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What People Are Writing About

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what people are writing about

BOOKS

The Sovereign State of ITT by ANTHONY SAMPSON, Stein and Day Publishers, New York, 1973, 323 pages, $10.

This impressionistic portrait of one of America's most controversial corporations was written by a political writer rather than a business reporter—and it shows. Accountants will find the book thin and lacking in concreteness. It is, nevertheless, an important book, for it raises some disturbing questions about the role of the multinationals in national and international affairs.

The International Telephone and Telegraph Corporation first burst upon the consciousness of the non-business sector of the American public when it became embroiled in two major scandals: the affair of the Dita Beard memo, with its implications that ITT had offered to underwrite San Diego's lukewarm bid for the 1972 Republican convention in exchange for Antitrust Division approval of its merger with The Hartford Insurance Group; and the affair of its alleged intervention in the Chilean elections of 1970, in which it apparently tried to get the Central Intelligence Agency to go along with it in creating "economic chaos" in Chile in order to prevent the rise to power of the late Salvador Allende.

These two incidents are, naturally, the climax of this book, and they are explored in detail. But the author, an editor of the *London Observer*, tries to do much more. He tries to present a full-scale portrait of this remarkable corporation, which, he thinks, embodies many of the virtues and defects of those two industrial phenomena of our age, the conglomerates and the multinationals.

To show the shaping of ITT's character (if such a word can be used for a corporation), the author goes back to its founder, Sosthenes Behn, a flamboyant tycoon who

REVIEW EDITORS

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built ITT into the world's major international manufacturer and operator of telephone systems. He tells how Behn collaborated actively and ardently with the Nazis before and during World War II; how he played fast and loose with the Communists during the Cold War in a risky game that eventually led to the jailing of two of his executives as spies in Hungary and the execution of two other men; and how he lobbied and manipulated officials in Britain, Canada, and the United States in an (eventually unsuccessful) effort to build a new transatlantic cable.

Effective and ruthless

All these operations, according to Mr. Sampson, suggest that ITT's own "diplomatic and intelligence services were more effective, and also more ruthless, than those of the Western nations it dealt with . . . How continuous are the charters of corporations? . . . in two central respects it still resembles Behn's invention. First, it is still constructed around a single dominating head . . . Second, ITT still regards itself as above governments, above controls, and above morals. It presents itself still as an American company in America, British in Britain, German in Germany; but it owes loyalty to none of them, and regards each government as an unnecessary obstruction . . . throughout its five decades, it has remained irresponsible and uncontrollable." It is, says the author, "like a jellyfish, both everywhere and nowhere."

The bulk of the book, however, deals with ITT's history under the leadership of Harold S. Geneen, the Lybrand alumnus who became the highest-paid manager in the world. He changed ITT from a holding company, "investing in factories thousands of miles away and hoping for the best," into a tightly controlled international conglomerate so centralized and so indoctrinated that it is almost "a closed system." Taking a dim view of ITT's prospects abroad, he reduced its dependence on foreign earnings from 82 per cent to 40 per cent, largely embarking on a major domestic merger binge. In the process he brought ITT up the size ladder of American corporations from fifty-second in 1959 to ninth in 1970.

Actually, the author thinks, Geneen's diversification was not necessary; ITT's foreign holdings, he says, are still the most profitable part of its business. But the acquisitions have made ITT a power to be reckoned with domestically.

The author traces the history of the major acquisitions, with particular attention to the methods that were used to get them. He criticizes the "unaccountable accounting" that enabled ITT in February, 1973, to report record earnings for the fifty-fourth successive quarter. He attacks the pooling of interests accounting by which "a conglomerator could absorb the merger company's net assets at their old book value, even though he paid a huge premium on the acquisition. Then the conglomerator could dispose of these acquired assets, and the proceeds, which were compared to the historical cost, could show enormous bookkeeping profits, which could appear on the conglomerates' statements as if they had really been earned." And he takes a swipe at Arthur Andersen & Co. for going along with these devices at ITT.

Chiefly, however, the author's concern is with the emerging independent power of the multinational companies: "The serious issue is not whether multinationals should be allowed, but how they should be controlled and counterbalanced. The scale of industrial development has far outstripped the scale of political development, a discrepancy which ruthless companies can easily exploit. ITT has been especially able to exploit it, not only through its size and diversity but through its tradition of deviousness and many-sidedness, and its mastery of communications."

ITT, the author thinks, is "a caricature of a multinational conglomerate, not a typical example." Yet "some of its traits . . . are ones which others are tempted to follow. And many of the questions which arose from the ITT scandals and hearings have a wider relevance. Has private power, as Senator Hart asked, now extended its reach so far that no government can control it? Does the scale of world trade necessitate giant conglomerates, which their home government cannot afford to defy? Do they have the right, and the power, to create their own foreign policy?"

This book has many flaws. It covers a lot of ground somewhat superficially, reflecting the haste with which it was prepared in order to capitalize on ITT's headlines. The author lacks the technical and business training really to put it all together, and, despite his frequent references to interviews and hearing records, much of the book reads like a rehash of the daily press.

Many readers would like something much deeper. Accountants, for example, will find that his attack on conglomerate accounting procedures adds nothing to what they already know, and students of management will feel frustrated that the allegedly unique and incredibly effective control system that Geneen has set up is not really explained.

Even so, this is a consequential and worthwhile book. Its author sees clearly what is important and what is not important about ITT and the other conglomerates and multinationals, and he asks the right questions. It is up to more sophisticated analysts to take it from there.

Zero-Base Budgeting: A Practical Management Tool for Evaluating Expenses by PETER A. PYHRR, John Wiley & Sons, New York, 1973, 231 pages, $13.95.

A great idea but a lot of work—that will probably be the immediate reaction of any manager—or even any accountant—who confronts zero base budgeting for the first time. This book, by the man who developed this new planning-budgeting

technique, is not likely to change any minds on either score. Every consultant needs to read it just the same.

In a 1969 speech Dr. Arthur F. Burns, then counsel to the President, identified the basic need for zero-base budgeting: "Customarily, the officials in charge of an established program have to justify only the increase which they seek above last year's appropriation. In other words, what they are already spending is usually accepted as necessary, without examination. Substantial savings could undoubtedly be realized if [it were required that] every agency . . . make a case for its entire appropriation request each year, just as if its program or programs were entirely new."

However, as Dr. Burns pointed out, "Such budgeting procedure may be difficult to achieve, partly because it will add heavily to the burdens of budget-making, and partly also because it will be resisted by those who fear that their pet programs would be jeopardized by a system that subjects every . . . activity to annual scrutiny of its costs and results."

Actually, according to this author, just such a technique is currently in use in Texas Instruments, Inc., and in the government of the State of Georgia, and it has not made budget-making impossible. Indeed, he says, ". . . effectively planned and properly managed, zero-base budgeting can actually reduce the burdens of budget making while significantly improving management decision making and the allocation of resources."

In the typical budgeting process, Mr. Pyhrr points out, most corporations and government agencies use current operating and expenditure levels as a base, from which they analyze in detail only those increases (or decreases) desired—thus looking at only a small fraction of the final budget dollars approved. This approach leaves two major questions unanswered: "How efficient and effective are the current operations that were not evaluated? Should current operations be reduced in order to fund higher priority new programs or increase profits?"

Three common problems

After an experience with the traditional type of cost reduction, a group at Texas Instruments identified "three problems that I think are common in budget procedures throughout industry and government:

"1. Some goals and objectives had not been established, or stated goals and objectives as understood and anticipated by top management were not realistic in light of the final amount of money budgeted. (In my conversations with several other companies, I have been told that they first establish their budgets and then determine their goals and objectives—which seems to put the cart before the horse.)

"2. Some operating decisions had not been made that affected the amount of money required. . . .

"3. Budget dollars were not strictly allocated in accordance with changing responsibilities and work loads. Some work loads had increased significantly while others had decreased, yet everyone had his budget cut from 1 to 10 per cent."

As a result, Mr. Pyhrr reports, he developed "the planning and budgeting methodology that we termed zero-base budgeting. The technique was used to prepare the 1970 budget for the staff and research divisions of Texas Instruments. Mr. Pyhrr later installed the system for the State of Georgia (beginning with the fiscal year 1973), and it also has "been adopted by other corporations and governmental agencies."

Zero-base budgeting "requires each manager to justify his entire budget request in detail and puts the burden of proof on him to justify why he should spend any money" at all, Mr. Pyhrr explains. For each activity or operation under his control each manager must prepare a "decision package" which includes an analysis of cost, purpose, alternative courses of action, measures of performance, consequences of not performing the activity, and benefits. In addition to identifying different ways of performing the activity, managers must analyze different levels of effort for it. They must identify a minimum level of spending and then, in separate decision packages, analyze the costs and benefits of additional levels of spending. This analysis "forces every manager to consider and evaluate a level of spending lower than his current operating level; gives management the alternative of eliminating an activity or choosing from several levels of effort; and allows tremendous trade-offs and shifts in expenditure levels among organizational units."

Once the decision packages have been developed, they must be ranked or listed in order of importance. This ranking process "allows each manager to explicitly identify his priorities, merges decision packages for ongoing and new programs into one ranking; and allows top management to evaluate and compare the relative needs and priorities of different organizations to make funding decisions. As the list of decision packages increases the cost also increases, and top management can decide at what point on the list the added costs outweigh the benefits."

Zero-base budgeting, according to Mr. Pyhrr is applicable to administrative, technical, and most commercial portions of the budget; it is not directly adaptable to direct production and manufacturing costs, but it can be used for expenses that are closely related to direct manufacturing operations, such as maintenance, supervision, production planning, and other manufacturing support services. It is also adaptable to capital expenditure analysis. "Although zero-base budgeting may apply to only a fraction of the total budget in a heavy manufacturing organization, the activities subject to zero-base budgeting techniques are usually the most difficult to plan and control and yet offer management the

greatest lever to affect profits," Mr. Pyhrr says. In government, since government is a service organization, the technique is applicable across the board.

Zero-base budgeting is more work and takes more time than traditional budgeting, Mr. Pyhrr concedes, especially at the beginning. However, in the second year of zero-base budgeting at Texas Instruments, the cycle "was reduced to half the first year calendar time, which was less than the time spent under the previous budgeting procedures."

The advantages, Mr. Pyhrr claims, are many: "Zero-base budgeting provides top management with detailed information concerning the money needed to accomplish desired ends. It spotlights redundancies and duplication of efforts among departments, focuses on dollars needed for programs rather than on the percentage increase (or decrease) from the previous year, specifies priorities within and among departments and divisions, allows comparisons across these organizational lines as to respective priorities funded, and allows a performance audit to determine whether each activity or operation performed as promised."

In the book Mr. Pyhrr describes in considerable detail how to pick the levels at which decision packages are to be prepared, how to design the packages, how to rank them, how to install the program, how to keep it going, how to use it to supplement or to replace Planning - Programing - Budgeting (PPB), how to use computers in the process, and how to evaluate results. The appendixes present a sample zero-base budgeting manual and suggest activities for which decision packages may be developed.

A great deal more is going to be heard about this technique in the years to come. For that reason, if for no other, every consultant needs to have zero-base budgeting in his bag of tricks and every accountant needs to have at least a nodding acquaintance with its principles. This is the definitive book on the subject.

The Corporate Computer: How to Live with an Ecological Intrusion by NORMAN SANDERS, McGraw-Hill Book Company, New York, 1973, 161 pages, $10.

How to run a computer operation in 19 easy chapters—many readers would like to have such a book; many authors have tried to write it; here it is at last.

Suppose that you, as an ordinary manager with no experience in computers, have suddenly been ordered to set up a computer operation in your company. This doesn't happen as often as it used to, but it's not impossible even today. What do you do?

This book sets up such a situation and tells you how to handle it —from how to decide whether or not to accept the assignment to planning your first expansion. It really does.

The author, a Briton with more than 20 years of computer experience in Europe, has a gift for differentiating wheat and chaff. In less than 150 pages he takes the reader through every step of computer management, concentrating on basic principles yet never neglecting vital procedural details. He is never dogmatic; where there are alternative ways of doing things he outlines the pros and cons; yet he is not afraid to take a firm stand on such issues as how to deal with users, with suppliers, with programers, and with top management. His style is light, sometimes funny, clear, concrete, and eminently readable.

No significant aspect of computer management is omitted. Among the chapter topics: Why you should reject the appointment and what to expect if you don't; the reasons for acquiring a computer; getting the backing of the top man; the fiscal impact; the need for a corporate plan, its appearance and promulgation around the company; the need for a technical assistant, how to choose him, the function he is to perform; organization of the systems department; organization of the service department; converging on the configuration; the selection process; the contract; how to hire and keep technical people; project control; standards and files; programing; how to help the manufacturer help you; finding out whether the computer is working; maintenance; documentation; operational research; measurement of results; and forecasting. Appendixes present a glossary of terms and a description of how to set up a "war room."

After reading this book the manager will really feel equipped to run a computer department. This may be an illusion, but if it can be done by the book, this is the book to do it by.

Corporate Power in America by RALPH NADER and MARK J. GREEN, Grossman Publishers, New York, 1973, 309 pages, $7.95.

The modern corporation has grown too powerful for the public good and must be curbed. That is the assumption rather than the thesis of this book, which concentrates on solutions.

Corporations must be made "responsible to more than merely their own self-contained rules and narrow horizons," the authors of this book declare in the preface. "As law professor Abe Chayes has written, 'the modern business corporation emerged as the first successful institutional claimant of significant unregulated power since the nation-state established its title in the sixteenth and seventeenth centuries.' Our large corporations are unparalleled as buffers shielding their executive decision-makers from public inquiry and accountability. A supposed democracy should not suffer the exercise of such uncontrolled power."

Only a few of the speakers at Ralph Nader's Conference on Cor-

porate Accountability, which was held in Washington, D. C., in the fall of 1971 and on which this book is based, bother to document this charge. A few supporting accusations are made: The antitrust laws have failed to restore the power of the marketplace; regulatory agencies have become arms of the industries they supposedly watchdog; corporations influence Congress and virtually dictate to the Administration; the corporation, in the words of Professor John K. Galbraith, has assimilated itself to the state.

But on the whole the speakers—economists, political scientists, and lawyers who have "distinguished themselves by their studies and commentary on corporate power"—accept the problem as given and concentrate on possible solutions.

Those solutions vary widely. Professor Galbraith predicts that eventually all the great corporations will become public enterprises. Congressman Fred Harris recommends reform of campaign financing, the end of income deductions for lobbying, a ban on political activity by corporations, elimination of the tax deductibility of institutional advertising, antitrust action to break up monopolies, and Federal chartering of corporations.

Social moves discounted

Actually, Federal chartering, the cornerstone of Mr. Nader's own proposals, is implicit in the recommendations of most of the speakers. But others go off in other directions as well, depending on their fields of interest. Professor John J. Flynn, seeing employees as the "only visible, practical, and legitimate constituency of the corporation," wants them represented on the board of directors. Robert Townsend offers "a modest proposal" for a public director. Professor Andrew Hacker advocates more consumer and citizen action of the Nader type.

Joel F. Henning, a fellow of the Adlai Stevenson Institute of International Affairs, dismisses the corporate social responsibility movement as a "shell game," and most of the other speakers apparently agree, for their emphasis is on compulsion—action by Congress, regulatory bodies, and the courts.

Legal action plan urged

Professor Arthur S. Miller draws up an action plan for the judiciary: Enforce the antitrust laws more stringently, use mandatory orders to make the bureaucracy" govern more adequately," enlarge the class action category, allow shareholders greater access to the corporate decisional process, permit *qui tam* actions to enforce antipollution laws, further enlarge the category of those with standing to bring the administrative process or judiciary into operation, apply constitutional norms to corporate activity, and allow more legal actions to be brought against the companies themselves, as in stockholders' derivative suits. Professor Walter Adams suggests a host of specific prohibitions and obligations, under Federal charter, for corporations with assets over $250 million and corporations that rank among the top eight producers in an industry where the eight firms among them control 70 per cent or more of the market. Such corporations would be prohibited from making acquisitions; granting or receiving any discrimination in price, service, or allowances unless such discrimination could be demonstrated to be justified by savings in cost; engaging in tie-in arrangements or exclusive dealerships, and participating in any scheme of interlocking control over any other corporations. In addition, such corporations should be required to serve all customers on reasonable and nondiscriminatory terms, license their patents and know-how, and pursue pricing and product policies calculated to achieve capacity production and full employment.

For accountants, probably the most interesting recommendations are those of Professor Willard F. Mueller, who calls for much more disclosure of corporate information to the public. He wants segmented disclosure of investment, revenue, and profit data by product lines drawn as narrowly as possible, public disclosure of product sales, public access to income and other Federal tax returns of large corporations, disclosure of intercorporate holdings, disclosure of publicly owned facilities operated or leased by private corporations, disclosure of foreign operations, disclosure of social costs, and public representation on the board of directors.

This is a provocative and controversial book. If some of the proposals seem extreme, it may well be that this is the grave American business has dug for itself. (References to ITT as a horrible example are rife throughout the book.) Most of the speakers at this Nader conference were not wild-eyed radicals, and this book may be an indication of the direction in which public opinion is swinging.

Confessions of a Corporate Headhunter by Allan J. Cox, Trident Press, New York, 189 pages, $6.95.

The world of the executive recruiter is a mysterious and glamorous one to most managers. This book does a better job of dispelling the glamor than the mystery, but it does offer a few helpful hints for both employer and employee.

In the preface to this book the author offers three reasons for writing it:

Out of "benign compassion" for today's mobile executive, he wanted to offer some advice on "coping with corporate wisdom."

On the basis of the insights he has gained as a corporate headhunter, he wanted to add to the general reader's understanding of corporate organization.

He sought to "present a challenge to American business" to reorder its priorities and make itself more appealing to the crop of young executives coming up.

All this is quite an order for a book of less than 200 pages, and,

as might be expected, he doesn't quite make it. The goals are too varied to make for a unified book, and the result lacks both cohesion and depth.

Advice for prospect

The most interesting part of the book—and also the most successful —is Mr. Cox's advice to the so-called "candidate." He tells how to get into contact with a recruiter without letting him suspect you are looking for a job, how to play hard to get, how to wend your way through the little rituals of the courtship, how to deal with psychological tests (fake them or refuse to be subjected to them), whether to ask for an employment contract (a simple severance arrangement is better).

His advice to the client, apart from an eminently sensible plea for complete honesty in dealing with the recruiter, is sketchy and rather supercilious. (A corporation president reviewing this book in *Business Week* found this chapter "presumptuous," "sensational," and "often bizarre.") His suggestions on how to deal with a candidate once he has been presented seem laughably obvious, but perhaps his rather dim view of clients' intelligence is justified.

His advice to business as a whole is sound and idealistic. The call for a stronger corporate sense of social responsibility, while neither original nor profound, is creditable and seemingly sincere.

Also of general interest is Mr. Cox's description of the way corporate headhunters operate, although it is more a collection of highly entertaining anecdotes than a genuine explanation. In the process he manages subtly to denigrate his competitors and imply that he is just about the only man in the business with sensitivity and integrity.

Here, perhaps, is the real clue to what the book is all about. For Mr. Cox is not proud of his profession, which he characterizes as "probably the most opportunistic, cynical, defensive, and manipulative of the corporate-service industries." (On the jacket blurb the term corporate headhunter is defined as "a mediator between executives who don't understand their problems and job candidates who don't care what the job is so long as there is a quick buck to be made.") Often his real objective in writing the book seems to be self-justification rather than service to the reader. Perhaps the title was not chosen purely for sales appeal but reflects the author's true aim—a cathartic apologia.

This is a book that promises a lot more than it supplies, but it is skillfully written, vastly entertaining, full of human interest—and it contains a few nuggets of wisdom that are relatively painless to dredge out. Most executives will enjoy reading it. Few will find it changing the course of their lives.

Profiles of Involvement by the Human Resources Network, Human Resources Corporation, 2010 Chancellor Street, Philadelphia, Pa., 19103, 1973, 843 pages in three paper bound volumes, $60.

This group of lavishly illustrated brochures presents the results of a survey of corporate social action programs.

Described in the text as "the first national compendium of corporate social involvement," this book offers brief descriptions of social action programs in 186 corporations; 59 foundations, associations and nonprofit corporations; and 40 government agencies.

The editors sent a form questionnaire to organizations they thought likely to have such programs, promising to publish the resulting "profile forms" without "manipulating or editing" the material other than improving the grammar or format. These profiles are the heart of the book.

There is a little more. Volume 1 contains, in addition to introductory material by the editors and profiles of 535 social action programs in the 186 corporations, a section called "perspectives," with articles on corporate social responsibility by selected persons "in the field" and selected speeches by corporate representatives. Volume 2 contains an article in addition to the profiles from nonprofit organizations and government. Volume 3 provides a bibliography (known here as a "biblio-view"), glossaries, and indexes.

The action programs themselves are briefly summarized and interpreted. The editors note that most of the programs were launched since 1970 as "band aid jobs" in response to the crises of the 1960's. The greatest number of programs, they report, are in the area of employment—employee training, upgrading of job skills, and integration of the hard core unemployed; the second most popular category is education, chiefly remedial or compensatory education programs aimed at minorities.

The most successful programs, the editors find, have these characteristics: They involve participation on the part of the people being helped; they involve "an exchange of perspectives"; and they are programs that "in some way contributed to a strengthening of self-esteem." Case studies of three programs that have these characteristics are presented.

This book is described by the editors as a "$300,000 experiment in communications." It is easy to see that it may have cost $300,000. The three volumes are an art director's delight, lavishly illustrated with four-color photographs, paintings, and graphics, heavily adorned with sidebars and other typographical attention-getting devices. But it is difficult to see in what sense it is an "experiment in communications," unless the format is to be considered experimental.

It is even more difficult to see why $300,000 should have been spent on it. The volumes are so heavily encrusted with art work that it is hard to figure out where

the articles begin and end, who wrote them, and what they deal with. The editors' contributions to the book are so encumbered by fine writing that merely to discover what the book is about requires a major effort on the reader's part.

Human Resources Network describes itself as "a nonprofit educational corporation whose charter purpose is to collect and disseminate important information about pressing social issues." It describes the purpose of the book as to provide a "collective exchange of ideas and experiences" about "corporate expeditions into the social arenas."

The accountant or businessman probably would have preferred a simply written, clearly presented report of the information contained in this book, which is substantial if you can dig it out. Such a report would not have cost $300,000, yet it would have been more useful, for the "experimental" format of this work clearly impedes communication. For those who love to look at pictures, it is another *Arizona Highways*.

The Foundations of Management by ROY A. LINDBERG, Oceana Publications, Inc., Dobbs Ferry, N. Y., 1973, 115 pages, $4.

This little volume represents one man's philosophy of management. That man, a management consultant in a CPA firm, is not a nationally known authority on management. He is, however, a thoughtful man, and in this book he has made an effort to distill the essence of his thinking and experience for other managers.

The theme of this book, according to Mr. Lindberg, is that "management, to be performed competently, requires more than experience or knowledge, that it also requires perceptions that may never be proven by any form of interaction with the outside world. These perceptions form the basis of management as each manager practices it."

A manager, Mr. Lindberg notes, must make decisions whether he possesses relevant knowledge or experience or not. He must, then, decide on the basis of "managerially relevant generalizations so simple, cogent, and persuasive they must be labeled beliefs, values, convictions . . . a true generalist . . . is a manager who . . . has decision guides in the form of concepts large, accommodating, earthy, and attractive enough to be capable in all situations of keeping him from making serious errors."

Manager must have philosophy

These concepts, he says, "must also be mutually compatible and woven into a comprehensive view. Therefore, it can be said that every successful manager has a philosophy—that is, a body of basic and integrated views, tenets, or convictions." This book is Mr. Lindberg's philosophy.

It presents "a number of propositions . . . that appear to the author to describe the basic character of business and management and managing as they exist in a 'free' economy. The propositions are offered with full recognition of their logical or empirical vulnerability, but with the confidence that they represent a step in the right direction."

The book is made up of 85 briefly discussed propositions—on the nature of business, on the nature of management, on the role of the manager, on planning, on control, and on "selected matters"—ranging from "A Business' Prime Responsibility Is to Survive" to "Organize for Unknowns as well as Knowns."

The majority of them, as the author himself notes, are generally familiar. "Some will not strike the reader as having any importance, and a few are likely to be rejected as being totally unacceptable. No harm. Consideration of the propositions offered in these pages cannot lead to worse than their rejection because they seem obvious, unrealistic or, even, absurd. On the other hand, consideration of them may stimulate new perspectives or ideas of value to the manager."

The manager or consultant who likes to stop and take stock occasionally of what he is doing and how he is doing it may find some of these thoughts worthwhile.

MAGAZINES

A Direct Approach to Choice Under Uncertainty by MORTON I. KAMIEN and NANCY L. SCHWARTZ, *Management Science,* April, 1972.

For certain classes of problems, an alternative conceptualization of decision making under uncertainty is considered. Under this direct approach, decision making is viewed as the selection of a modification program for a given probability distribution; practical applications are developed for problem covering preventive maintenance policies, monopoly product pricing, and R&D project planning.

In theory, decision making under uncertainty in the past was considered a problem in selecting the optimal from a set of available probability distributions. The selection of a portfolio has been most often used to illustrate this process. A certain amount of funds are available to distribute among the various securities, each having an associated probability distribution over the return it could yield. The allocation of the funds among the securities then results in a composite probability distribution over the rewards from the entire portfolio. The decision is to choose which allocation scheme maximizes the utility of the return, or simply to choose the best composite distribution from the available set.

In some circumstances, it is argued, this indirect approach is not always the most natural. In the portfolio selection problem, the presence of a securities market enables the decision maker to modify his set of probability distributions and obtain a desired distribution. In the absence of such a market, the decision maker would have

been forced to rely solely upon his previous or "inherited" probability distribution. Under these circumstances, the decision maker could modify his existing distribution only by direct action. For example, a firm may alter the failure rate of its equipment by a policy of preventive maintenance; thus, the invoking of the policy is a direct method to modify the probability distribution over the date of machine failure.

The authors contend that their direct approach is more appropriate in those situations where the decision maker is unable to resort to an existing market to obtain probability distributions. In these cases, the decision maker would select a most preferred distribution over payoffs by direct modification of an existing or "inherited" probability distribution, at some direct monetary cost. This may be illustrated where a monopolist faces possible market entry by competitors.

By setting his prices at some relatively high mark, P_0, the monopolist stands to reap great profits; however, his market also may be invaded by competitors anxious to share those profits with him. By lowering his prices to some P_1, where $P_0 > P_1$, the monopolist will be able to discourage the market entry of his rivals and prolong the period of monopoly. The monopolist's trade off is the cost of reduced profits against the payoff of extended monopoly life. The monopolist, facing the possibility of competition, thus can directly modify the probability distribution governing such market entry by means of pricing policy.

This direct approach to decision making under uncertainty should be considered by accountants for two reasons: 1) its theory and application is relatively simple and straightforward; and 2) in most problem areas encountered, the established market will be nonexistent. Undoubtedly many decision makers are already familiar with this decision process. For those who are, this article may clarify your thinking. For those who aren't, it offers a new alternative.

KENNETH FERRIS
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Improving the Profitability of Retail Merchandising Decisions by DANIEL J. SWEENEY, *Journal of Marketing*, January, 1973.

Mr. Sweeney notes the recent decline in the financial performance of retail department stores and suggests that the use of a modified return-on-investment measure in merchandising decisions may be the answer. The article includes the results of a simulation conducted by the author in support of his proposal.

Mr. Sweeney feels that the decline in rate of return on owner's equity (from 8.98 per cent to 7.25 per cent between 1965 and 1970) can be traced to the turnover of inventory. He cites the fact that the ratio of net profit to inventory cost fell from 19.08 per cent to 14.60 per cent between 1965 and 1970. This is due primarily to the fact that while stores have successfully raised their initial markups from 40.28 per cent to 43.62 per cent during that period, the rate of stock turnover declined from 3.47 to 3.17 times.

Thus he concludes that merchandising executives, while concerned with margins, neglect overall return on investment. Mr. Sweeney feels that one of the major causes for this neglect of rate of return is the uncertainty among both theorists and executives as to an acceptable definition of rate of return. He suggests that the simplest, and at the same time one of the most valid, is gross margin return on investment (GMROI). He defines this as gross margin dollars divided by either average or end-of-month inventory investment. Alternatively it may be calculated as the product of the gross margin per cent times the average rate of inventory turnover:

$$\text{GMROI} = \frac{\text{Gross Margin Dollars}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Average Inventory}}$$

Companies using retail valuation for inventory may employ this retail inventory base in the calculation. The gross margin return thus completed, while not a measure of return on investment, is still a useful measure.

Mr. Sweeney points out that not only does GMROI provide a measure of the management control of the major asset of a retail firm, but also allows comparisons between the performance of product lines or different divisions.

To test the validity of this measure as it applies to retail decisions, he worked with a large midwestern department store to develop a model of their decision making process. After the validity of the model was established using historical data, a corresponding model was constructed using GMROI as the primary decision rule. A five-year simulation was run with both models and the results were compared using Wilcox on matched pairs signed-ranks test (used to measure overall variations between a series of matched scores, in this case certain monthly performance data).

Several things emerged from the simulation. Volume increased using GMROI due to the fact that the number of stockouts dropped to zero, reflecting the understocking of some items and overstocking of others. Markon and margin percentages were virtually unchanged, but gross margin dollars rose 11.81 per cent. Turnover increased 13.84 per cent while average inventory value increased only 2.31 per cent. GMROI increased 11.33 per cent from an average monthly percentage of 113.99 per cent under traditional decision rules to an average of 126.91 per cent under GMROI rules.

In summary, it would seem that the use of GMROI in making inventory decisions results in signifi-

cantly better inventory management with associated better profitability performance. Two things should be pointed out, however. First, the simulation was conducted using data for stable merchandise items. Thus one should be careful when using GMROI with nonstaples. This is not to say that it is invalid, but only to say that other factors must be given greater weight.

The second, and probably the major problem, is that of implementation. As with any budgeting or evaluation procedure, care must be taken that the figures are realistic. It must be remembered that there may be valid differences among departments even with a generally comparable measure such as this. Lastly, implementation will involve fairly substantial reorientation and reorganization and will require a solid backing from top management. Mr. Sweeney presents a good case that the end result is worth it.

DAVID A. PATTON, JR.
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The MBA and the Accounting Profession by JOHN J. MCDONOUGH, *The CPA Journal,* April, 1973.

The author presents some developments and their implications for the graduate business school and the accounting profession. He suggests that the MBA's knowledge of accounting issues and the MBA's attitudes towards the accounting profession will determine the future importance of accounting in business schools.

During the last 20 years, according to John McDonough, the business school's teaching and financial interests have shifted from undergraduate to graduate education. The number of schools granting graduate degrees and the number of students graduating from such schools have increased. In addition, graduate business schools have experienced two phenomena (i.e., the education of large numbers of MBAs and the research emphasis of academic accountants) which have implications for the accounting profession.

MBAs weak in accounting

If importance is measured by the number of graduates, the MBA is the most important current product of the graduate business schools. The MBA has a heavy bias towards financial management positions in large corporations and in financial institutions. Mr. McDonough describes the MBA's accounting knowledge as follows:

1. The MBA is oriented towards managerial accounting aspects but is weak in financial accounting aspects.
2. The MBA is unfamiliar with basic accounting processes and is unable to link technical problems with functional implications.
3. The MBA places a low value on the accountant's attest function.
4. The MBA bases his attitudes towards the accounting profession on the status and the competence of the accounting professors that he encounters as a student.

Accordingly, the MBA has a limited knowledge of accounting issues and has a poor attitude towards the accounting profession.

The research emphasis in graduate business schools has developed for the following reasons:

1. Research support of the academic accountant has covered the costs of the research and has also covered some university overhead costs.
2. Research success of the academic accountant has been required for budget support, for influence over university policies, and for university promotions.

Accounting research provides an important link between the academic accountant and the business community, but the MBA receives no direct benefit from such research.

John McDonough suggests a need for integration of research and teaching efforts to provide for professional management education. The proposal could be implemented in schools which require two years of graduate education for the MBA degree. The success of the proposal will require the cooperation of academic and practicing accountants.

The academic accountant can promote the integration of research and teaching efforts by supporting curriculum changes such as the following:

1. If the MBA is searching for electives, the academic accountant must provide courses which will broaden the student's understanding of accounting issues.
2. If the MBA is pursuing accounting as a career, the academic accountant must provide a three- or four-course sequence which will give the MBA an adequate knowledge of accounting issues.

The practicing professional accountant can promote the integration of research and teaching efforts by taking the MBA seriously in the job market (i.e., by hiring the MBA whenever possible) and by using the MBA as a prime source of managerial talent.

In summary, John McDonough presents a proposal which will keep accounting the premier discipline in business schools. If the integration of accounting research and teaching efforts is not achieved, large numbers of MBAs holding positions which can influence the future of graduate business schools will have neither an adequate knowledge of accounting issues nor a favorable attitude towards the accounting profession. The author suggests the time is right for the integration of research and teaching efforts, the facilities are already available for such integration, and the prospects look promising for success from such integration.

JERRY L. HAUGLAND
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Leadership and Organizational Performance: A Study of Large Corporations, by STANLEY LIEBERSON and JAMES F. O'CONNOR, *American Sociological Review,* April, 1972.

As a two-phase study on the relative importance of leadership influence in the performance of a firm, where performance is measured by economic criteria, the influence of changes in top management of a firm due to such factors as the state of the economy, the industry, and the firm's overall performance position within the industry are isolated for 167 firms over a 20 year period. Three measures of performance (sales, net earnings, and profit margins) were used.

Using an analysis of variance technique to analyze the data, the results of the first phase were that leadership did not greatly influence performance measured by the first two variables. However, when time lags were introduced to allow for the possible long-term effects of a leadership change, leadership became the most important influence on the third performance variable, profit margins. (In this study, profit margin is defined as the ratio of gross margin to sales revenue.)

The various constraints which operate on top management, both internal (committees, regulations, standard procedures), and external (competitors, government regulations, unions, customers and supplies) are one set of factors restricting its influence with respect to sales and earnings. Also, the effects of the other variables (state of economy, industry, and industry position) are less influential with regard to profit margins than the other two performance measures.

The second phase of the study broke the companies down into their respective industries, to determine if different leadership effects existed across different industries. Some industrial characteristics, such as degree of concentration, advertising expenditures and the number of vice-presidents employed, were correlated across industries in an attempt to outline some characteristics of organizations where leadership influence is significant.

With respect to sales, it was found that leadership influence was high in concentrated industries. With profit margins, on the other hand, leadership impact was high in industries low in labor intensity. It was similarly found to be so in rapid growth industries, industries where advertising is important, and also where the number of vice-presidents in the industry's average company was relatively high. With regard to the latter factor, it is suggested that a large number of vice-presidents may give top management tighter control through better policy execution and greater feedback on company operations.

Overall results important

Although questions can certainly be raised about the methodology, which is not clearly explained and validated, the overall results of the study are of great interest.

In the divisionalized firm, where assessment of responsibility and overall performance of division managers is generally made on the basis of their net earnings performance, the study suggests that they should, perhaps, be evaluated on the basis of their profit margins. For here is where a manager can apparently exert the most influence and so his performance in exerting it can be assessed, taking account of the other variables as well. Further, this internal assessment method, especially where divisions are selling outside the organization, may be able to be utilized to get a better overall comparison of one division against another, rather than the net earnings criterion which is currently utilized most widely.

DAVID C. HAYES
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How Business School Students Rate Corporations, *Business and Society Review,* Summer, 1972.

Results of a survey of graduate business students designed to rate the social performances of 50 corporations are reported.

The survey was conducted by the National Affiliation of Concerned Business Students, a new nonprofit educational organization of graduate business students whose primary purpose is to promote research on social aspects of the corporation.

This brief article tabulates the results of a questionnaire mailed to 300 graduate business students and returned by 150. The appropriateness of the questionnaire and the validity of the survey cannot be analyzed because it is not presented in the article, nor are the statistical procedures used in the survey described.

The ratings reflect participating students' evaluations of the responsiveness of 50 corporations to social problems. Possible corporate averages ranged from a maximum of 5.00 to a minimum of 1.00. The highest average scores were attained by: Xerox, 4.12; First Pennsylvania, 3.54; IBM, 3.54; Cummins Engine, 3.48; and Prudential Insurance, 3.37. The worst averages were received by: Con Edison (N.Y.), 1.81: Standard Oil (Calif.), 1.97; U.S. Steel, 2.00; L.T.V., 2.11; and Commonwealth Edison (Chicago), 2.12.

A significant aspect of the survey is that it is not intended to reflect a factual analysis of corporate social policies, but rather the opinions of the participants. This would appear to be a source of relevant information for corporate businesses. For instance, the survey may reflect how effective a specific corporation's social policies have been in establishing a social awareness image. Another possibility is that the survey may hold a hint as to why some corporations have difficulty in recruiting the most promising students as employees.

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Accounting System for Earnings Per Share by R. J. Huefner, *Management Accounting,* March, 1972.

This article presents a formal accounting system designed to facilitate the complicated procedure of maintaining the relevant information needed to compute earnings per share.

As a result of Accounting Principle Board Opinion No. 15, the once direct operation of computing earnings per share has now become a complicated process. Under Opinion No. 15 all securities which possess a potential claim to common shares must be identified, their effect on earnings per share determined, and, if appropriate, incorporated into the computation. Each of these securities may or may not be included in the computation of earnings per share and each security may affect the computation in a different manner. Because of the difficulties caused by APB Opinion No. 15, Mr. Huefner has designed a practical accounting system to accumulate and maintain the data relevant to the computation of earnings per share.

The system provides a set of self-balancing accounts which are "in effect, proforma accounts." They are designed to accumulate and maintain the permanent data relevant to the computation of earnings per share and also to reflect any temporary data employed in the computation in a particular period. Thus, the system provides all data employed in the computation of earnings per share in an organized manner for each period.

Permanent information is recorded in a set of permanent accounts and reflects securities that are considered "common stock equivalents." Each security is recorded in a manner that will facilitate the computation of earnings per share. The accounts for convertible securities serve as "contra accounts" to the regular accounts and, therefore, reflect the assumption of conversion. In the case of options and warrants, entries are made to reflect the asset that would be generated by exercise or conversion. These accounts normally have debit balances, the offsetting credit going to the "committed common stock" account. Therefore, this account reflects any potential increase in equity resulting from conversion or exercise of these residual securities.

Generally, there will not be a need for adjustments to the permanent accounts since common stock equivalence is determined at the date of issue of the security and usually does not change. However, if the conversion rate does change during the life of a security, adjustments will need to be made to reflect the change in committed common shares.

Mr. Huefner's accounting system provides a set of temporary accounts which reflect temporary information and adjustments needed in the computation of earnings per share. The adjustments are concerned with the "earnings available for common stock." These adjustments arise when the conversion of residual securities would affect these earnings in a dilutive manner. Other temporary accounts reflect the residual securities that enter into the computation of "primary" and "fully dilutive" earnings per share.

Mr. Huefner's system for accounting for earnings per share is a very uncomplicated and practical system. It should be of great value to both management and public accountants. It provides a systematic and organized method of accumulating and maintaining permanent and temporary data used in the computation of earnings per share and, therefore, provides an organized record of each year's computations and provides a base for the following year's computation. Because of these organized records, the auditing function will be greatly enhanced since the procedures employed in computing earnings per share can be traced through these accounts.

Charles S. Douthitt
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