what people are writing about

BOOKS

The Wreck of the Penn Central by Joseph R. Daughen and Peter Binzen, Little, Brown & Company, Boston, 365 pages, $7.95.

Imagine two giant corporations, neither of them earning a substantial profit, two administrations, one geared to better marketing practices, one aimed at volume for the sake of volume, three top executives, none of whom is on cordial —or even speaking—terms with the others.

Merge the corporations, on a one-for-one basis, where all three antagonistic top executives are held in positions of major authority, and where line management is taken over by representatives of each of the two companies so that a department head from Company A has as assistant an executive from Company B.

Superimpose on all of this a Government regulatory body which has control of the prices that can be charged, the services that must be maintained, whether profitable or unprofitable, and you have *The Wreck of the Penn Central.*

This history of the dismal, 871-day record of the largest corporate merger in American history (which ended with the most resounding bankruptcy in American history) touches nearly all the stops in its detailing of the almost incredible downhill path of the transportation complex, from its formation in February, 1968, until its ignominious end in June, 1970.

Take, first of all, the three principal officers, Stuart Saunders, Alfred Perlman, and David Bevan. The first and the last were old Pennsylvania Railroad men, but they both seemed to believe that the railroad's profitable days were over, that the future lay in diversification, in investing railroad money in other ventures that would return a higher profit. The third, Alfred Perlman, a New York Central man, believed the business of the railroad was the railroad, that every penny spent on improving maintenance or rail service would pay off in increased earnings.

Saunders, the Pennsylvania man, was made chairman of the board of the new Penn Central. Perlman, the New York Central man, was made president and chief of operations for the complex. Bevan, the financial man, was made vice president of finance, but was not given a seat on the board of directors.

Divided authority

So, in effect, a troika form of government was set up—made even more divisive by the fact that Saunders knew comparatively little about railroading, and that Bevan, though in charge of finance, was not allowed to control the budget. As a matter of fact, he wasn't even allowed to see it; Perlman didn't believe in income budgets and refused to submit them.

Add to this, the fact that operating headquarters for the new complex was located in Philadelphia, but that Perlman refused to move there from New York, and that line executives from the two railroads, which had been bitter rivals for years, were inextricably mixed up in the new organization.

There lay the seeds of the eventual disaster, the book's authors, two Philadelphia newspapermen, Joseph R. Daughen and Peter Binzen, seem to believe. Or, at least, the sheer size of the eventual disaster resulted from these causes.

For disaster there might have been in any event. The two lines were both in very bad shape physically at the time of the merger. They had come out of the war years the largest carriers in the East but they had come out with a badly exhausted physical plant, with rails worn out by the constant traffic of troops and freight trains, with rolling stock worn out by the same hard use. They were handicapped, too, by a freight pattern in the nation's most densely populated area that caused most freight hauls to be short and, therefore, comparatively unprofitable.

And the Penn Central had the highest wage costs of any railroad in the country.

The merger compounded all the troubles facing both lines.

First of all, the two lines' computer systems were incompatible. Although both roads had IBM systems, one was fed computer printout and punched tape, one used IBM cards for entry. So all information generated in New York Central territory had to be laboriously translated into a second medium in New York for eventual transfer to the main computer center in Philadelphia.

Then the merging of personnel, although it looked good on paper, worked out disastrously in practice. The two lines each had freight yards of their own in a number of cities, but the dispatcher, if he were an old New York Central man, was apt not to know the location of the Pennsylvania's yards in Cincinnati, Chicago, or Cleveland (the reverse, of course, being true if he were an old Pennsylvania man). So freight trains became disastrously snarled, waybills became separated from the cars they presumably were accompanying, entire trainloads became lost between their dispatch points and their destinations.

All of this hit the railroad financially, of course, because the Penn Central never had enough freight cars, and so was always renting them on a per diem basis from other lines. With entire trains lost somewhere in the system, costs mounted astronomically just as income was dropping.

This, in turn, hastened the financial day of reckoning. Perlman was still plowing money into the railroad; Bevan and Saunders were still attempting to invest railroad assets in businesses that promised a more profitable return. The railroad's cash flow position became more critical daily. Bevan, although he had no control over the budget, was responsible for getting money for the operations of the line and he mortgaged almost every physical asset the railroad and its various properties had, finally resorting to borrowing money from banks with no collateral at all. The Penn Central's credit with the banks was always good; the Pennsylvania Railroad had never missed a dividend since its establishment in 1849 and even during its darkest days the new complex kept on paying dividends.

Eventually, of course, the bubble burst. There was a last-minute attempt to get Federal guarantees for one more loan, and for a time the railroad fervently believed the guarantee would come through—as did many officials in Washington. However, powerful Congressional opposition developed to the loan guarantee scheme, and its most ardent sponsors abandoned it and the Penn Central. A special meeting of the railroad's board on Sunday, June 21, 1970, drew a petition for reorganization under Section 77 of the bankruptcy act.

The board, true to the Penn Central tradition of doing nearly everything wrong, raised the salaries of many of its top officers as the first order of business before moving on to the distressing matter of petitioning for reorganization under Section 77. The order was signed within the hour by Judge C. William Kraft, Jr., of the United States District Court for Eastern Pennsylvania.

The Penn Central Transportation Company had reached the end of the line.

The book ignores the detailed accounting implications of the collapse, but it does sketch in the incredibly involved picture of properties owned by the railroad, and the financial machinations some of its officers allegedly indulged in. Some officers, for example, are reported to have formed a private investment club. They would then use Penn Central funds to make vast purchases of stocks held by the club, after which they would sell their personal holdings at artificially high levels, while simultaneously buying additional quantities for the Penn Central portfolio.

Whether the final disaster could have been averted is one of those intriguing questions that can never be answered unequivocally. What does seem certain is that if the merger had never been attempted in the first place, the New York Central would have put what money it could raise into improving service, and relations between Perlman and his own financial man would have been incomparably better than they were between Perlman and Bevan. The Pennsylvania would have let the railroad deteriorate but would have kept pumping money into its attempt to build a conglomerate—and it would probably have done so far more successfully if it had not had to enter into increasingly dubious ventures to finance Perlman's demands for cash.

And, finally, if the two roads had never merged, the incredible tie-up that occurred from misdirected trains and bad computer communications would not have occurred.

All in all, this book is almost a case history of how not to go about a merger and so is must reading. The sheer size of the merger was, perhaps, its one overwhelming attraction; on every other score it made little or no sense. The clash in corporate philosophies between the New York Central men and the Pennsylvania men, their ignorance about the locations of the other's facilities, the divided responsibilities at the top—all these were early harbingers of trouble.

All in all, it was a hell of a way to run a railroad.

Valuing a Company: Practices and Procedures by George D. McCarthy, CPA, and Robert E. Healy, CPA, The Ronald Press Company, New York, 1971, 521 pages, $25.

This manual, by two partners of Price Waterhouse & Co., covers just about everything a professional would need to know about valuing a business.

Four major purposes of company valuation are stressed in this concise, comprehensive, but far from lively guide: for public offerings; for acquisition and merger purposes; for tender offers; and for Federal estate, gift, and income tax purposes.

The section on valuation for public offerings is of interest to investors as well as to management and CPAs.

It reviews SEC requirements for initial offerings; tax, procedural, and pricing considerations; and the weight that should be given to various factors in the securities markets.

A unique feature of the book is a series of comprehensive tables presenting critical data for companies in various industries involved in mergers and acquisitions, public offerings, tax valuations, and tender offers and for a selected number of conglomerates. These tables were the result of "a vast amount of research" in financial publications, proxy statements, annual reports, stock listing applications, and tax decisions.

Information tables

For reference in preparing initial offerings, the book tabulates, for 20 industries, the total number of stock issues listed on the New York Stock Exchange, the total number of shares and the total market value in 1968 and in 1970 and gives similar information for listed bonds. Another table reports, for 11 dates between 1962 and 1967, price-earnings ratios of 11 industry stock groups, compared to the price-earnings ratio of a composite of 425 industrial stock. In a table that stretches over nearly 14 pages the authors give basic data on 200 initial offerings of common stock between 1962 and 1966: offering date, number of shares outstanding after offering, aggregate and per-share price to the public, underwriters' discounts and commissions, estimated expenses, earnings per share for the three years prior to the offering, price-earnings ratio for the fiscal year prior to the offering, and the highest and the April 28, 1967, market prices.

The section on business combinations covers basic considerations, caveats and investigations; accounting questions; SEC and Stock Exchange requirements; tender offers; valuation factors; and conglomerates. A tabulation of 75 tender offers lists the shares outstanding at the offering date, the number of shares requested, the offering price, the approximate market price before the offer, the premium offered (as a percentage of the market price) and the results of the tender offers. A mammoth set of tables on mergers lists 142 acquisitions financed by issue of stock, 57 cash purchases, and 25 acquisitions by a combination of stock and cash, with pertinent financial data from and after the merger.

Conglomerates

A chapter on conglomerates attempts to evaluate the advantages of this method of expansion, with tabulation of indebtedness, stockholders' equity, and net income for 21 of them. A fairly detailed case study of Walter Kidde & Company illustrates how earnings per share may be improved through acquisitions.

Other types of valuations discussed include those required for a "stepped up" basis in a taxable acquisition of a company; valuations of small professional and personal service organizations; valuations in regulated industries; and valuations for dissenting stockholders.

An appendix more than 50 pages long contains such background documents as listings of the financial statements required by the SEC for a new issue and for an acquisition, a digest of the Justice Department's merger guidelines, and a summary of state laws regarding rights of dissident stockholders.

This book is not light reading, and its price is as heavy as its style.

It is, nonetheless, an invaluable reference work that belongs in the library of every CPA firm and probably of most corporations as well.

Briefly listed

Black Capitalism: Strategy for Business in the Ghetto by THEODORE L. CROSS, Atheneum, New York, 1971, 274 pages, $3.45 (paperbound).

This is the paperback edition of a book that received the McKinsey Foundation award in 1969. Its analysis of the problems inhibiting the development of "black capitalism" and what to do about them led to the establishment of the Opportunity Funding Corporation, through the Office of Economic Opportunity. On the whole, in spite of the organizations that stemmed from it, the book is probably as valid now as it was in 1969 —and certainly as interesting.

Institutional Investing: The Theory and Practice of Managing Large Portfolios of Other People's Money — in Pension Funds, Mutual Funds, Endowments, and Trusts—and Achieving Sustained Superior Performance by CHARLES D. ELLIS, Dow Jones-Irwin, Inc., Homewood, Illinois 60430, 1971, 253 pages, $9.95.

This book, by a vice president of Donaldson, Lufkin & Jenrette, Inc., describes the portfolio management methods of the leading institutional investors. It is aimed at present and prospective investment analysts and portfolio managers and at those who select them. Topics include bond, cash, and equities policies; portfolio operations; portfolio analysis; opportunity analysis; financial analysis; business analysis; analytical pitfalls; risk analysis and management; market analysis; endowment funds; pension funds, and individuals as clients; and the impact of institutional investing on corporations and capital markets.

MAGAZINES

The Accountant, Data Collection and Social Exchange by JOHN J. MCDONOUGH, *The Accounting Review*, October, 1971.

Contemporary controllers are operating in a changing organizational environment and have an opportunity to expand their role by supplying better intelligence to top management. An understanding and application of social exchange theory helps focus upon the problems this larger rôle presents.

The rate of corporate growth, decentralization, and expansion of high technology industries have, in recent years, emphasized management's need to maintain adequate control over operations. The controllership function has responded to this increased need for intelligence by modifying its objectives toward acquiring more relevant, timely, and accurate information. In order to accomplish this task, the controller has to go beyond the traditional approaches of data accumulation and comparing actual performance against standards to compute variances. Since the variances alone seldom provide sufficient insight for managerial action, additional information must be obtained from individuals who may be in remote parts of the organization.

McDonough suggests that the accountant's ability to collect data on an unprogramed and ad hoc basis may be the key to greater organizational influence, but is not without additional problems.

The theory of social exchange describes the underlying dynamics between two parties in some social relationship as a series of transactions in which both perceive a "profit" from the other. This process calls for a general balancing of obligations in order to sustain meaningful relationships.

For McDonough, social exchange theory is extremely valuable as it calls attention to several factors relevant to information collection.

(1) Information collection emphasizes the commodities exchanged in order to sustain interaction.

(2) The commodities are a number of social needs including power, status, affection, respect, help, knowledge, and emotional support.

(3) Any relationship has a great deal of uncertainty because of its dependence upon the unknown needs and values of the other party.

(4) The feedback process provides a sensitive mechanism to signal an unstable condition in the balance of obligations.

Conflict areas

McDonough discusses three areas which contribute to weakening the accountant's position as he attempts to collect data. The first of these is that the objectives or priorities of the informant are not congruent with those of the solicitor. This can result in conflict as the informant regards requests for information as secondary to his primary task.

Secondly, the solicitor initiates nearly 100 per cent of the social exchanges by requesting information and thus immediately upsets the "balance of trade," by going into debt.

Another problem that is likely to cause breakdown is that the informant has a greater degree of control over the relationship than one would at first suspect. The informant often may feign compliance while avoiding real cooperation. Some of these tactics are:

(1) Delay—Stall techniques are often effective and are popular as a "first line of defense."

(2) Feigned Ignorance—The solicitor is often in the position of not knowing whom to ask or precisely the best, penetrating question. This makes it difficult to evaluate the worth of an answer or judge its sincerity.

(3) Overcompliance—Using this tactic the informant overwhelms the solicitor with a mountain of information in the form of manuals, tapes, files, and memos. He thus

avoids giving meaningful information while appearing to comply.

The author's conclusions are that as controllers expand their role and supply better intelligence to management, they should be aware of the real problems the expanded role presents. The financial management function may not be viewed as most important to line managers; therefore, the accountant's approach must be consistent with his bargaining position. The informant has several tactics available to him to avoid cooperation, in addition to the lack of skill on the part of the solicitor in framing sharp questions.

If successful at developing stable communication nets within the organization, the role of the accountant will move away from that of partisan watchdog of top management toward one of "integration." The work of Lawrence and Lorsch suggests the need for achieving unity of effort among the functional specialists in business. McDonough nominates accountants to fill this need as the focus shifts from that of uncovering "skeletons" toward facilitating interaction within the organization.

K. B. Ehrenreich, CPA
University of Southern California

City Hall Discovers Productivity by Dan Cordtz, *Fortune*, October, 1971.

The burgeoning demands on the resources of local governments are requiring reexamination of the traditional emphasis on simply finding new sources of funds. Currently, there is a newly awakened interest in more efficient cost management and improved productivity.

This article presents a concise picture of the dilemma of local governments in the United States today. It points out that, while many municipal services are still a bargain by some standards, the costs of such services are skyrocketing but the services themselves often appear to be deteriorating. The increasing costs are in direct contrast to the mood of the local taxpayer, irrespective of the fact that local taxes are but a small percentage of Federal taxes. The reason that the taxpayer expresses his angry mood toward local taxes is that these taxes have risen sharply in recent years while Federal taxes have been high for decades.

Characteristics of local spending

The revolt of local taxpayers against new funding and taxes was brought out by the author in citing examples of amounts and types of expenditures. For instance, Newark property taxpayers pay $2,700 on a $30,000 home. Nearly 26 per cent of the $34.2 billion in 1970 municipal taxes, or $7.2 billion, went for general administration and control of the municipal operations. Nearly all functions of the services rendered are labor intensive and the number of workers is increasing more rapidly than the population as a whole. The public is well aware of this growth and is resisting all efforts to raise the local taxes. Local officeholders are realizing that lowering costs and increasing productivity are the answer to providing adequate services without increasing the costs to the local taxpayer. How is this to be accomplished?

Productivity

While the computer is omnipresent, its use as an analytical tool for decision making has been virtually ignored by municipalities. Now, however, the computer is being utilized in finding possible increases in productivity. Los Angeles, for instance, was able to reduce the time it takes to collect a ton of refuse from 2.68 hours to 1.67 hours through a computer-based study that even included measurements of energy expended by crew members. The computer is aiding crime detection and prevention as well—with analysis of massive historical data, deployment of police can be optimized. The same methods were applied to the deployment of fire equipment.

New York City's massive problems have led to the Technology Application Program. TAP winnowed some 500 suggestions down to 15 high-priority cost cutting and effectiveness programs—the most significant of which increased fire protection productivity at an estimated savings of $15 million. Again trash and garbage collection problems were attacked, but to absolutely no avail in New York, where the collection costs are $49 per ton. San Francisco, on the other hand, simply turned the job over to a private company—at an average cost of $18 per ton. The obstacles to raising worker productivity are prompting officials to seek more and more services that might be performed by private companies.

This article should be carefully considered by all citizens as well as governmental managers. The author is far from being overly optimistic about the newly awakened interests of municipal leaders. He does point out, however, that pressures are causing local leaders to reevaluate their function of simply finding new sources of funds and to turn their interests toward more efficient management and increased productivity.

Barry A. Knight
University of Southern California