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Chester R. Smith

David K. Banner

Billy Grantham

J. N. Cetinich

J. R. Charrin

See next page for additional authors

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Letters

Authors

Chester R. Smith, David K. Banner, Billy Grantham, J. N. Cetinich, J. R. Charrin, and Hollis M. Black

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Company man?

MANAGEMENT SERVICES has been a steady item in my reading diet since its inception. Many articles have been of interest, and several have offered direct approaches to solutions to problems encountered.

Once in a while, as in the January-February, 1970, issue, an article appears with a statement that outrages me! In the first paragraph of "What a Financial Manager Should Know About COBOL and Assembly Language" [by David K. Banner, p. 37], the question is raised, "Who is best qualified to run an EDP installation, the experienced company man or the qualified EDP technician?"

My outrage is *not* related to the answer subsequently given to this question but rather to the implication made that there is a distinction between a company man and an EDP technician. I have never seen facts establishing the presumed difference embedded in his assertion that an EDP technician could not be a company man. What is a company man?

I suggest that Mr. Banner owes readers a clarification of his implication, and, I believe, he should apologize to those EDP technicians who are excellent company men—unless, of course, Mr. Banner wished to display . . . the blind allegiance . . . of some CPAs who would have us believe that a *company man* is "a financial manager" (and here, I believe, the implication is strong that the financial manager should be a CPA).

I truly believe that if Mr. Banner's company man needs to know the content of his article to manage the data processing area, then the top management should reconsider the overall organization of having the data processing under the responsibility of the financial manager! I for one would rather have the EDP technician in charge and have him report to someone else.

Chester R. Smith
Arlington Heights, Illinois

P.S. I am neither a CPA nor an EDP technician. I do, however, manage a medium-size data processing installation (including systems work, programing, and operations) but do not report to financial management. I receive MANAGEMENT SERVICES through our controller, who is not a CPA.

No real conflict

I do believe . . . [Mr. Smith] misunderstood the implicit meaning of my statement about the "experienced company man and qualified EDP technician." It is quite possible for these to be the same man. However, in my experience, a common dilemma facing corporate management is whether to import a technician as EDP manager or

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use a loyal company man with less technical expertise.

It is largely a philosophical question, depending upon how "technical" a man you think is needed to supervise *technicians* in a data processing installation. I personally believe the loyal company man, with a sufficient general knowledge about hardware *and* software, can be highly effective in the role of EDP manager. After all, a leader needs to *direct* the efforts of others; the "others" are assumed to have the intricate, sophisticated technical expertise.

David K. Banner
Peat, Marwick, Mitchell & Co.
Houston, Texas

Utmost clarity

I have just read Mr. Harvey E. Schatz's "The Uses of Work Management" in your November-December [1969] issue [p. 15]. After years of exposure to work "measurement" and after reading numerous articles on the subject, this seems to me to present work management with utmost clarity and simplicity. Although I have been a reader of your magazine a very short time, I'll certainly continue to read it with pleasure in the future.

Billy Grantham
U. S. Army Aviation Center
Fort Rucker, Alabama

Finds analysis biased

I would like to comment about the article, "A Lease-or-Purchase Decision Model for the XYZ Corporation" [by Jack R. Charrin], presented in your September-October [1969] issue of MANAGEMENT SERVICES [p. 19].

To the knowledgeable, the author's analysis was highly biased toward the leasing alternative. In the instant case the only analysis required was the fact that XYZ Corporation, under its present debt structure, was restricted from taking on additional debt. Since the decision was made to acquire use of equipment, the options were limited to leasing (or possibly purchase with working capital).

Even had there been no debt restriction, the analysis was faulty. The article stated that the equipment, at the end of six years, had a market value of $140,000. This should have been included as a cash flow consideration at the end of the period.

In the comparative analysis contained in Table VI [September-October '69, p. 24], I cannot understand why gross depreciation (Column 3) was not taken in an accelerated manner rather than straight line if cash flow was such a factor. I also fail to comprehend why the investment credit was not all taken the first year.

As an added consideration: If equipment was purchased, since it had still about 20 per cent residual value at the end of six years, an eight-year life for the equipment would seem appropriate. This would allow taking the full 7 per cent credit, and enjoying the cash benefits during the entire term, even though one-third might have to be refunded at the end of the six-year period.

If the cost comparison between the purchase and lease alternatives given had been made with due consideration of the residual, accelerated depreciation, and investment tax credit, then the present values of both lease and purchase cash flows, discounted at 10 per cent, would have been approximately equal. The comparison would have highly favored purchase if the life of the project was extended one or more years.

While the article indicated that the bank credit line would not be impaired under the lease alternative, a responsible bank officer would inquire about the company's outstanding lease commitments.

I am not sure that the decision would have been any different in this instant case had the comparison been evaluated more objectively (even if it had no debt restrictions). However, I deplore [the possibility] that the less knowledgeable may attempt to mimic this analysis for their lease/buy decisions. Leasing does have a place in a corporate financing scheme; however, its value is not enhanced by the misleading analysis presented in this article.

J. N. Cetinich
Manager, Analytic Services
Southern Pacific Company
San Francisco, California

Stresses flexibility

Coming from a manager of analytic services, [Mr. Cetinich's] rather emotional comments were surprising.

Commenting on [his] specific observations:

While the debt structure was restrictive, if XYZ had decided to use either purchase or lease, the lender would have allowed [it] in view of other considerations facing XYZ Corporation at the time. The analysis was undertaken to show a method of analysis XYZ *could* use. Its working capital position showed a downward trend (Table 1, M/S September-October '69, p. 20), which eliminated a purchase with working capital option, as you suggested.

My reply to Professor Stephens' letter in the January-February issue of MANAGEMENT SERVICES [see pp. 1-6] discussed the residual value aspects of this equipment. It was not used in the cash flow due to its highly uncertain value at the end of six years. The $140,000 was approximate and, therefore, not used except in the cost comparisons.

Depreciation was taken on a straight line basis at the request of XYZ. The model is flexible, which is the main point the reader or analyst should note.

Investment credit was spread over two years because of XYZ's tax liability limitations. Again, the model used an actual company as input data. Another company might well elect to take credit in the first year. [The] same comment applies to using an eight-year life versus six years used in

the model. (See Footnote A, p. 2, M/S January-February '70.)

I was gratified that [Mr. Cetinich's] final comment was not shared by other readers. The method of analysis used is one of many and is flexible enough for most to adapt the model for their particular ends.

J. R. Charrin
Assistant Division Treasury Manager
Continental Oil Company
Salt Lake City, Utah

Lease-borrow-buy review

Members of the finance staff at Monsanto are currently reviewing lease-borrow-buy decision criteria as the first step in establishing corporate procedures for the analysis of each type of decision.

In reading [Mr. Charrin's article] I was left with three questions:

1. Table II, p. 21: Why is Column 3 not consistently the difference between [Columns] 1 and 2? Column 2, Lease Net Cash Out, is a cost to the company cash flow for the first three years but not during the last three. Why?

2. In finding a present value, shouldn't the salvage value be an integral part of the calculation?

3. Since the cost of capital (discount rate) includes the after-tax cost of interest expense, is there a need to penalize the purchase alternative with the cost of interest on debt?

Since [Mr. Charrin] quoted Vancil's *Harvard Business Review* article twice, I am curious to know if [he] agrees with [Professor Vancil's] methodology for analysis of the "lease-vs.-borrow" problem.

Hollis M. Black
Monsanto Company
St. Louis, Missouri

Background reading

In answer to [Mr. Black's] three specific questions:

1. This was a math error which has been noted by other readers. [See M/S January-February '70, pp. 1-5.]

2. Salvage value was considered along with lease finance charges versus purchase costs in dollar cost differences only. This was discussed on page 26 [of the article] and again on page 5 of the letters column [of the January-February issue]. Since the salvage value *is* highly uncertain and [it is] difficult to place a dollar or percentage value on it, I chose not to consider this in calculating a present value. However, salvage value should be considered as something that is given up in leasing. Being aware of an approximate dollar figure should be a part of the decision model under the cost factor.

3. I believe the letter on discounting by Professor Stephens [M/S January-February '70, pp. 1-3] answers this question. The discount rate was applied simply to relate future dollars gained by leasing to a present value as of today. The rate was related to the firm's cost of capital or investment opportunity rate and would not affect considering interest expense as part of the purchase cost when comparing cash out in the two alternatives.

With regard to Mr. Vancil's *Harvard Business Review* article on the "lease-vs.-borrow" decision, as I recall, this method involved only one factor in the . . . decision —cost. The method of calculating cost of each was complex and difficult to follow. As I pointed out, there are other factors to consider in a lease-or-purchase decision. In most cases, leasing commands a higher dollar cost compared to purchasing. The difference, however, can be offset by what use is made of freed dollars when leasing.

Mr. Vancil's approach . . . is useful as background reading on the lease-purchase decision, but the approach does deal with only one factor, as I see it, and takes a rather involved approach to the cost factor. As a general rule, leasing is more expensive, but consider the cash flow differences and [the] uses [that can be made] of these differences.

J. R. Charrin

The method of analysis used is one of many and is flexible enough for most to adapt the model for their particular ends.

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