books. "There is an audience out there for good scripts and unusual ideas."

R.W.S

The BOOK Business: A Whole Different Challenge

Consider them the blockbuster stars of the publishing business, authors like Michael Crichton, Dean Koontz, Danielle Steel, Anne Rice, John Grisham, Tom Clancy, Judith Krantz, John Le Carré and others whose books are immediate best-sellers and whose next book is eagerly awaited by a large and loyal following.

But publishers, while always on the alert for best-selling authors with legs (i.e. writers who can produce with reassuring frequency), face different challenges than the makers of blockbuster movies.

"Studios develop a handful of movies per year whereas our industry develops 50,000 titles," notes Alberto Vitale, WG'59, chairman, president and CEO of Random House Inc., the largest trade publisher in the U.S. "And the investment in a movie is infinitely greater than the investment in a book."

Also, whereas a blockbuster movie like *Independence Day* or *Jurassic Park* can bring studios millions of dollars in box office receipts and ancillary revenues, best-sellers in the publishing industry aren't quite so lucrative.

"Publishers can't live on blockbusters alone because they are unpredictable," says Vitale. "You can't plan for them unless the books are from an established major author. Yes, you need best-sellers but you also need to have a variety – new authors, fiction writers, non-fiction writers and so forth … *The New York Times* best-seller list has 30 books on it every week, but for many of those weeks the books are the same. I would estimate there are only 300 to 500 best-selling books per year."

"All books contribute to the bottom line," adds Harold Clarke, WG'90, president of Random House Juvenile Division, which publishes about 350 books a year under three major imprints – Random House, Knopf Books for Young Readers and Crown Books for Young Readers. "You can't come in with a machete and say you are going to cut out the non-performers and suddenly be more profitable. The economics of publishing are such that you need all the books."

Every year, Clarke says, "a publisher completely reinvents itself. It's not like you have finally created the perfect sugar free shredded wheat and now it's done. In publishing you are recreating every single book.

"And because it's a talent business, the cumulative benefit of that creativity usually accrues to the author. The author owns the brand."

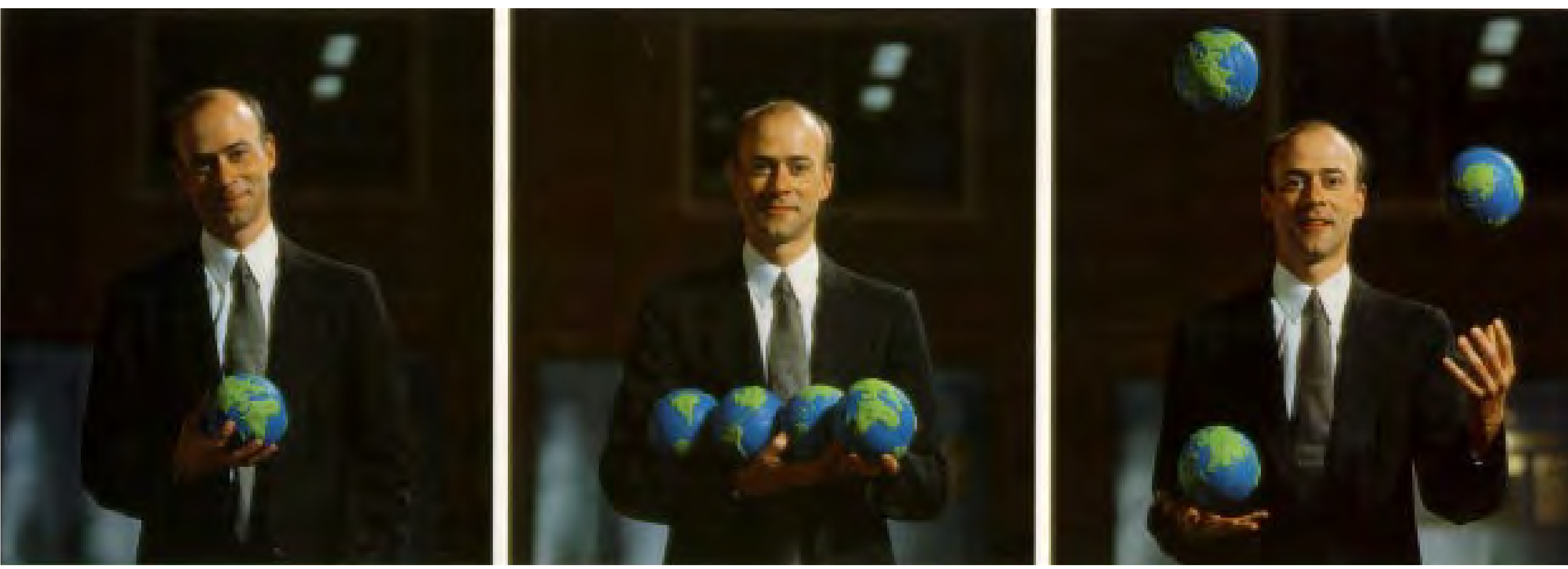
Which means the author can always decide to jump publishers depending on who offers the biggest advance and best deal. "The only brands publishers have are authors," notes Philip Grabfield, WG'87, a consultant with the Marketing Corporation of America who spent eight years with Kraft Foods before being hired at Bantam Doubleday Dell in New York to "bring the packaged goods marketing philosophy and methodology into publishing. The experiment didn't work because the framework wasn't right. Publishers are reluctant to put a lot of money into

Continued on page 29

FEATURE

From Comparing Global Financial Systems To Creating Shareholder Value

Professor Franklin Allen's Research Looks at the Upcoming Shakeout in World Economies as Well as the Need for Companies to Better Integrate Finance and Strategy



PHOTOGRAPHS / PETER OLSEN

In last June's world economic summit in Denver, during a meeting of the G-7 nations (Canada, France, Germany, Italy, Japan, the United Kingdom and United States) and Russia, U.S. government officials crowed about America's booming economy. Low inflation, low unemployment and the unleashing of entrepreneurial creativity was fueling a raging bull market generating envy around the globe. Many were asking if the American model of entrepreneurial capitalism and free markets is so successful that it should be copied worldwide.

But some economists, especially in Europe, believe that America still has not adequately dealt with the downside of its system – inequalities of income and wealth, below average public education and health services and the social problems that follow.

Why do Europeans and Americans view the U.S. model so differently? According to Franklin Allen, Nippon Life Professor of Finance and Economics, some people believe that the current economic models in countries like France and Germany are less than efficient because their huge social safety nets have become too costly. In addition, rigid labor laws tend to slow new hiring and government regulations discourage entrepreneurs.

On the other hand, many French and German citizens believe that the

U.S. model, with its recent reliance on downsizing and benefits slashing, is too harsh. They still believe that society should guarantee its citizens a minimum standard of living. France, although in the midst of major economic difficulties, has rejected the U.S. model outright.

Allen, one of the world's leading researchers on the comparison of global financial systems and financial strategy, believes that many world leaders have not looked seriously at the different components of each other's models. Is there a system that can combine jobs and growth with an acceptable level of economic fairness?

"The world has very different types of financial systems, even though we tend to think of all the major economies as capitalist," says Allen, whose most recent research looks at the financial systems of the U.S., Germany and Japan. "In the U.S., the notion of capitalism is based on Adam Smith's idea of the 'invisible hand.' Firms exist to maximize profit and consumers exist to maximize their own ends, and the invisible hand of the market supposedly allocates everything efficiently."

The structure of a country's financial system can have a big impact on the types of investments firms undertake and the efficiency with which they are carried through, says Allen, a British native who earned his doctorate and master's degree in economics from Oxford and a BA from the University of East Anglia.

"Market systems are probably better in the long run because they encourage innovation among firms," Allen says. "For example, railroads in the 19th century and industries such as automobiles, computers, aircraft and biotechnology in the 20th century were arguably developed in the U.S. primarily because of the existence of the stock market.

"There is a tendency to think that what the U.S. does is good and that other financial systems are backward, which is not necessarily the case," says Allen. "The Europeans are just starting to move towards market-based systems, but it's not clear that it's a good thing." Financial markets, while they offer many advantages, can also cause big problems. "The most dramatic example is the situation in Japan, which had huge bubbles, or runups, in stock prices and real estate followed by a huge collapse in those prices and then problems in the banking system. A similar situation occurred in Scandinavia in the mid 1980s."

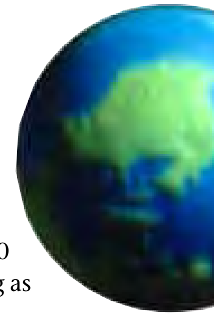
Winners and Losers

Traditional superpowers, like the U.S., Germany and Japan, and upstarts, like China and Korea, will be strongly affected by a shakeout in the world economy, says Allen. That shakeout will produce some clear winners and losers.

"The U.S. will have an advantage, because various countries are moving toward a market-based system and the Americans are already experienced in this," Allen says. "China, if it continues to grow at its current rate, is poised to become the number two economy, aided by the capital and management experience of the ethnic Chinese in Southeast Asia. Those factors, combined with a well-educated workforce, could be very powerful in the country's continued economic development."

Events such as the Chinese takeover of Hong Kong and the likely adoption of a single European currency will also have a big impact on the global financial system, Allen notes. Within 20 to 30 years, the Euro could become a major challenger to the dollar as the world's leading currency.

He also emphasizes that one should not focus only on a nation's current economic strength when predicting its long-term prospects. "Korea was one of the world's poorest countries 50 years ago. Today, it is emerging as an economic force."



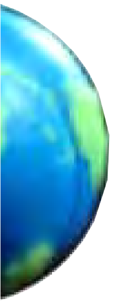
When the Bubble Burst

In Japan, Allen says, "firms are much more like a group of people working together and shareholders are viewed more like bondholders. They need to be given a return, but that's not the main purpose of the firm. The firm's primary function is to provide employment and look after the workers."

Until the end of the 1980s, Japan was regarded as the postwar economic miracle, rising from ruin in the 1940s to world power status within several decades. But Allen says that Japan's recent economic problems, like its success, were rooted in its unique form of capitalism, whereby the structure of institutions and government reduced the level of risk faced by individual firms and other agents compared to a U.S. style market economy.

In market capitalism, risk must be compensated for and so is costly, Allen notes. "But the Japanese structure attempted to eliminate risk and its associated cost. Japan achieved an economic miracle, but was simultaneously laying the groundwork for its downfall." According to the *Wall Street Journal*, total asset value suffered a loss of close to $10 trillion during the first half of the 1990s, equivalent to Japan's estimated economic loss from World War II.

That's because controlled risk capitalism created a "moral hazard" among Japanese private-sector investors. Perhaps the best example, says Allen, was the real estate industry's pursuit of ever-rising property prices without proper regard for



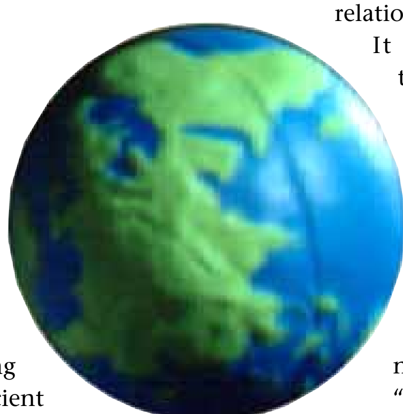
investment return. "They were investing with borrowed funds, which in some cases were guaranteed by the government. To the extent that there is a moral hazard problem between investment and fund managers/owners because the fund managers are investing with other people's money, the same problem arises in the equity markets."

Compounding the problem, the Bank of Japan provided funds to fuel hyperspeculation in the equity and real estate markets, Allen notes. The economic bubble burst in the early 1990s.

Japan is fighting its way out of a six-year recession. An announced overhaul of its financial industry is set for completion by 2001, along with deregulation in the electricity and telecommunications industries. As the economy becomes increasingly unfettered, some experts argue that pervasive group behavior will not be as rewarding, allowing Japan to emerge as an economic power with competitive companies and individual entrepreneurs.

"It remains to be seen whether this will actually happen," says Allen.

For Your Information



One of the main differences between financial systems is the way that information is generated and used, Allen notes. "Different financial systems assign different roles to the price system in conveying information for the efficient use of resources. They also provide different incentives for investors and creditors to monitor firms."

Allen, who has conducted much of his country comparison research with colleague Douglas Gale of New York University, says that an important difference between the U.S. and Germany is the amount of information that is publicly available. In the U.S., for example, the large number of firms that are publicly listed – and the SEC requirements that they release extensive accounting reports – makes available a great deal of financial data.

"This has implications for the allocation of investment," Allen says. "The wide availability of information helps firms to make good investment decisions. Firms can also make better decisions about whether to enter or exit an industry. This allocational role of the stock market has traditionally been viewed as one of its most important attributes."

In contrast to the U.S., few companies in Germany are publicly listed and those that are do not release much useful accounting information, Allen says. This can be advantageous, because it may reduce the risk born by investors. But it also raises the issue of how investment is allocated. Without the price signals and other information available to U.S. firms, German firms would appear to be at a significant disadvantage in making investment and entry decisions.

Meanwhile, banks in Germany are heavily involved in the control of industry and form long-term relationships with firms. It can be argued that a German type of financial system, where a small number of large banks play a prominent role, may permit some substitute mechanisms.

"If banks have a large amount of information about the profitability of firms, they can use this information either directly by advising firms or indirectly when they decide whether or not to grant loans to finance investments," Allen says.

Although substitute mechanisms allow duplication of many functions of the market, there remain some apparent disadvantages to reliance on intermediaries, Allen notes. Most importantly, without an active stock market, it may be difficult to decide on appropriate risk-adjusted discount rates.

Access to seed money is also important to the success of financial systems. "Both Japan and Europe are becoming increasingly worried about their lack of venture capital," says Allen. "The absence of a liquid stock market makes it difficult to cash out. Also, the hierarchical nature of banks compared to the horizontal nature of markets makes it harder to raise money because markets have critical input from numerous influential people, whereas a bank gets input from just a few."

Another important factor, says Allen, is the role of the financial markets. "In the U.S. and U.K., the financial markets are much more important, whereas the markets play much less of a role in Japan, Germany or France where institutions, banks and insurance companies in particular, are much more important.

"There are advantages and disadvantages to both systems," Allen continues. "For example, competitive financial markets tend to impose a great deal of risk on individuals. People in the U.S. hold lots of equity, whose market value varies significantly over time. This can have disastrous consequences for individual shareholders. A classic example was the roughly 50 percent drop (in real terms) in the U.S. stock market during the early 1970s. People who had accumulated wealth in the stock market up to then were hurt badly."

Other economies do not bear as much financial risk. "For example, in Germany and Japan, people hold much of their wealth in bank accounts and other fixed instruments, so they're not affected as much by how the stock market moves."

Riding a Wave Vs. Creating Value

A critical factor in fueling a global economy is how firms integrate finance and strategy to create shareholder value. It's a subject that has recently been the focus of research by Allen and Wharton colleague John Percival.

"In a financial system where capital markets are important firms need to worry about how to create value," Allen says. "In a strict sense, it's increasing the stock market value. In a wider, more general sense, it's using resources efficiently. For example, Coca-Cola and General Electric are two highly successful companies that look very carefully at where value comes from."

Some time ago, Allen says, Coca-Cola followed other companies by diversifying across industries. Subsequently it reexamined that strategy and concluded that the soft drink business was where the company was most successful in creating shareholder value. Coca-Cola refocused the business and saw its value increase substantially.

To understand the relationship between strategy and finance it is useful to draw a distinction between companies that 'ride a wave' and companies that create value, Allen says.

"Riding a wave simply requires being in the right place at the right time with the right characteristics. Revenues grow, the company is profitable and the stock price rises. It is easy to fall into the trap of assuming that these financial outcomes are the direct result of strategy. Profitability is, however, extraordinarily fragile.

"For example, Apple had a great product, which it developed at the start of the boom in personal computers. So Apple was able to ride the wave of the PC revolution for several years and did extremely well."

But a company must have a passion for the objective of creating value for shareholders, he adds. "If it is not the focus of strategies it will not happen by chance. Capital markets may be content with companies that ride waves.

"To understand the relationship between strategy and finance it is useful to draw a distinction between companies that 'ride a wave' and companies that create value."

The implications for companies that fail actively to create value can be devastating, however. IBM, Apple and Kodak had outstanding personnel and excellent products, but suffered greatly from the cresting of their waves. IBM is a particularly good illustration of this. They didn't pursue personal computers because they feared that PCs might erode their highly profitable mainframe business."

A firm that has been exceptionally successful in creating shareholder value, says Allen, is Emerson Electric, a $9 billion U.S.-based manufacturer of relatively low technology goods such as electric motors and compressors. It has had 40 years of increased earnings and has earned at least its opportunity cost of capital for most of these years, creating a large amount of shareholder wealth.

Emerson has a sophisticated planning process: each division is required to prepare a detailed five-year plan which contains projections of financial results and a discussion of why the projections are sensible. Managers use the Dupont System, a simple method for trying to understand how returns are generated. It is the product of margins (i.e. income/revenues) and turnover (i.e. revenues/assets). It thus decomposes rate of return (income/assets) into two components which are determined by operating and marketing strategies, Allen explains. Executives responsible for division-wide planning are grilled by the senior management of the company. Managers are required to display an in-depth knowledge of how their plans will be implemented and why the financial projections presented are realistic in terms of the marketing and operating strategies involved.

The Wal-Mart Approach

To help understand the relationship between strategy and the creation of value, Allen and Percival recommend employing the Dupont System "because at some level most strategies involve a trade-off between margins and turnover," Allen says. "The system allows simple insights into the effect of the various possibilities on the rate of return. The system is most valuable when used prospectively, providing a way for managers to gain insights about the return a strategy will generate. It forces management to focus on how rate of return comes from the competitive conditions in a product market and customers' reactions to management's decisions. Rate of return does not come from margins or turnover but from margins and turnover. Actions that increase margins tend to reduce turnover and vice versa."

For example, if a firm moves upmarket by increasing its prices, margins will increase but typically turnover will fall. The trick in creating value is to increase margins without lowering turnover or vice versa.

Look at Wal-Mart's success, says Allen. "Traditionally it has been manufacturers that develop customer loyalty, a situation that gave manufacturers the opportunity to charge higher prices and thus earn higher margins. Retailers historically focused to a greater extent on higher turnover."

Wal-Mart, on the other hand, has been able to create a strong base of loyal customers and effectively combine high margins with high turnover. As a result, the company has consistently earned higher returns than its competitors.

Integrating Marketing, Operations and Finance

Finance must have two separate roles, Allen says. One continues to involve the tasks that finance staff have traditionally performed, such as recommending and implementing capital structure and dividend policies and risk management. The other role, however, is not traditional. It is the development of the financial implications of non-financial strategies.

This second role for finance, says Allen, involves the process of asking and answering questions regarding how a proposed strategy will provide future cash flows that will create value. "For example, 'How can we use the improved market position that comes from a proposed strategy to earn more than the opportunity cost of capital?' This is essentially what Coca-Cola and GE have done so successfully in considering which businesses to stay in and which to leave."

A key to creating value, adds Allen, is financial awareness on the part of nonfinancial people who use this thought process while formulating strategies involving competitive advantage, technology investment, pricing and product mix decisions, reengineering and outsourcing.

All discussions of strategy ultimately come around to dealing with change, Allen says. "Strategies that earn more than the opportunity cost of capital under one set of circumstances may not earn those returns when the customers, competitors, technologies and economic environment change. This was Apple's problem. When Windows was developed the company was not able to adapt and its wave crested."

"Far too many companies have not moved on a timely basis to eliminate or change lower profitability businesses that take away sales from their core operations."

Integrating finance and strategy is crucial in dealing with what Allen and Percival call the change trilogy: knowing when to change, knowing how to change and changing.

"Only when strategy and finance are integrated can managers avoid the pitfalls of both and make effective decisions," says Allen. "The concepts of strategy need to be used to develop an understanding of how cash flows are generated. What is the competitive environment in which the firm operates? How are the strategies or projects a firm undertakes likely to affect its revenues or costs? What actions will competitors take in response to the firm's changes in its products, pricing and other competitive decisions? How can the firm minimize its costs of production and at the same time maximize the quality of its products?"

For instance, far too many companies have not moved on a timely basis to eliminate or change lower profitability businesses that take away sales from their core businesses, Allen says. Bausch & Lomb, for example, failed to introduce disposable contact lenses, presumably because of its concern about the impact they might have had on the company's existing contact lens and solutions business. The delay enabled Johnson & Johnson to enter the market for disposable lenses and gain considerable market share at Bausch and Lomb's expense.

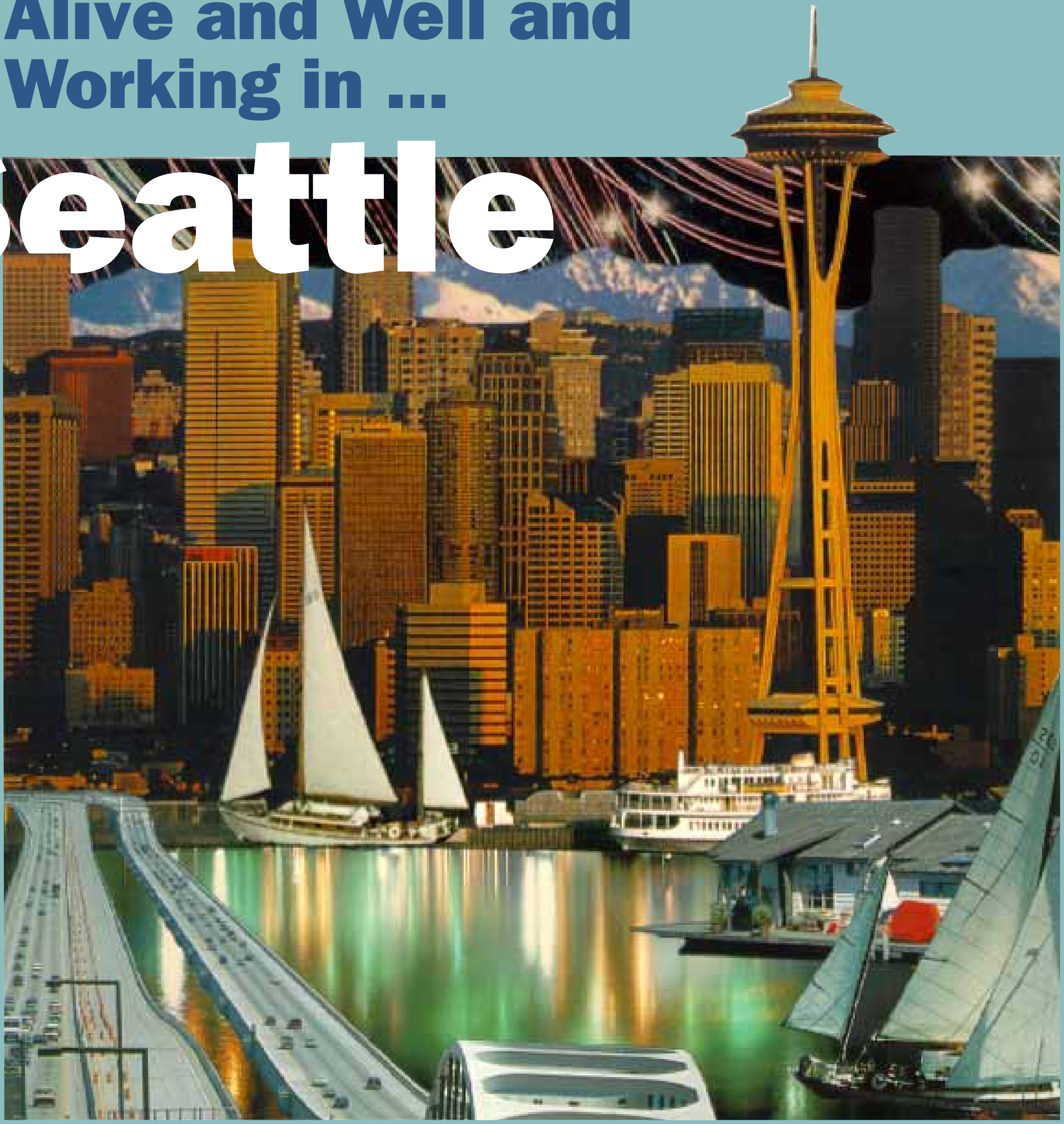
"The managers of firms that ride waves bear significant risks," says Allen. "Even the most astute manager may not be able to predict when the wave will crest or crash. It's only through a thorough understanding of how the firm creates value that executives will avoid crashes and assure consistent profitability."

Michael Baltes

FEATURE

Alive and Well and Working in ...

Seattle



IF NATURAL BEAUTY, ACCESS TO THE OUTDOORS AND A NEAR FLAWLESS SUMMER CLIMATE WERE ALL THAT MATTERED, SEATTLE WOULD PROBABLY RANK AS THE MOST POPULAR CITY IN AMERICA. NOT THAT SUN AND SCENERY ARE SEATTLE'S ONLY DRAWS. ALL THE ALUMNI INTERVIEWED BELOW PRAISED THE AREA'S ROBUST ECONOMY, ANCHORED BY BOEING AND MICROSOFT AND FUELED BY AN INCREASING NUMBER OF START-UPS, SPIN-OFFS AND MOST RECENTLY, VENTURE CAPITALISTS. ▶ SEATTLE – WITH A POPULATION OF ABOUT 475,000, INCLUDING APPROXIMATELY 200 ALUMNI – IS ON A CAFFEINE HIGH, AND IT'S NOT JUST BECAUSE OF STARBUCKS.

ILLUSTRATION / PIERRE-PAUL PARISEAU

Nicole W. Piasecki, WG'90


Piasecki

JOB TITLE: Sales director, commercial airplane group, The Boeing Company

JOB DESCRIPTION: Markets all of Boeing's commercial products – ranging from the smallest airplane (the 737) to the largest (the 747) – to five customers around the world. Three biggest customers are International Lease Finance Corp. in Los Angeles, GATX Capital in San Francisco and Mitsubishi Corp. in Tokyo

PREVIOUS JOB: Senior manager of sales operations, Boeing

MOST NOTABLE REGIONAL BUSINESS TREND: Seattle's efforts to foster an extremely healthy venture capital environment and be sensitive to the needs of an increasing number of startups. Also, the city's attempts to ensure that the transportation systems can support the economic and population growth that is expected over the next 10 years

LIKES BEST ABOUT THE CITY: Its natural beauty and access to the outdoors. Also, the whole Puget Sound area is very committed to community works. It's still small enough and accepting enough of new ideas and visions that you can become politically and civicly involved and make a difference

LIKES LEAST ABOUT THE CITY: People in Seattle are, in my experience, more subtle about their opinions and less willing to engage in a disagreement or a different point of view

FAVORITE CULTURAL EVENT/INSTITUTION: Summer concerts on the pier

FAVORITE RESTAURANT: Matt's in the Market

FAVORITE HOTEL: The Sorrento

Stephen Lewis, WG'70

JOB TITLE: President and CEO of Weyerhaeuser Real Estate Co.

JOB DESCRIPTION: Manages a group of homebuilding and land development companies

PREVIOUS JOB: Senior vice president of the above organization

MOST NOTABLE REGIONAL BUSINESS TREND: The strong economy, due to Microsoft and its spin-offs, Boeing and the Pacific Rim trade

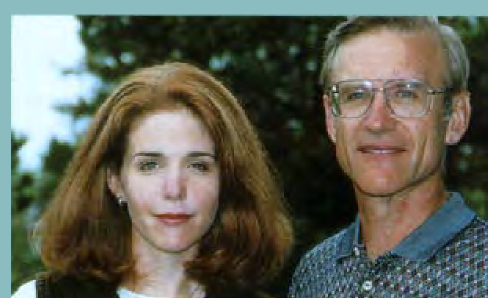
LIKES BEST ABOUT THE CITY: It's very livable. Seattle doesn't close up at night like some other cities. Good restaurants, good entertainment, very strong arts community and very culturally diverse

LIKES LEAST ABOUT THE CITY: Its unwillingness to recognize the need for affordable housing in the greater Seattle area. A large portion of the Seattle community has decided that it is not important for their children — or for people moving here to take on new jobs — to be able to afford housing. The city has put in a series of new laws and regulations that has dramatically increased the price of land

FAVORITE CULTURAL EVENT/INSTITUTION: Seattle Symphony

FAVORITE RESTAURANT: El Terrazo Carmine (very Italian)

FAVORITE HOTEL: The Inn at the Market


Lisa Lewis and father Steve Lewis

Lisa Lewis, WG'93

JOB TITLE: Senior program manager at Amazon.com

JOB DESCRIPTION: Responsible for working with software and editorial departments to produce new features for web site

PREVIOUS JOB: Senior product manager at Edmark

MOST NOTABLE REGIONAL BUSINESS TREND: Explosion of on-line start-up companies across the board

LIKES BEST ABOUT SEATTLE: Easy access to incredible outdoor activities, including hiking, skiing, kyacking and golf

LIKES LEAST ABOUT SEATTLE: So far from East Coast

FAVORITE CULTURAL EVENT/INSTITUTION: Seattle Symphony

FAVORITE RESTAURANT: The Palace Kitchen (northwest with a Mediterranean flavor)

FAVORITE HOTEL: The Alexis

A. Rogers Weed, WG'90

Weed

JOB TITLE: Publisher of Slate magazine at Microsoft Corp.

JOB DESCRIPTION: General management responsibility for on-line magazine of news, politics and culture. In charge of all hiring, marketing, budgeting and business planning

PREVIOUS JOB: Group product manager for Windows 95

MOST NOTABLE REGIONAL BUSINESS TREND: At one end of the spectrum, Boeing's business is booming. At the other end of the spectrum has been the development of a strong technology community, especially in health-related areas. The result is a lot of start-ups and the arrival of venture capital firms drawn by an increasing number of investment opportunities

LIKES BEST ABOUT THE CITY: The climate and lifestyle. The fact that it is a large city but it is still livable and relatively safe. Lots of great city neighborhoods

LIKES LEAST ABOUT THE CITY: Being three time zones away from most of my family

FAVORITE CULTURAL EVENT/INSTITUTION: Starbucks, which I consider all one big cultural institution

FAVORITE RESTAURANT: Etta's (seafood)

FAVORITE HOTEL: Four Seasons

Sajan Thomas, WG'88

Thomas and son Christopher

JOB TITLE: President and founder of Thomas & Associates, a private equity investment company

JOB DESCRIPTION: Focusing on creating and marketing private equity investment vehicles

PREVIOUS JOB: Managing director, Frank Russell Capital

MOST NOTABLE REGIONAL BUSINESS TREND: Tremendous high-tech development, very strong entrepreneurial flavor, increased trade with Asia and a growing Asian population. Our governor is Chinese-American, with very strong ties to China and Asia. In addition, there are world-class companies here that people don't know much about. That means a lot of wealth and a lot of ideas

LIKES BEST ABOUT SEATTLE/TACOMA: From July to September, the weather is perfect. And the people here are very, very friendly

LIKES LEAST ABOUT SEATTLE/TACOMA: The weather from October to April. Wet, dark and gray

FAVORITE CULTURAL EVENT/INSTITUTION: The Tacoma Philharmonic; also an international modern glass museum that is currently being built. The world's foremost modern glass artist is from this area

FAVORITE RESTAURANT: Stanley & Seafort's (steak house and seafood in Tacoma)

FAVORITE HOTEL: Four Seasons (in Seattle); also, the Salish Lodge, a resort east of Seattle

Peter Gelpi, WG’87

Gelpi

JOB TITLE: COO and part-owner, Envision Telephony

JOB DESCRIPTION: Founded the company with three partners (one active and two silent) in 1994. Job involves everything from installing software to raising money from venture firms. Company makes software for recording telephone conversations in call centers. Customers include Nordstrom’s (a retailer that uses the system in its catalogue sales business), Provident (an insurance company that uses it for quality management) and Utilicorp (an electricity broker that uses it to confirm verbal contracts)

PREVIOUS JOB: Director of operations for Adobe Systems until January 1997, when he left to work full-time in new company

MOST NOTABLE REGIONAL BUSINESS TREND: The growth of small ventures that are in the incubation stage

LIKES BEST ABOUT THE CITY: It takes me five to ten minutes to get to my office, five minutes to walk down the hill to my sailboat and 20 to 30 minutes to hike up to 9,000 feet in the mountains

LIKES LEAST ABOUT THE CITY: Microsoft. It sucks up all the available talent and is impossible to compete against. Makes it hard for the rest of us to be successful

FAVORITE CULTURAL EVENT/INSTITUTION: Don’t have one. Lots of diversity. Five new theaters opened this year alone

FAVORITE RESTAURANT: Café Lago (Italian)

FAVORITE HOTEL: The Vintage Park

Ruthann Lorentzen, WG’87

Lorentzen

JOB TITLE: Director of marketing for Microsoft’s interactive media division

JOB DESCRIPTION: Responsible for brand management and marketing functions for a class of consumer products, including children’s reference and geography products, and games

PREVIOUS JOB: Group product manager for the Microsoft project product line. Moved to current job in 1995

MOST NOTABLE REGIONAL BUSINESS TREND: Software, particularly Internet software, start-ups

LIKES BEST ABOUT THE CITY: Working for Microsoft and being in a region that is absolutely fantastic for outdoor adventures

LIKES LEAST ABOUT THE CITY: That it’s gray six months out of the year

FAVORITE CULTURAL EVENT/INSTITUTION: The new Seattle Art Museum

FAVORITE RESTAURANT: Lampreia (nouvelle cuisine with a French twist)

FAVORITE HOTEL: The Inn at the Market

Martin Selig, W’59

Selig

JOB TITLE: President, Martin Selig Real Estate

JOB DESCRIPTION: Owns approximately 2.5 million square feet of office buildings in Seattle, making him the city’s largest office landlord. Manages staff of 60.

PREVIOUS JOB: Started company while a student at Wharton.

MOST NOTABLE REGIONAL BUSINESS TREND: An exceptionally tight office market helped along by a strong local economy

LIKES BEST ABOUT SEATTLE: Sunny days

LIKES LEAST ABOUT SEATTLE: Its losing football team

FAVORITE CULTURAL EVENT/INSTITUTION: Seattle Symphony

FAVORITE RESTAURANT: Carmine's (Italian) or Canlis (American)

FAVORITE HOTEL: Four Seasons

Eileen and Jim Simpkins, WG'91

Simpkins and son Christopher

JOB TITLES: Both recently left Microsoft to pursue projects and spend more time with their young son. Eileen was a product manager from 1994 to April 1997; Jim was a group program manager from 1992 to April 1997

PREVIOUS JOBS: *Eileen:* Associate product manager, Colgate Palmolive

Jim: developer, Fox software in Toledo, Ohio, from 1991 to 1992 when the company was acquired by Microsoft

MOST NOTABLE REGIONAL BUSINESS TREND: *Eileen:* Tremendous high tech growth. Not only is Microsoft growing but there are many spin-off companies as well. Also, the resurgence of Boeing

Jim: The multiplier effect of all the new wealth generated by Microsoft, which shows up in housing, construction, the arts, entrepreneurial ventures and charitable giving

LIKES BEST ABOUT THE CITY: *Eileen:* Mix of outdoors and indoors – beautiful mountains but also great cafes and good theater scene

Jim: Its jet age feel, mainly because of Boeing

LIKES LEAST ABOUT THE CITY: *Eileen:* So far from East Coast. Feels like you are three hours behind the real world

Jim: It's crowded and getting more so

FAVORITE CULTURAL EVENT/INSTITUTION: *Eileen:* Seattle Repertory and other wonderful professional theaters

Jim: Theater scene

FAVORITE RESTAURANT: *Eileen:* Adriatica (informal Mediterranean)

Jim: Café Lago (neighborhood Italian)

FAVORITE HOTEL: *Eileen:* The Inn at the Market

Jim: The Woodmark

Michael H. de Maar, W'70

de Maar

JOB TITLE: Regional industry leader for the West coast for Deloitte & Touche's health care management consulting practice

JOB DESCRIPTION: Strategy, operations, information systems and reengineering engagements for large payors, insurers, integrated health systems and providers

PREVIOUS JOB: Director of policy and evaluation for the U.S. Department of Health and Human Services in Washington, D.C. Came to Deloitte & Touche in 1985

MOST NOTABLE REGIONAL BUSINESS TREND: The spawning of new high tech and venture capital firms surrounding Microsoft's leading edge in the technology world. Puget Sound is becoming competitive with Silicon Valley in attracting talented visionaries and entrepreneurs

LIKES BEST ABOUT THE CITY: It's the greatest place in North America to live. I like everything about it, including the rain

LIKES LEAST ABOUT THE CITY: It's becoming too crowded. Other people have discovered it

FAVORITE CULTURAL EVENT(S): Seattle Opera

FAVORITE RESTAURANT: His own home, with some fine wines from the cellar

FAVORITE HOTEL: Olympic Four Seasons

Summer in The Gambia

and Nine Other Countries:

Volunteer Projects that Change People's Lives

by Gopi Kallayil, WG'98

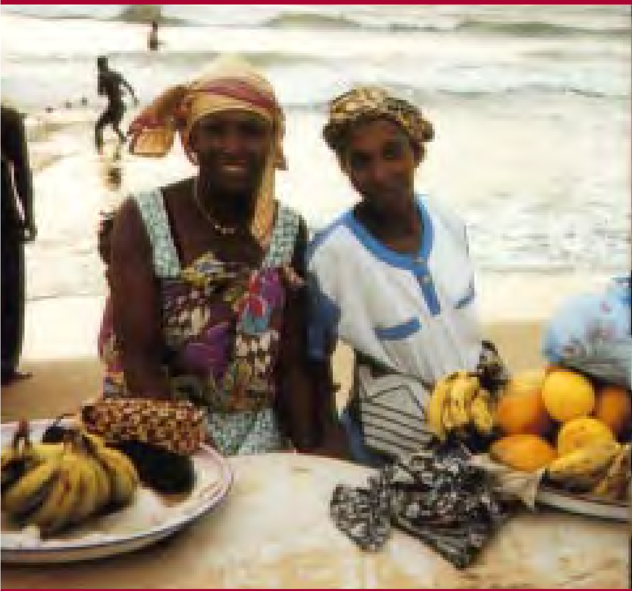
In the searing May heat I looked around the room for a fan and there was none. I looked at the walls and I could spot no switches or wiring. I realized that the school we were in had no electricity. But the rural high school students we were talking to ran a sophisticated company complete with marketing departments, finance directors and annual reports to the shareholders. The country had no stock exchange but the 14-year-olds displayed a financial acumen and understanding of business basics that astounded us. We were in The Gambia, West Africa, as part of the Wharton International Volunteer Project.

The Wharton International Volunteer Project (WIVP) is a student-led initiative that sends teams of Wharton students to work in partnership with non-governmental and charitable organizations on local projects in emerging economies as well as in underprivileged U.S. communities. The projects provide management services to these agencies on a pro-bono basis.

This past summer, 31 students worked on projects in 10 countries including India, Belize, El Salvador, Dominica, Mozambique, Ecuador, Russia, South Africa, The Gambia and the Philippines. The team in India worked with Project Mainstream to help street children micro finance their own businesses. The team in El Salvador helped small local businesses with their marketing plans. In Belize project members joined with an ecotourism group to develop a plan to promote ecotourism while protecting the area's natural resources. And in Mozambique, the volunteers worked with Action for Enterprise to identify economic sub-sectors with strong potential for small enterprise.

There were five of us from Wharton who went to The Gambia. The word "international" in WIVP had really been stretched on our team. David Hinton is American, Finn Mcclain is Dutch-American, Esther Perkins is English, Jane-Frances is Scottish and I am an Asian-Indian. Though The Gambia is an English speaking country, it has a medley of several tribal languages. To that mix we were adding multiple accents, much to the amusement of the groups we worked with.

The Gambia is the smallest country in Africa with a strange geography. Located on the West African bulge, it is only 30 miles at its widest point, but is 300 miles long. The mighty Gambia River, 12 miles wide at its mouth, runs along the length of the country, dividing it into two narrow strips of land on either side. This English-speaking area is surrounded by French-speaking Senegal on three sides, forcing Senegalese to pass through The Gambia to get from one side of their country to another. The mainstay of the economy is a single annual crop of peanuts.



His vision is to develop the technical and business skills of the youth in The Gambia, promote an entrepreneurial culture and generate employment through the private sector.

The Atlantic coast of The Gambia is blessed with spectacularly beautiful beaches that stay sunny and warm throughout the year. European sun worshippers who flock to the beach resorts have created a thriving tourism industry. Although the country's population is only a million people, the annual inflow of tourists numbers approximately 100,000.

The Gambia shot to the limelight in the United States in the 1970's when Alex Haley published *Roots* and traced his ancestry back to Juffureh village on the River Gambia.

Our host organization in The Gambia was The President's Award Scheme, an organization that focuses on youth development in The Gambia and also runs vocational skills training centers and a program that trains and finances young entrepreneurs.

During our three-week stay the team worked on several projects at various Gambian organizations. We taught business courses in different business development programs, provided computer training at the local chamber of commerce and drafted a long-term plan to finance and expand the computer training center at a rural school. We also developed the course material for their entrepreneurship training program, making sure that the business examples used in the program were relevant to the Gambian economy.

The Gambia has a young and ambitious government determined to make the country a model economy in West Africa. President Yahya Jameh, now 31, became president when he was 28. His government has developed a long-term plan for the country titled "The Gambia Inc. – Vision 2020." The minister for youth and sport, Lamin Bajo, met with the team from Wharton and expressed his appreciation for the work we were doing. Forty-five percent of the Gambian population is under the age of 25, he explained, and therefore his ministry, which sponsors our host organization, has a significant role to play in The Gambia's growth through youth development. His vision is to develop the technical and business skills of the youth in The Gambia, promote an

entrepreneurial culture and generate employment through the private sector. He hoped that a long-term relationship will develop between Wharton and Gambian youth development agencies.

One day, Lamin Cessay, one of the students at a school we were working in, took me to the open air lunch shed where women were selling foodstuffs. I decided to get my daily fix of authentic Gambian 'gerte' – peanuts. An elderly woman sold me one handful for 20 bututs, or two cents. I was stunned at this micro-transaction. But in ways incomprehensible to me, out of these two cent transactions, a profit was going to be generated, perhaps a family supported, and a living made. I had difficulty in imagining how businesses could be born in an economy with such tiny transactions.

And therein lay a tale and a hope that people around the world, given the spirit of enterprise, could create opportunities and wealth for themselves under the most difficult of circumstances.

And yet we found success stories. On the Fajara beach, at the Fajara Arts and Crafts market, we met Fatou Mata. She was a graduate of the President's Award scheme and now ran her own business. She sold beautiful African print fabric and tie-dyed material in her shop and tailored them for the tourists on Fajara beach. "In a year," she said, "I should have paid off the government loan and this business will be mine." Later that night we met her again, dancing happily at a concert, looking splendorous in one of her designs. And therein lay a tale and a hope that people around the world, given the spirit of enterprise, could create opportunities and wealth for themselves under the most difficult of circumstances.

Gopi Kallayil, WG'98, grew up in India and completed his undergraduate degree in electronics engineering at the University of Madras. He worked in the information technology industry in India, Hong Kong and the U.S. before coming to Wharton. An entrepreneurial management major, he spent part of last summer working with Bain & Co. in San Francisco.

Michael Horvitz, W'72: The Business of Art

Right off the bat, there are several important things to know about the Cleveland Museum of Art. First, the museum is considered to have one of the most impressive comprehensive art collections in the country, in a league with the Philadelphia Museum of Art, the Museum of Fine Arts in Boston and the Art Institute of Chicago. Second, it is one of the few major art museums that doesn't charge for admission. Third, terms of the museum's $500 million endowment specify that half of the endowment's annual income must be spent on art acquisitions.

"Our collection is about 35,000 pieces, small compared to the hundreds of thousands and even millions of pieces in some other collections," says Michael Horvitz, an attorney who was appointed president of the 25-person museum board last December. "But the quality of each individual piece is superb. It's like a diving competition, where you take the execution of the dive and multiply it by the degree of difficulty in order to arrive at the final score. If you take each piece of our collection and multiply it by the degree of quality, our institution ranks among the top."

Horvitz' goal is clearly to explore, debate and build on the 81-year-old museum's tradition of excellence. "My primary role is to help set the tone and direction of the institution in the long term," he says. "Museums face a number of issues today, ranging from the appropriate role of technology in helping to make collections accessible to the broadest possible audience, to the reduction or elimination of arts programs in many of our public schools."

Not to mention the more immediate issues surrounding what is arguably any museum's most precious commodity – space. Horvitz has set in motion an intensive one-year study of the museum's facilities needs: space for storage, space for curators and others on the 240-person staff, public space for visitors and exhibition space.

HORVITZ

"We have a café now," he notes. "Should we have a restaurant? More meeting rooms? Receptions for community organizations?"

The museum board is also, for the first time in its history, attempting to articulate an acquisitions philosophy. "Our view is that you don't define major pieces just by the price tag," says Horvitz, who describes himself as a "modest" art collector who tends to focus most heavily on 18th and 19th century European paintings. "It's possible to buy a work of art that is the best example of that work in its field for a relatively reasonable price." The museum's most recent acquisition is a painting by American artist Chuck Close entitled "Paul III."

Although the board has no immediate plans for a major capital campaign in the near future, Horvitz is well aware that ongoing fundraising is necessary to support new programs and exhibitions – such as this year's very successful "Fabergé in America," an assemblage of the famous Fabergé eggs and other works of decorative art from the Fabergé workshops. "Cultural philanthropies are very important," he notes. "In many ways a community's cultural life is the heart and soul of its civilization."

Horvitz currently sits on four civic and/or cultural boards in Cleveland (down from a high of 10 two years ago). Because he is a lawyer – and "lawyers know how to keep track of time" – he can tell you that last year he spent about 15 percent of his time on civic activities vs. about 20 percent this year. "It's important to have a balance between family and work and community," notes Horvitz, who lives with his wife and two daughters, 13 and 9, in Shaker Heights.

The 'work' leg of that tripod involves Horvitz' law practice at Jones Day Reavis & Pogue in downtown Cleveland which Horvitz joined after earning a JD from the University of Virginia and an LLM in taxation from New York University. He specializes in counseling members of privately held businesses, focusing specifically on the area of "business divorce – i.e. situations where partners are not getting along or where family members are experiencing significant tension. But I don't do litigation," he notes.

"When I get involved there is usually a transactional answer to the problem. Somebody is bought out, the company gets sold or goes public, etc. I enjoy my practice because I am always dealing with people who have a very personal stake in the outcome."

Rosalind Copisarow, WG'88: Microlending in Poland

COPISAROW

It was an article in the *Financial Times* on the Grameen bank in Bangladesh that was partly responsible for Rosalind Copisarow's decision three years ago to leave her job at J.P. Morgan and start up Poland's first micro fund.

The article noted how the Grameen bank, a pioneer institution in the field of microlending, had made approximately two million loans to low-income residents of Bangaldesh since its beginning in 1976.

Copisarow's Fundusz Mikro, open for business since 1995, has to date processed more than 6,000 loans and created what Copisarow estimates is 4,000 new jobs. The fund's repayment rate is 99.7 percent. "We are enabling people to become financially self-sufficient," says Copisarow. "They are no longer disenfranchised."

But back in July 1994, it wasn't at all clear to Copisarow that her career switch was a good idea. She would be trading 15 years of experience in commercial and investment banking for a job where the average loan size is $1,500 and the clients are businesses that employ approximately five people and are considered "unbankable" – unable to get access to credit from formal financial institutions. In Poland, Copisarow says, there are more than one million such microbusinesses – what she calls "the bottom layer of economically active people in the country" – ranging from taxi drivers and street stall owners to carpenters, stone masons and hairdressers.

Copisarow had two lucky breaks. First, shortly after reading the *Financial Times* piece in 1993, Copisarow, who at that time was J.P. Morgan's country officer for Poland, happened to sit next to Poland's finance minister at a dinner party. "He told me that Grameen Bank was exactly what Poland needed and stated that if I were willing to give up my whole career to establish a similar institution that he would give me every support he could."

Second, $24 million in start-up money from the Polish American Enterprise Fund "landed in [her] pocket." The fund had been established in 1990 by a special act of the U.S. Congress as part of George Bush's initiative to help promote the development of private enterprise in formerly communist countries.

Polish officials already had successful loan programs for such areas as venture capital, small businesses, mortgages and housing development, says Copisarow. "They were willing to try one more experiment – the micro-

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Alejandro Di Capua, WG'90: Turning Around a Utility

DI CAPUA

Alejandro Di Capua sees his goal in very clear terms: to transform Edesur, a $1 billion electricity distributor in the southern half of Buenos Aires, from an inefficient government agency to "the best public service company in Argentina."

It's been challenging, to say the least. Di Capua was hired in 1992, shortly after the company was privatized, as part of a four-person executive team charged with turning around what is Argentina's largest utility. Over the past five years, the company has: cut the workforce from 8,500 to 3,000; converted $30 million per month in net losses to $100 million in annual net income after taxes; cut debt from about $400 million to $170 million, and instituted a host of new employee incentive systems and financial controls.

Continued on page 30

Research Wire

Below is a summary of several research projects recently completed by Wharton faculty.

The Payoff on Diversification: Geography vs. Industry

Although the effects of industrial diversification (expanding to other non-related businesses) and geographic diversification (expanding beyond the home country) have been studied independently of one another, they have never been explored simultaneously.

A recent study led by Wharton's Gordon Bodnar examined the effect of geographic and industrial diversification on firm value using a sample of more than 20,000 observations from U.S. corporations from 1987 to 1993. In all cases, the researchers found that the size of both the geographic and industrial diversification effects have a large economic impact, ranging from 2 to 7 percent of firm market value. In addition, they found that although the magnitude of industrial diversification effect was larger than that of geographic diversification, it negatively impacted firm value, while the impact from geographic diversification was positive. Based on these findings, "companies are better off staying with what they do best and expanding abroad rather than expanding into unrelated businesses domestically," says Bodnar.

In addition, the researchers say that future studies must take into account both industrial and geographic diversification simultaneously in order to accurately assess the relative value impact of each form of diversification. Bodnar and his colleagues found that not controlling for geographic diversification leads to a 40 percent over-estimate of the average negative effect of industrial diversification on value.

Gordon M. Bodnar, Charles Tang, and Joseph Wientrop; Both Sides of Corporate Diversification: The Value Impacts of Geographic and Industrial Diversification

Are Consumers Saving Enough?

Are consumers saving adequately for retirement? Where are they placing their money? What specific products appeal to them? As part of an ongoing project conducted jointly by the Wharton Financial Institutions Center and KPMG Peat Marwick LLP, researchers have examined these issues and identified several findings including:

- The retirement asset market itself is growing rapidly as baby boomers save at a faster pace than their parents (at the same stage in their life cycle). However, household asset accumulation is considerably less than would be required for adequate retirement income.
- Advice sought regarding retirement savings options is often ad hoc and rarely expert. As a result, people are probably buying too few annuities with their retirement wealth.
- Educating workers about their retirement saving needs increases the chances they will save.
- The retirement products used by baby boomers have shifted substantially, such that: defined benefit plans within the pension asset category are declining as a percentage of wealth and retirement assets; traditional corporate defined benefit pensions are being overtaken by participant-directed accounts including IRA and 401(k) plans; annuities, offered primarily by insurance companies, have grown in importance relative to wealth, but are slipping as a percentage of retirement assets.
- Mutual fund market share growth has occurred primarily at the expense of depository institutions, most notably in IRA and 401(k) assets.

"Changes in demographics, regulatory conditions, and economic forces, are forcing us to think in new ways about retirement saving and dissaving," said Wharton's Olivia Mitchell, one of the project's researchers. "Among the changes we face is a movement away from government and corporate-sponsored defined benefit programs, toward employee-driven alternatives, such as 401(k)s and IRAs. This risk transfer from larger group pools to individuals is challenging the financial service industry, and insurers in particular, to find new products and new distribution channels to serve the retirement market."

Olivia Mitchell, Anthony Santomero, Harris Chorney and Jill Goldman; The Competitive Performance of Life Insurance Firms in the Retirement Asset Market

Siskel and Ebert: Long-Range Forecasting Tool?

Conventional wisdom suggests that movie critics have their greatest influence on box office revenues early in the life cycle of a motion picture, because during that time, information such as word-of-mouth is more scarce. However, according to a recent study co-authored by Wharton's Jehoshua Eliashberg, the aggregate impact of critical reviews on actual box office revenues at the beginning of the movie's life has little impact. But the study found that critical reviews are significantly related to the late box office revenue, as well as cumulative receipts. The authors note that critics could be less prominent than other factors, such as TV advertising, trailers and talk shows, in motivating moviegoers to attend movies. However, the critical reviews may provide a useful forecasting tool for estimating the ultimate potential of a motion picture.

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"Executives in the entertainment industry may wish to reevaluate their perspective on the role, importance, and impact of critics as a result of our research," says Eliashberg.

Jehoshua Eliashberg and Steven M. Shugan; Film Critics: Influencers or Predictors, published in Journal of Marketing, April 1997

What Really Happens When Hospitals are "Reengineered"?

More than 60 percent of all U.S. hospitals have invested in reengineering initiatives and have spent billions of dollars in the process, yet no one really knows exactly how that money is being spent or what the payoffs have been.

To answer these questions, Wharton researchers recently studied a sample of 14 hospitals nationwide, ranging from large urban teaching hospitals to small rural community hospitals. Their findings identified seven distinct areas around which, in various combinations, reengineering projects were organized: patient aggregation, clinical resource management, changes in managerial structure, decentralization of organizational services, downsizing layoffs, skill mix alterations, and non-core cost savings changes.

Interviews with 255 executives, mid-managers, physicians, staff nurses and non-nurse members, highlighted numerous factors that seemed to affect the fate of reengineering efforts. Those factors included clarity and consistency of vision, training and preparation for change, communication, support and involvement, measurement mechanisms, authority and responsibility, transition between project phases and physician involvement. Researchers concluded that an overall strategy for change must link and manage these factors simultaneously. "If one or more is undermanaged," they write, "the ultimate success of the change effort is at risk."

John R. Kimberly and Stephen L. Walston; Reengineering Hospitals: Evidence from the Field, published in Hospital & Health Services Administration, Summer 1997

Technology and Performance: It's the People

As organizations continue to pour billions of dollars into information technology (IT), the jury is still out on whether it is actually improving productivity and efficiency. While there is evidence of a payoff in the manufacturing sector, little research has focused on the service sector. In an effort to analyze the impact of IT in the U.S. retail banking industry, researchers from the Wharton Financial Institutions Center gathered data from 115 banks and found that additional investment in IT capital (hardware and software) may have no real marginal benefits and may be more of a strategic necessity to stay even with the competition. However, investments in IT labor have a much higher payoff (nearly $450 for every dollar invested).

The researchers also found that the more profitable banks put more emphasis on maintenance of IT systems, had more in-house development of IT and less outsourcing, and allowed IT staffers to have more input in project selection and funding decisions of IT investments. Says Wharton's Patrick Harker, co-author of the study, "Machines can't give you a competitive advantage. It's all about the people."

Patrick Harker and Baba Prasad; Examining the Contribution of Information Technology Toward Productivity and Profitability in U.S. Retail Banking

Books *Continued from page 12*

marketing their brands … They feel it's risky to build equity behind a specific brand (author) because the stronger you make an author the easier it is for him or her to demand bigger advances."

Despite the search for, and cost of, best sellers, no one seems to feel that unknown authors are being denied opportunities to publish their work. "If the publishing business was dominated by only large publishing companies, then perhaps new authors would have a hard time getting contracts," says Clarke, who adds that with children's books the process of finding authors and nurturing them over long periods of time is still the operating approach of most quality publishers. "But if you look at the landscape and note how many books are published each year by non-giants, then you would see that there is no lack of publishing activity … Talk to a retailer with 100,000 books in his store and ask him how many different publishing companies he works with. You would be astounded by the number."

"The American public is not being denied good books," adds Vitale. "You have to look at the whole industry. In addition to the large publishing houses, there are always the smaller presses." And if they are bought by big companies? "New ones will always start up," he says.

COPISAROW *Continued from page 27*

market."

Banks typically stay away from microlending because of the "riskiness of the clients and because the transaction costs of processing a loan are bigger than the income from the loan itself," Copisarow says. But she takes exception to the idea that low-income people are inherently greater credit risks. "It's a total myth. My belief is that the poorer people are, the more credit worthy they are. If you lend to people who are destitute, on trust, they make sure they pay you back."

Her theory is reflected in the methodology that Fundusz Mikro adopted after a period of researching similar funds and then testing out different approaches. "We rely on psychological pressure between groups of friends or business partners who know each other. If any one person can't pay back the loan, the others have to chip in. If they all pay back the loans, the next day they get bigger loans to develop their business even more.

"It works," Copisarow says. "Not only does it make a tight repayment rate, but it reduces the transaction costs. We tell a person to find the best partners possible to work with. That means we end up loaning money to between four and seven people, which raises the income for us. Also, we can give the group a cheaper interest rate than would be possible for an individual. Approximately 80 percent of our clients are group clients."

Fundusz Micro has branches in 20 cities in Poland and hopes to open another 10 to 15 in the next year, an expansion plan that would enable the fund to cover every place in Poland with a population of more than 150,000 people. One of the fund's three directors is Jamshed Ghandhi, associate professor of finance at Wharton, who taught Copisarow a course in capital markets.

All the 60 plus employees of the fund are Polish, except Copisarow. She was born in France, grew up in England, earned her undergraduate degree from Oxford, and worked for Citicorp, Midland Bank, Samuel Montaqu and J.P. Morgan before starting Fundusz Mikro. At Wharton she was in the Joseph H. Lauder Institute of Management and International Studies program.

GOERGEN GIFT *Continued from page 3*

nesses, commercializing new technologies, venture capital and managing rapid growth; and serving as a bridge for student business acquisition information.

• Expand international programming through increased visiting scholar programs, student exchanges and the establishment of entrepreneurial programs in developing countries.

• Expand doctoral initiatives and teacher development.

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DI CAPUA *Continued from page 27*

For example, one of Di Capua's first moves was to set up a budget process whereby "all employees must get permission to make an expenditure before the expense is incurred, not after, as had been the case. Even many American companies don't operate like this because it is considered impolite or because it limits an employee's freedom. My system initially was considered radical; no one in a government-owned company had ever budgeted this way, and on a monthly basis."

Di Capua, however, looks beyond the numbers to find measures of his success. "Graduates of some of the best schools in Argentina now want to work here," he says. "We have shown the benefits of a turnaround that could not have been shared with 8,000 employees but that could in fact be shared with 3,000 … People are starting to feel proud that they are part of a company which offers job security, promotes people from within, distributes dividends to its shareholders, pays taxes and provides a better service."

Edesur's three biggest shareholders are Chilean-based Enersis, U.S.-based Entergy and a local group, Perez Companc. Employees own 10 percent of the company through an employee stock ownership plan.

Di Capua grew up in Buenos Aires, attended public schools, including the University of Buenos Aires, and worked for J.P. Morgan, Morgan Stanley and McKinsey & Co. before joining Edesur. He and his wife, a graduate of Harvard Business School and a vice president at Chase Manhattan, have one son, Nicholas.

Edesur's biggest challenge over the past five years has been cutting down on electricity theft in poor neighborhoods. Total electricity losses today are 9.8 percent as opposed to 27.1 percent five years ago. Now, one of its main challenges looking ahead is to grow the business, primarily through acquisitions both inside Argentina and out. "The opportunities are there as electricity distributors in neighboring countries start to privatize," says Di Capua. "We will expand in big steps."

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