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STANFORD
BUSINESS

NOVEMBER 2003

The Dark Side of Global Business

Meet Best-Selling
Business Author
ERIC TYSON, MBA '89

Japan's Debt Doctor
KAZUHIKO TOYAMA,
MBA '92

STANFORD BUSINESS NOVEMBER 2003

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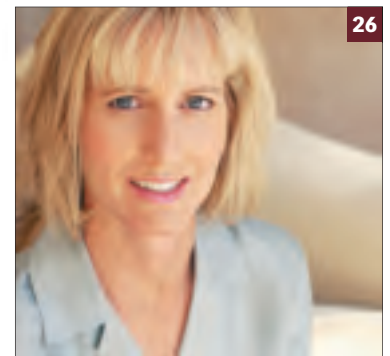
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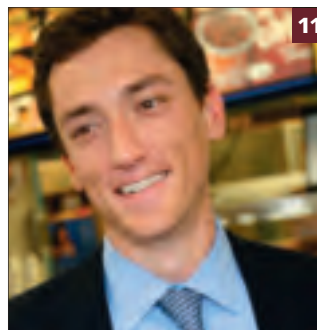
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about this issue

Igniting Innovation

AFTER MIDNIGHT ON FEBRUARY 10, 1953, my mother leaned over the bed and whispered orders to get up. You could tell by her tone this was no time to dally. The wind that had piled snowdrifts up against the north side of our house was now blowing embers from the burning barn toward us. In the next few hours, I learned that we had lost not just the barn but all of our cattle and four sheep. My father's hands were badly burned from trying to open the barn doors. He could not because the animals stampeded against them. The great Chicago fire allegedly began when Mrs. O'Leary's cow kicked over a lantern; in our case, the culprit was a ewe with new lambs.

I was reminded of these fires when reading the story on page 14 about the new *Social Entrepreneurship Startup* course in which students developed rechargeable lights for communities without electricity. This



may be the age of high tech, but for more than 1 billion people, Bill Snyder reports, "turning on the light, if it's possible at all, still means lighting a smoky, dangerous kerosene lamp."

After World War II the U.S. Rural Electrification Administration spread light rapidly across this country. As a child in the fifties, I took electrical power for granted and expected no corner of earth to be too remote for electrical wires. If you read Fred Rose's story on page 8 about Professor Jerry Meier's half-century career teaching economic development, I think you will find it was not only the children of that era who made optimistic assumptions. By 1965, however, Meier was beginning to chronicle problems with implementing large-scale industrial development plans in the many places with mostly agricultural economies. While rural electrification clearly aided the transition of the American postwar economy and places like Taiwan successfully followed suit, the models did not work across the board.

The implementation of many ideas does not progress as smoothly as we hope, which is why the trial-and-error design of the *Social Entrepreneurship* course seems brilliant to me. The business and engineering students involved learned to design LED lights while collaborating with each other, with manufacturers, and, most important, with people living in the communities they hope to help. As a result, they learned that a product design and business model suited to one area of India is likely to fail in one area of Mexico.

I neglected to tell you that the 1953 fire was caused not by a dangerous kerosene lantern but by an electrically powered heating lamp. Not long after the fire, my family joined other plains farmers in planting shelterbelts of trees, a new university-initiated plan. With this protection from gale winds, cattle and sheep no longer needed to be herded into a barn during a blizzard. That's the meandering way the world changes some of the time.

Kathleen O'Toole

EDITOR

Thanks for a Record-Breaking Year

EARLIER THIS FALL, AS I REVIEWED OUR 2002–03 financial year, which closed August 31, I was struck once again by the commitment and generosity of our alumni.

This was evident to me in a variety of ways. In 2003, a record-breaking 37 percent of our MBA alumni contributed to our annual giving campaign, which provides us with essential, unrestricted funds with which to operate the School. This represents a steady increase since 1999, when the participation rate hovered around 30 percent. And at 37 percent, our current alumni giving activity exceeds that of nearly all our peer schools. Naturally, I am very pleased and proud to see so many of our alumni engaged in supporting the School financially and hope to see this participation continue to rise.

Other records were broken in the last year too: The Class of 1977 set a 25th reunion participation record with a 69 percent participation rate, beating a 13-year-old record by 7 percentage points.

I also have been impressed by the sense of optimism and enthusiasm displayed by our last two graduating classes. Despite having to cope with uncertainties surrounding the difficult economic climate and job market, the classes of 2002 and 2003 each broke records with their class gifts. The Class of 2002 pledged \$311,200, more than double and in some cases even triple most of the class gifts in earlier years. More importantly, 91 percent of the class participated, the highest participation rate ever and a huge increase over previous years. Not to be outdone, the graduating Class of 2003 raised \$334,300 this year with a very healthy 87 percent participation rate.

These recent classes have understood the fundamental importance of strengthening our operating funds. In the past, graduating students have generously left the School with gifts that have been enhancements to the physical plant, such as a new student lounge. But the 2002 and 2003 classes earmarked their giving to help support ongoing programs that are important to students. By working closely with staff members before graduating, they were able to commit expendable funds to be used for budget line items. The monies from the Class of 2003, for example, will support Career Management Center programs and needs. We are most grateful to our recent graduates for supporting the operating budget by helping to sustain and enhance areas that matter most to them.

Annual giving is critical to us because, as many of

you may already know, our financial model leans heavily on alumni giving. Every September, we start the year with the need to raise \$15 million to \$20 million in annual giving to balance our budget. We depend on your annual support as well as endowment income from gifts made by alumni in years gone by to cover 45 percent of our \$91 million annual operating budget—a much greater percentage than other schools, which typically depend on alumni giving to fund only 10 to 20 percent of their budgets. This is in large part because



We are most grateful to our recent graduates for supporting the operating budget by helping to sustain and enhance areas that matter most to them.

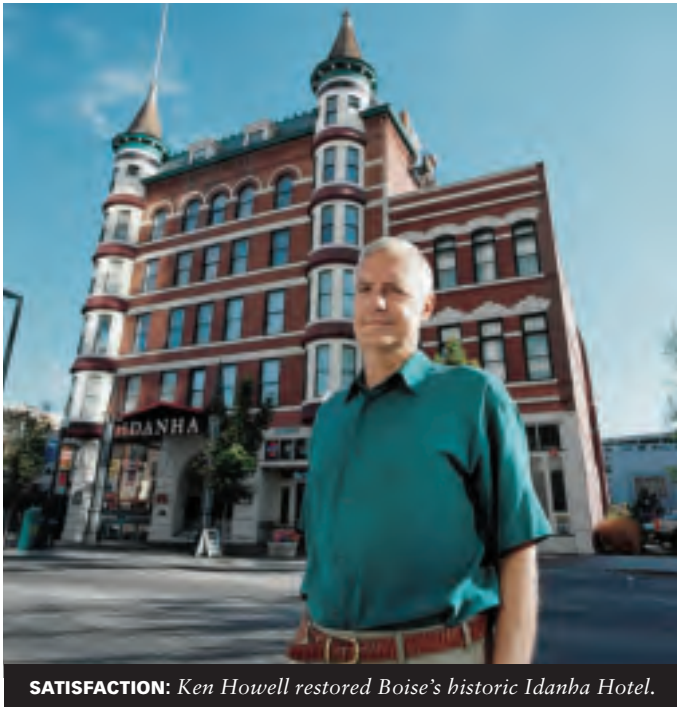
of our decision, made in close consultation with our alumni four years ago, to remain small and of high quality—to offer the same experience you and I had as students here in earlier years. This has meant resisting a major expansion of the full-time MBA student body or adding on company-paid, part-time executive MBA programs as some of our peer schools have done.

We have taken important steps in the last year to enhance revenues and rein in costs. We have greatly expanded our offerings of short-course executive education programs, which produce important revenue for the School. This year we raised tuition 9 percent to \$36,252—near the top of the range of similar schools. We also trimmed parts of the operating budget without compromising academic quality.

I want to thank each and every alumna and alumnus who supported the School this past year—in both large and small ways—through either participation or giving. Our goal is for you to engage with the School in a variety of ways to keep your GSB connection alive and strong—whether it is through our Lifelong Learning online newsletter and research resources or participation in alumni seminars, reunions, recruiting, orientation, student mentoring, admissions interviews, or the classroom. Keep up your involvement. We need you now and even more in the future for the GSB to continue its leadership and impact. ■

Spreadsheet

WHAT'S UP | News About the GSB and Its Graduates



SATISFACTION: Ken Howell restored Boise's historic Idanha Hotel.

Restoration and Renewal

KEN HOWELL'S MIDLIFE CRISIS BEGAN after Business School graduation in 1967 when he realized there would be no more summer breaks. That led him to become a \$350-a-month hired man on an Idaho ranch. Business School classes on operations and cases were useless, he discovered, when trying to help 300 heifers deliver their first calves. In addition, his bride from New York City wasn't thrilled about living in their 60-foot trailer. "So after calving and the last cutting of hay, we moved 30 miles to Boise."

There, in a slim job market, he molded a new career. Howell developed income property, emphasizing apartments and historical restoration. It took a while to realize that he loved this work, especially renovating some of downtown Boise's landmark buildings.

But it also took longer to accept that there was more to life than work. "Life is an endless unfolding," the late John Gardner told Howell's classmates at their 25th reunion in 1992. "An endless process of self-discovery, an endless and unpredictable dialogue between our own potentialities and the life situations in which we find ourselves." Gardner, who joined the School faculty in 1989 to teach self-renewal and leadership, died in 2002.

"His remarks had a profound effect on me," says Howell, who saved a copy of the speech and reads it occasionally. It prompted him to "explore in many ways questions beyond vocation."

(One of Gardner's self-renewal speeches to GSB alumni is included in a new book of Gardner's writings, *Living, Leading, and the American Dream*, edited by Gardner's daughter Francesca.)

An Intuit-ive Idea

IN THE MID-1980s, it was still possible to pluck pedestrians who had never used a computer off the streets of Palo Alto. Tom LeFevre, MBA '74, who worked for a software startup, cooked up an audacious idea: Intent on achieving ease of use for the company's proposed accounting software, he asked folks off the street to install the program and print a check within 15 minutes. LeFevre then tested the product—what became Intuit's highly successful Quicken—on members of the Palo Alto Junior League. His was the "first instance of the usability testing that later became a standard [software] industry practice," according to a new book, *Inside Intuit: How the Makers of Quicken Beat Microsoft and Revolutionized an Entire Industry*, by Suzanne Taylor and Kathy Schroeder, both MBA '90.

Taylor is a marketing consultant who worked eight years at Intuit, a company that today has 6,000 employees. In 2001 she became reacquainted with classmate Schroeder, a market-

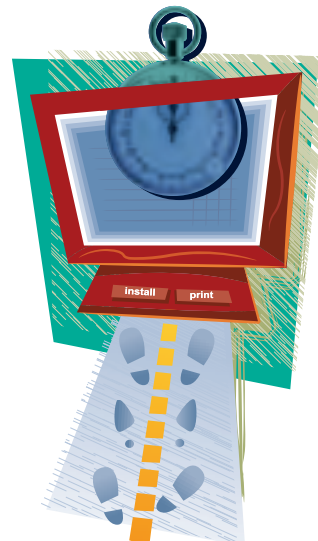
ing executive and writer, when both taught a Stanford continuing education course on marketing. They decided to write a book about Intuit's roller-coaster history and got permission from Intuit cofounder Scott Cook to conduct extensive interviews. Besides LeFevre, Intuit's first vice president of marketing, other Business School alumni prominently mentioned in the book are Ridge Evers, MBA '82, the maverick project manager for QuickBooks, Intuit's accounting software for small business; and Steven Aldrich, MBA '95, who founded Interactive Insurance Services, a Web business that was merged into Intuit but later sold.

Biggest PhD Class

WITH A SHORTAGE OF business professors at business schools looming worldwide, employers of future MBA graduates should be pleased to hear that a record 29 students entered the Business School's PHD Program this fall. Normally, the School enrolls a class of 25 students.

Only 35 of 748 applicants were offered admission this year, but more than 80 percent accepted, said Professor Ken Singleton, the incoming director of the PHD Program. Several factors may account for the increased acceptance rate, he said. "First, the GSB has an excellent faculty, and aspiring doctoral students are often attracted by the opportunity to work with specific faculty members. We saw this desire expressed in numerous applications this year.

"Second, Susan Gutierrez, who recently joined the doctoral



MITCH YORK

DARLENE MCELROY



ERICA SOTO

office as our fourth staff person, worked with faculty and graduate students to enhance the experiences of our admitted and wait-listed applicants during Admit Day,” an opportunity to meet faculty, current students, and their prospective peers.

Finally, in a recent report, the Association to Advance Collegiate Schools of Business predicted a national shortage of more than 2,600 professors for business schools by 2012 unless efforts are made to expand programs. “Many of our graduates are receiving job offers from top universities around the world, a not inconsequential consideration for prospective students in today’s difficult job climate,” Singleton said. Gutierrez said one of her goals is to make undergraduate counselors more aware of doctoral programs in business schools and of the job market.

Alum Trio Negotiates California Credit

LAST JUNE three Business School alumni arranged the largest ever one-day municipal bond sale to keep the state of California from falling into an even worse budget crisis. Newly elected state controller Steve Westly, MBA ’83, worked with chief deputy controller Mark Battey, MBA ’84, and financial advisor Paul Rosenstiel, MBA ’83, to organize the complex Internet auction. The event was over in an instant but took four months to arrange because of uncertainty surrounding the state’s deteriorating financial condition.

The stage was set in January,

Mark Battey, Steve Westly, and Paul Rosenstiel bonded over California’s bond problems.

when Governor Gray Davis announced a \$38 billion budget deficit. California needed to borrow \$11 billion to get through the summer—a huge loan in the municipal bond market even under the best of circumstances, according to Rosenstiel, who is a partner in municipal bond investment bank E. J. De La Rosa & Co. But California was falling out of favor with bond market participants concerned about the growing deficit. The state suffered downgrades of the credit ratings on its debt in December and again in February.

Because the Securities and Exchange Commission limits the amount of lower rated short-term notes that managers of money market funds may buy, Westly explained, “it was clear to us that the state, on its own, was not going to get the credit rating it needed to sell all the notes.” So the state’s team negotiated “nearly around the clock for several weeks,” he said, to convince seven commercial and investment banks to provide a form of credit support for the one-year notes in order to raise the credit rating.

The notes sold on June 11 with 10 investment banks paying an average rate of 1.13 percent. Just a month later, after the state missed its deadline to pass a budget, California’s credit rating was dropped to nearly junk bond status by Standard & Poor’s, and interest rates on state bonds jumped sharply.

High Schoolers Study Entrepreneurial Ideas

INSTEAD OF HIRING themselves out for summer jobs, some Bay Area teenagers have become entrepreneurs as a result of summer education sessions called BizCamp, organized by the National Foundation for Teaching Entrepreneurship (NFTE) and held at the Business School.

Carlos Montenegro, BizCamp 2002 participant who entered San Francisco State this fall, earned about \$4,000 from his DJ business and recently produced a new music CD called *SF’s Best Kept Secret*. He was named the 2003 Young Entrepreneur of the Year Award winner.



For the past three summers, Bay Area teachers looking for more experience in developing classroom programs in entrepreneurship have come to campus a week ahead of 9th to 11th graders who then arrive for classes and to work on business plans for companies they have envisioned. Each BizCamp climaxes with a competition judged by volunteer business leaders.

The national organization behind the programs, NFTE (www.nfte.com), is dedicated to creating a greater understanding of the free enterprise system, to improving the quality of students’ lives, and to helping them dream for the future. Summer program sponsors are the Myers Family Foundation, the NASDAQ Educational Foundation, and Merrill Lynch.

FOR THE RECORD



NEW FACES: Incoming students Kristin Ostby and Mauricio Plaschinski joined classmates during an icebreaker this fall.

MBA ’05 Student Profile:

GENERAL

Total Applications	5,089
Enrollment	374
Women	35%
Minority	21%
International	32%
Students with Advanced Degrees	9%
Median Years of Work Experience	4.0

SCHOOL/GEOGRAPHIC REPRESENTATION

U.S. Institutions	95
Non-U.S. Institutions	50
Countries (including the U.S.)	45

UNDERGRADUATE MAJOR

Economics	99
Engineering	87
Business	57
Behavioral Sciences	55
Humanities	38
Applied Sciences	24
Mathematics	14

TOP 5 INDUSTRIES

Financial Services	22%
Consulting	19%
High-Tech	10%
Nonprofit/Government/ Education	9%
Manufacturing (non High-tech)	5%

Source: MBA Admissions office

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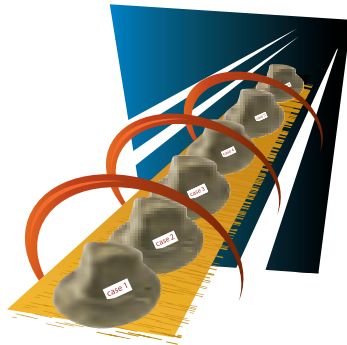
Spreadsheet

Demand for Cases Up

IN THE PAST YEAR, nearly 100,000 copies of cases written under the supervision of Stanford Business School faculty were purchased or downloaded for use in classrooms and boardrooms around the world.

The majority of Stanford business cases are distributed nationally through Harvard Business School Publishing, where sales of Stanford cases rose more than 28 percent to about 89,500 copies. The case on Southwest Airlines written by Charles O'Reilly III continues to be the leading seller, including more than 10,000 copies sold in the past year.

In addition to those sales, cases written for the School's Center for Electronic Business



and Commerce (CEBC) are distributed without charge online. Statistics are sketchier for electronic users, but Web use statistics show that for the month of June, nearly 7,000 copies of 10 CEBC cases were downloaded.

Demand is met by the School's Case Writing Office headed by Margot Sutherland, which produced about 80 new

cases during the 2002–03 academic year. For a listing of cases, see <http://gobi.stanford.edu/cases/default.asp>

Preseason Camp for NFL Executives

"WE GET SO SEGMENTED. We don't get to look at other areas such as marketing, TV deals, and revenue-sharing," said the football player turned team executive. Martin Mayhew of the Detroit Lions' front office was praising the networking and business acumen he picked up last summer at the Business School's first executive education program for the National Football League and the NFL Players Association.

The one-week, custom-designed Program for NFL

Managers included executives from all 32 league teams, representatives of the NFL front office, and members of the players association, including active players Troy Vincent, Robert Porcher, and Ryan McNeil. In addition to sessions led by GSB faculty, the group heard from Paul Tagliabue, NFL commissioner; Gene Upshaw, players association executive director; and some team presidents and general managers.

The June 22–28 program was codirected by Professor George Foster and Lecturer Bill Walsh—formerly head coach and general manager of the San Francisco '49ers and a former Stanford head football coach.

It grew out of an expertise in sports management developed for the Stanford MBA Program through the collaboration of Foster and Walsh. "We wanted to deepen the core business skills of the participants and give them a greater appreciation of all aspects of the NFL, the clubs, and the players association," Foster said. ■

DARLENE MCELROY



Entrepreneurship Conference 2004: Building for the Long Run

SATURDAY, FEBRUARY 21, 2004
AT THE GSB

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Application deadline: February 15, 2004

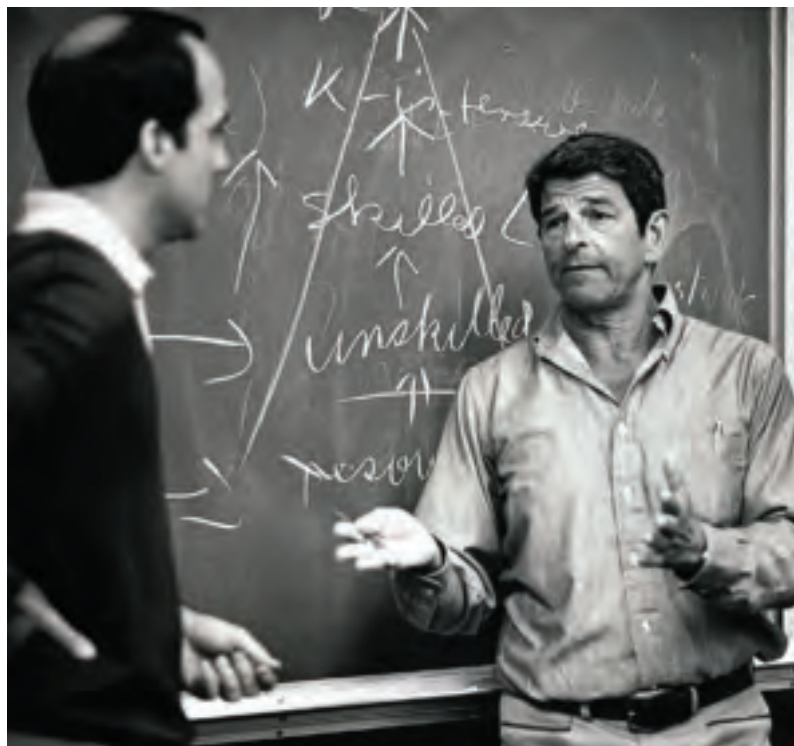


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Biographer of Development Economics

After 50 years of teaching the sometimes preachy subject of development, Jerry Meier's self-deprecating approach continues to appeal to students.



Pictured here in the 1980s, Meier has taught economic development to Stanford students for nearly 40 years.

times rowed against the business school mainstream. “In the environment of the late 1990s where the paradigm of the day was excitement about dot-coms and the Internet, Professor Meier succeeded in making economic development interesting through his passion and his intellectual rigor,” says Brand, who is senior director of research and development for ACCION International, a not-for-profit institution with development programs worldwide. She says Meier’s style was part of his strength: “His lightheartedness and witty sense of self-deprecation were unique in a topic where people tend to be preachy.”

Meier’s courses built on the classic economic analysis of Adam Smith, David Ricardo, and John Stuart Mill, and of more recent theorists to derive an understanding of the forces in underdeveloped economies. His 1957 textbook, *Leading Issues in Economic Development*, coauthored initially with Harvard economist Robert E. Baldwin, was translated into seven languages, and the influential text was used to teach several generations of economists. McMillan recalls reading the work as an undergraduate in New Zealand. “It remains far fresher in my memory than any other textbook I read at that time.”

In the summer of 2003, the evolution of development economics was very much on Meier’s mind. Deeply tanned at 80 years old, he lounged in khaki shorts, a tennis shirt, and sneakers, with a baseball cap pointed jauntily skyward. Outside, palm trees baked in the sun of the campus. Inside, the air-conditioned conversation turned to his latest project, a history of development theories, and Meier tapped a foot-high stack of manuscript pages on his desk labeled *Economic Development: Biography of a Subject*. After a decade, the manuscript is finished, but the subject certainly isn’t. “I call the final chapter ‘An Unfinished Biography,’” says Meier. He might as well call the book “Present at the Creation,” for Meier was witness to the very beginnings of the modern discipline.

The climate at Oxford University was far different in 1949, when as a Rhodes Scholar, a young Meier attended a lecture on the economics of poor countries, by Hla Myint, later a leading figure in development theory. In the late 1940s, Europe’s colonial empires were crumbling. Political independence was around the corner for some of the poorest economies in the world. Yet how would the postcolonial economies of Africa and Asia

BUSINESS STUDIES usually dwell on success, but for over 40 years economist Jerry Meier has taught thousands of Stanford students to focus on failure.

Meier—more formally Gerald M. Meier, the Kono-suke Matsushita Professor of International Economics and Policy Analysis, Emeritus—has brought a pioneering passion to economic development and guided generations of students through some of its stormiest debates. Starting in 1957, Meier coauthored what is believed to have been the first economic development text in the United States. Early in his Stanford tenure, he introduced one of the first economic development courses to the MBA world.

Nobel Laureate Joseph Stiglitz calls Meier a leading figure in the evolution of development economics. “His publications over an extended period have helped define the field,” Stiglitz says. “It’s a credit to Stanford’s business school it has had such a fine development economist on the faculty.” Adds John McMillan, professor of economics: “Because of Jerry’s efforts, the GSB is perhaps unique among business schools in its longstanding focus on development.” McMillan succeeded Meier last spring in teaching courses in the subject.

Monica Brand, MBA ’97, recalls that Meier some-

stand on their own two feet? What would encourage their growth? Those were huge questions. “It was a subject of enormous promise,” Meier says. “It became a passion of my life.”

The subject spread, but the content was always in flux. There was at first enormous optimism that new insights of economics could greatly facilitate the postcolonial world’s emergence into a wealthy future. Theories focused on the “big push,” as it was known, which called for huge capital investment in an underdeveloped region—a steel mill, auto plant, or similar sudden industrial intervention. The factory’s output could be exported to pay for the plant. The new facility was to foster a network of domestic suppliers who would boost the nation’s economy. Or that was the plan. It was a disaster.

Economists went back to the drawing board. Through much of the 1950s, more elaborate theories of “national policy” called for broad restructuring. Central, state planning was needed, it was argued, not out of doctrinaire demands for socialism but out of urgent need to reverse the plight of the poor. In time, grand restructurings, too, would fail.

Meier spent much of the 1950s teaching and writing, first at Williams College, where he introduced development economics to the United States, then at Wesleyan University. “I took it everywhere I could,” he would later say.

His had been a meteoric career to that point, with visiting appointments at some of the world’s most prestigious institutions and tenure at Wesleyan. He was not yet 40 years old. Then he undertook a year of research at Stanford. There was no academic attachment to the University at the time but by the end of that year, 1962, the Meier family had come to like Stanford and Palo Alto. Their neighbor, the late Ezra Solomon, began wooing Meier to join the Business School.

The recruiting worked, although not as easily as its perpetrators might have thought nor on quite the terms that Meier expected. It would be more than a year before the Meier family—Meier; his wife, Gretl; and three boys, soon to be four—permanently moved west. “I came to Stanford because I had young children,” Meier has said. The Business School’s dean, the late Ernest Arbuckle, persuaded the Meiers to take a chance—on a limited term appointment. “I gave up tenure and I came here on a three-year deal,” Meier says. “Terrible,” he adds with a grimace.

Meier didn’t teach a course in development economics until a student petitioned Arbuckle. Over time, student travels and more attention to international economies spurred demand for the subject.

It was the subject itself that was in trouble. Meier early on was concerned about the weaknesses of centrally planned development schemes. In a prescient 1965 working paper, he cautioned that consultants’ use of spiffy economic modeling and linear pro-



“Because of Jerry’s efforts, the GSB is perhaps unique among business schools in its longstanding focus on development.”

gramming might wow client governments in underdeveloped nations but that “subsequent experience has too often been sobering.” Market pricing and allocation were being tossed aside in favor of central planning, and agriculture too often was neglected in favor of industrialization, Meier wrote.

It was a classic Meier cautionary step, notes Stiglitz, now a Columbia University professor. “Jerry is somebody who brought eminent good sense to development economics.” By the 1970s, the shortcomings of early economic development hardly needed spotlighting. Rampant inflation in Latin America sent economies there spinning. Development schemes to replace imports in underdeveloped countries with domestic goods had fostered inefficient, tariff-protected factories throughout the developing world. Monetarists of the Chicago School crowed that market forces were ignored and that money supply issues had been overlooked in favor of boosting output.

By the 1980s, theories had tilted far toward free-market structures. A centrist, Meier again argued that things had swung far past a sensible balance. In his latest work, the biography of economic development, he complains that “instead of pursuing the grand theories and general strategies of the first generation of development economists, the second generation was now almost moralistic, dedicated to virtuous policies based on neoclassical (market) economics.” But in these Reagan years, institutions ranging from the White House to the Treasury

to the International Monetary Fund and the World Bank were so firmly lined up behind free-market advocacy that the remedial regime of private industry, tariff removals, and tight monetary policy became known as the “Washington consensus.”

“The eighties were very hard,” Meier recalls. By 1988, he asked in a research paper the essential question, “Do development economists matter?” Meier conceded that cherished theoretical assumptions of

the discipline had long since passed. “If development economists are now to have more influence,” he wrote, “the subject of development economics must move beyond neoclassical economics.” The often-naive notion that governments always acted in the public interest had been crushed time and again. Meier admitted that without many simplifying assumptions, development economists’ jobs would grow far more complicated. However, “we must open the black box of the state,” he wrote. Public bureaucracies must be analyzed, as should interest groups. Sociological insights shouldn’t be overlooked, nor should various political factions.

“Do Development Economists Matter?” and other Meier papers were on the mark. In the 1990s, the deeply rooted inadequacies of the “Washington consensus” approach were amply demonstrated in Argentina’s instability and its subsequent economic plunge in 2002. And, true to Meier’s call back in 1988, development economics has moved past its singular concentration on one-size-fits-all free-market fixes toward a more realistic and encompassing multidisciplinary approach.

Looking back on it all—the analysis of rising and falling theories, the success and failure of half a century of development, and the passing of those lessons on to generations of students—Jerry Meier shakes his head. “I don’t know what value my career has been, if any, but certainly I would say it’s the teaching that I most value.” ■



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Behind the Scenes

MICHELINE LIM CHAU, MBA '76

MICHELINE CHAU'S ROAD to the top of the entertainment industry was, in her own word, circuitous. As a 16-year-old Singapore schoolgirl, Micheline Lim found herself halfway around the world at Wellesley College in Massachusetts. Four years later she took her bachelor's degree in English to Stanford, where she earned her MBA and, incidentally, met her husband, classmate Armand Chau. Now she is second in command at Lucasfilm Ltd., known worldwide as the home of the Star Wars and Indiana Jones series.

"I had very little real-world experience before I went to B-school," Chau recalls. She learned on the job. Over 15 years she worked in retail, restaurants, venture capital, financial services, and software. In 1991 when Lucasfilm was looking for a chief financial officer with diverse experience, Chau's roundabout route served her well.

Early this year founder and chief executive George Lucas announced he was uniting what had been four companies into one. Lucasfilm Ltd., the film and television production company, would now include sound and visual effects, interactive software, and licensing and merchandising. Lucas tapped his CFO as chief operating officer of the restructured company.

"My job is mostly strategic," Chau says. "It's to provoke, to ask the right questions.

I spend a lot of time with the business unit heads thinking about how we can best organize their businesses and the enterprise as a whole. We MBAs are taught that career track is important," she says, "that it's all about what's my next job and what's my next step up the ladder. But I think what's really important is to find a place that fits your skills and values and then to be passionate about it.

"Lucas has the old-fashioned values that have gone missing. Everybody here is family. Everybody succeeds on merit. I think the challenge for us is to keep those values going. As we grow, we can't forget where we came from."

— JANET ZICH

Hi Tech to Hamburgers

BEN NEMO, MBA '98

"ARE YOU TOASTING IT TWICE?" Ben Nemo asks another Burger King employee who is holding sourdough bread. Classmate J. J. Ramberg is videotaping the scene for a TV news segment on former dot-commers in their 1998 MBA class. She has left the Internet frenzy for a reporting job with CNN Financial News, and Nemo has escaped from Silicon Valley to Burger King's corporate headquarters in Miami, where he is manager of U.S. product marketing. On this summer day, he is out in a restaurant, however, because "in this business the little decisions we make can throw off operations and impact the customer."

Nemo came to the Business School from investment banking in New York and Brazil with the idea of joining a consumer brand, but the Internet boom waylaid him. Shortly after graduation some classmates were collecting seven figures from investors, and those who weren't were asking each other why. "I felt I was going to miss out on my chance not only to make money but to have an impact at a young age," he recalls. "It gave me a lot of anxiety to see success stories about my classmates in the newspapers."

So he joined an Internet startup—a Los Angeles company with two short lives. The first published free Web home pages. "That model fizzled because a lot of competition emerged, and so we tried to reshape ourselves as an application service provider hosting software for companies that didn't want to buy it." The challenge was to "figure out how to stay alive in a dynamic environment," he says, which was fun, but eventually he felt limited by the intangibility of envisioning how a business *might* work.

Friends like to tease him about flipping hamburgers, he says, "but everyone can relate to our products, and I love seeing the brand on street corners and talking to customers in our restaurants." Burger King measures sales performance and check averages every day in 8,000 domestic restaurants and keeps a close watch on competitors too. "It's really nice," Nemo says with hard-won appreciation, "to be able to see an immediate impact of what you do."

— KATHLEEN O'TOOLE ■



JOHN PARRAS PHOTOGRAPHY



Japan's Debt Doctor

Faced with resuscitating the nation's debtor companies, Kazuhiko Toyama, MBA '92, brings past success and an understanding of market forces to the task.

WHEN ONE OF JAPAN'S leading manufacturers of printing equipment filed for bankruptcy in 2001, many people wrote off the company. After all, Tokyo-based Akiyama Machinery Manufacturing Corp. had emerged from a previous bankruptcy just eight years before, and the faltering Japanese economy wasn't likely to supply many potential buyers.

But an Akiyama customer, fearful that it would lose its major supplier, looked to turnaround specialist Corporate Directions Inc. and its president, Kazuhiko Toyama, for help. Toyama studied the company and agreed that it was worth saving. The 43-year-old Stanford MBA helped structure an unusual deal that led to a purchase by Shanghai Electric, a leading Chinese company employing more than 100,000 people.

It was a risky and imaginative solution. But it paid off. Akiyama is once again a profitable company.

Now Toyama is facing a much bigger challenge, one that puts his reputation as a corporate ER doctor square-

ly on the line. In April, he was named chief operating officer of the Industrial Revitalization Corp. of Japan (IRCJ), a new government agency charged with helping to salvage at least some of the approximately \$320 billion in bad loans that are crushing the banking system. Backed by a government guarantee of 10 trillion yen (U.S. \$86 billion), the IRCJ has five years to guide debtor companies back to economic health.

The IRCJ will buy the loans of selected debtor companies at a substantial discount—what Toyama describes as a haircut—and revitalize them by restructuring their operations and, if necessary, their management.

Sound like a bank bailout in a fancy wrapper? Toyama denies it.

"This is not like the S&L crisis in the United States," he told *Stanford Business*. "The problem has spread far beyond the financial sector." Overburdened by debt and hampered by outmoded employment policies, Japanese industry has been underinvesting for years, Toyama said. "It's a disease that we needed to treat 12 years ago."

“Our mission is to save the heritage of industry for the future. The tradition of passing on know-how and technology from generation to generation is dying.”

For Toyama, a father of two, one of the worst symptoms of the disease is the lack of opportunity for young people—unemployment among Japanese in their late teens and early twenties now stands at about 10 percent. And many more young people work part time or hold one short-term job after another. This state of underemployment has become so prevalent the Japanese have coined a new word to describe these workers: “freeter,” a combination of the English word “free” and the German word “*arbeiter*” (laborer).

“Our mission is to save the heritage of industry for the future. The tradition of passing on know-how and technology from generation to generation is dying,” Toyama said.

The fix won't be pain free for creditors, managers, or employees.

Asked about his strategic view of the recovery, Toyama frequently talks about Carlos Ghosn, who took over as CEO of Nissan in 1999 when the automaker was deeply in debt. Ghosn transformed a \$5.5 billion loss in fiscal 2000 to a \$2.7 billion profit the next year. He trimmed billions from Nissan's \$20 billion debt and boosted the stock price 30 percent. But to do so, he cut 23,000 jobs in a country where lifetime employment is the norm, closed factories, and ended decades-old contracts with suppliers, according to *Bloomberg News*.

“The question is,” Toyama said during a Bloomberg panel discussion in early July, “within five years how many Nissans can we create?”

Substantial numbers of employees of companies rescued by IRCJ may well find themselves unemployed, he acknowledged during his discussion with *Stanford Business*, adding that those who lose jobs “are leaving situations where they are no longer needed, but [they] might have another chance for life fulfillment in a revitalized economy.”

Still, the sacrifice will be a shared one. Case in point: Kyushu Industrial Transportation Co., a bus company with a \$480 million debt that is one of the IRCJ's first rehab cases. The agency expects creditors to eat a substantial portion of the debt and management to step down.

Toyama's rise to prominence is no surprise to those who knew him at Stanford. “He's smart, he's serious, he's assertive,” said Jeff Donnelly, a 1992 Stanford MBA

who remains in contact with his classmate. Donnelly, now a general manager at semiconductor equipment maker KLA-Tencor, recalled that other students, particularly those from Japan, looked to Toyama for leadership.

While at Stanford, the two men jointly developed a paper contrasting Japanese and Silicon Valley management styles. Although Toyama's English is excellent (he lived in Australia for part of his childhood), he convinced Donnelly that a native speaker should do the actual writing. The episode illuminates an important facet of Toyama's character: His ego is strong. Many business people in their thirties would be embarrassed to concede that some of their skills are less than perfect, but Toyama realized that reaching his goal was more important than losing a bit of face.

The paper got a good grade and 11 years later, “a lot of what we said still rings true,” Donnelly said.

Toyama passed the bar and received a law degree from Tokyo University in 1985, but like many successful Japanese businessmen, he had little interest in becoming a lawyer. “People of my generation [and social class] had few options other than being a salary man,” he said. But being a white-collar worker for one company for his entire career was not the life Toyama wanted.

His training in law helped Toyama land a job in Tokyo with the Boston Consulting Group. He then joined Corporate Directions, a business consultancy, and saw the need for a more focused education. Why Stanford? “I was very much attracted by the GSB's environment, particularly its closeness to Silicon Valley and its background of high tech/IT and traditions of entrepreneurship,” he said. The good weather, golf course, and proximity to San Francisco didn't hurt either, Toyama added.

When Sadakazu Tanigaki, minister in charge of industrial rehabilitation, named Toyama chief operating officer of the newly created IRCJ, his reputation as a turnaround artist alleviated some of the concerns about Toyama's comparative youth. After all, many high-ranking Japanese officials are nearly twice his age, and Toyama has never led a large industrial or financial enterprise.

One argument in favor of his appointment: Toyama's success with Akiyama.

Akiyama International Co., as it is now

called, is already profitable, according to a recent story in the *Washington Post*. It has trimmed production costs by 15 percent through aggressive bargaining with suppliers. It has instituted a merit-based pay system that eliminated perks for senior employees while creating opportunities for younger ones, the *Post* reported.

Moreover, the turnaround demonstrated the kind of unconventional thinking that will be needed to make IRCJ a success.

World War II left a bitter legacy that still plagues economic cooperation between Asia's economic superpowers, and turning over a Japanese company to Chinese investors is virtually unknown. Moreover, poorly run Akiyama was sinking under a mountain of debt related to overexpansion despite its reputation for technological excellence. But Toyama, whose father was a printing company executive, was right. The business was worth saving.

With the IRCJ now up and running, it's becoming clear that Toyama will need every bit of the strength of character that impressed his friends at Stanford. The IRCJ has a very high profile, and rumors about its decisions frequently spark action on the stock market. Mitsui Mining Co., for example, jumped 21.7 percent in one day on reports that the company might get support from Toyama's agency. The government is so worried about leaks and the potential for serious conflicts of interest within the body that all meetings are videotaped, telephone conversations are recorded, and a member of the public prosecutor's office is attached full time to the IRCJ, Toyama said.

The IRCJ gets a good deal of scrutiny in the Japanese press, and Toyama will get plenty of criticism if it appears that he is wasting the mountain of cash entrusted to him. In fact, some Japanese business analysts worry aloud that the agency will create “zombie” companies—organizations that are alive only because of the infusion of public money—and do little to make the economy more competitive.

But Toyama sounds supremely confident when he describes his plans and says he acts from a sense of duty. “I'm a Japanese citizen; I share the sense of crisis, and like our parents' generation we have to sacrifice for the future.” ■

Bill Snyder is a San Francisco-based writer for TheStreet.com.

LED Lamps Light the Way for Social Entrepreneurs

The lamp itself is a small part of the class project, which requires developing a business plan to spread and sustain the technology.



These solar-powered LED lights were designed by a team of business and engineering students with input from industry experts and potential users in other countries.

Moreover, LEDs, which are solid-state circuits made of semiconductor material, are durable—able to last for as long as 40 years. And it is much easier to use inexpensive lenses to focus light produced by an LED (think point source) than a standard or fluorescent bulb.

Headed by professors Bill Behrman and David Kelley of the School of Engineering and James Patell of the Graduate School of Business, the *Social Entrepreneurship Startup* course was inspired by and builds on the work of David Irvine-Halliday, the founder

of LUTW. Irvine-Halliday, a Scottish-born Canadian electrical engineer, hit on the idea of using LED technology to replace kerosene lamps while trekking in the Himalayas in 1997.

Within three years, 134 homes in four regions of the mountainous country were lit using battery-powered LEDs recharged by a mix of solar, pedal, and hydroelectric power. And because Irvine-Halliday believes that economic development projects will spread and sustain lighting technology more efficiently than giveaways, he helped start Pico Power Nepal, which now builds LED lamps in a small factory in the countryside.

The problem Irvine-Halliday, and then the team at Stanford, set out to solve is rather like an iceberg. The most visible part of the solution, the lamp itself, turns out to be only a relatively small part of the whole. Consider the power source: Is the community on the electric grid at least part of the time—if so, a battery and a conventional recharger might do the trick. If not, pedal-powered generators might work—but only if there are enough people in each user community to justify the expense and share the labor.

TURN ON THE LIGHT. For most of us, it's second nature. Electric lighting is clean, safe, and relatively cheap. But for more than 1 billion people in underdeveloped countries, turning on the light, if it's possible at all, means lighting a smoky, dangerous kerosene lamp.

A groundbreaking partnership between Stanford University's *Social Entrepreneurship Startup* and the non-profit Light Up the World Foundation (LUTW) is working to bring safe, affordable lighting to people in China, India, and Mexico. And in the process, 21 students in business and engineering are learning invaluable lessons about product development, market research, and applied engineering that would be hard to duplicate in a traditional classroom.

In 10 short weeks, a team of Stanford students, helped by volunteer advisors from private industry, developed three business plans (one for each country) and prototypes of three LED-based lamps bright enough to read or work by at a fraction of the cost of conventional incandescent lighting or kerosene lamps.

All the prototypes are inexpensive to manufacture and maintain, durable, and, most significantly, ultraefficient. That's because LEDs, or light-emitting diodes, produce nearly 50 times the amount of useful light per dollar of a conventional bulb and up to 200 times more useful light than a kerosene lamp, according to Evan Mills of the Lawrence Berkeley National Laboratory, who acted as an advisor to the project.

Looked at another way, 90 percent of the energy used to power a standard bulb produces heat and 5 percent produces light. An LED works roughly the opposite.



dents who were developing a solution for Mexico found that earlier attempts by the government to bring solar-powered lighting to the countryside had failed and tarnished residents' image of solar power.

What shape should the lamp be? Should it hang from the ceiling or sit on a table? Should it be a task light—a reading lamp, for example—or should it provide more diffused light across a larger space? Settle all those questions and that still leaves the question of price, including the bill for materials and the cost of assembling them into a finished product.

To make the job manageable, the spring quarter class was divided into teams for each country. Some students concentrated on engineering tasks, others on business- or market-oriented tasks, but “there was a tremendous amount of cross-fertilization,” said Patell. And a tremendous amount of preparatory research.

Like students in any university class, project members spent countless hours on the Internet and in the library to ferret out basic information about conditions in the three target countries. Consider India, the

At times the class resembled nothing so much as a Silicon Valley startup, with students pulling pizza-fueled all-nighters while they struggled to finish an iteration.

second most populous country in the world: Between 150 million and 300 million people are without electricity; as many as 80,000 rural villages are not connected to the power grid; many areas on the grid have power for just six to seven hours a day.

But this project needed significant amounts of primary research as well, and Stanford's position as a preeminent institution of learning opened many doors.

Behrman contacted the Indian government and was able to arrange a meeting with a cabinet-level official, who in turn introduced the project to a number of non-governmental organizations and local academics. And those contacts enabled the students to work with villagers who became vital sources of information and feedback.

One Indian, Bharatsinh Patel, is an agricultural worker in semirural Gujarat. Patel, who has 11 people in his family, is on the grid, but power is off much of every day.

Although kerosene costs only 30 cents a liter, his average fuel expenditure for back-up lighting accounts for as much as 4 percent of his monthly budget—a serious problem for a man who only earns \$300 to \$600 a year. What's more, Patel spends more precious cash buying disposable flashlight batteries.

The solution: the \$20 Mighty Light. Looking a bit like an iron, the LED-based Mighty Light can be carried like a flashlight,



hung by its handle to light a room, or set on a table. It runs on two AA batteries that provide around four hours of light when fully charged. It has a built-in photovoltaic (solar power) panel that will charge the batteries in a little more than seven hours and costs about \$10 to build.

The business plan: Light Up the World initially will act as a virtual manufacturer, subcontracting manufacture to a third party. Once the product and business concept has been proven, LUTW will throw the design open to competing manufacturers to produce and distribute the product.

The foundation initially will support the sales channel with marketing and promotion activity and handle inventory. But in the long run, LUTW's goal is the creation of a self-sustaining local infrastructure that will build, distribute, and sell the lamps.

At times the class resembled nothing so much as a Silicon Valley startup, with students pulling pizza-fueled all-nighters while they struggled to finish an iteration (each prototype had about 10) for the next day's critique. Their audience was a tough one: experts from companies including IDEO, the Palo Alto, Calif., industrial design company whose credits include the first mass-produced computer mouse and the Palm VII; and Solectron, one of the world's largest contract manufacturers, plus designers and engineers from other firms and universities.

The advisors heeded the advice of the project leaders to be supportive but critical. “Eventually, we established a rule that the experts had to say one nice thing for every

nasty thing,” said Stanford's Patell. Actually, the critiques were a lot less bruising than those in the real world. Nevertheless, they were taken very seriously. “It's a lot better for us to find mistakes here than to have something fail in the field 6,000 miles away,” Patell added.

Prototypes of lamps and business plans were sent regularly to the target countries for feedback. Villagers used the lights for several days and were then debriefed by LUTW

Industry and design experts worked with students from initial concept to demonstration models of several different LED light designs.

representatives who sent the information back to Stanford for incorporation into the next round of product development.

By mid-June, the team had settled upon two light designs, the MightyLight and the MightyTorch. At about \$7.30, the MightyTorch looks like a flashlight, contains three small LEDs, and is powered by one AA NIMH battery, recharged by a photovoltaic panel on the side. Its intended use? Task lighting for poor people without electricity in any country.

Neither of the solutions is perfect. “They don't have to be,” said Patell. “What we want to do is produce something that a non-profit can show to a group of investors and get their attention.” Similarly, the business plans are closer to proposals than economic blueprints.

Five students spent two weeks of the summer deepening their research in India. “The experience has been too inspiring to let go,” said Matthew Scott, MBA '03. Students are continuing to work with the Foundation to develop plans for a full-scale pilot project beginning spring 2004.

Others will move on—to jobs or new academic challenges. For all, it was a memorable 10 weeks. “I got to combine my interest in technology and business with social entrepreneurship,” said Scott. “It opened my eyes to the world of development.” ■



The Labyrinth of Global Ethics

ALUMNUS GREGG MARSHALL OFFERS A CAUTIONARY TALE OF CORRUPTION
AND OTHER DANGERS IN TODAY'S BUSINESS ENVIRONMENT.

CONSIDER THIS: Fortified with your freshly awarded MBA you arrive in a small but rapidly developing country to close a U.S. \$52 million infrastructure sale and oversee its implementation as the country manager of a Fortune 100 company. > The client is a government-owned utility, and the project has been three years in the making. Your firm has spent over \$2 million supporting the sale and won out in fierce competition over six eager, well-funded, and otherwise similar competitors from North America, Europe, and Japan. The decision maker on your deal is a government minister. You've yet to meet due to the honorable minister's frenzied campaigning for parliamentary elections to be held in less than one month,

PHOTOGRAPH BY MARK HOOPER



so you're delighted when his private secretary phones and instructs you to come over immediately. As you rush out the door your local assistant pulls you aside and warns you to be careful. Careful? Yes. The minister was part of a group of which some members were arrested overnight and charged with homicide in the beating death of an opposition party official in a far-off northern province. > Moments later you're seated opposite the minister in his unrenovated British colonial chambers. It's mid-afternoon, but the curtains are drawn. A single lamp barely glows in a far-off corner. The room reeks of whiskey; the minister is drunk. But he wastes no time. "I would like you to sponsor \$100,000 of campaign posters," he says. "We need the funds for printing immediately. We would like you to be able to carry out your project. I'm sure you can understand."

SOUND FAR-FETCHED? Scenes like this one in which I was the freshly minted MBA are repeated daily in capitals around the globe. It is difficult to write about, especially with names, because often there is no way to prove your version of events. However, many of us working in the global economy know that corruption and fraud are endemic and remain the biggest challenges facing business people working outside the richest countries. Recent headlines suggest there also was plenty of corruption fueled by greed during the bubble economy of the nineties in the United States, perhaps on a scale that dwarfs the common gouging and extortion of the developing world. That has been written about in other issues of this magazine and is beyond my expertise because I have been living and working abroad for 21 of the past 25 years.

Stories like the one about the minister's request, in addition to raising the specter of corruption, typify the significant cross-cultural pitfalls that confront people working in social and legal environments outside their home country or other countries they know well. And that, in our current era of full-throttle globalization, is greater and greater numbers of business people everywhere.

I've asked myself and others over the years why certain kinds of corrupt practices are so popular in poorer countries. In 2000, then Microsoft CEO Bill Gates spoke to business leaders in the Philippines about his vision for a better world, and how the information technology industry is making that world possible. The first question during the discussion that followed was penetrating. "In the Philippines," said one executive from a major

information technology company, "a majority of the population does not have adequate shelter, food, clothing, or health care. How is IT going to provide that?" To Gates's credit, he replied that these things are indeed priorities and that information technology can only really help people whose basic needs are covered. He has since donated an enormous chunk of his personal fortune to a foundation dedicated to improving living standards in the developing world.

Some observers to the discussion with Gates took the position that corruption is not a large problem in the United States because Americans have evolved a broad social agreement that it is not an acceptable practice to bribe people in order to get what you want. Several hundred years of rapid economic growth have demonstrated that win-win transactions in which everyone is entitled to their income and margin lead to the fastest economic growth and largest dispersion of wealth. In addition, the economic, social, and ethical cases against corruption are clear and well understood everywhere, including in the developing world. Politicians and business leaders are keenly aware of the role it plays in distorting trade by increasing costs, slowing procurement processes, and therefore rendering many projects unprofitable at best and uneconomic as well as shoddy at worst.

However, in many cultures people's behavior conflicts with these beliefs: Broad social agreement recognizes that individuals can and even should ask for payments on the side in keeping with the significance of the goods or services they are delivering. Official policy drawn up by highly articulate government officials to help their country compete for global capital condemns side deals but cannot quickly overturn centuries-old norms and personal habits. Nor, as in the example of Gates, are those policies thought by many business people or officials to help put food on their own tables.

In places with few resources and slim prospects, people believe in taking what they can get, when they can get it, because the opportunity might not come their way again. In lands of plenty, people have faith in rising prosperity; life does not seem so tenuous.

But resources are scarce and always fleeting in poorer countries. For this reason, corrupt business practice remains common

Are Your Papers in Order, Sir?

CORRUPTION IS NOT THE ONLY WAY to be placed in harm's way when overseas. You may—wittingly or not—break any number of laws and find yourself before the bench. An American journalist recently was tried in Indonesia for breaking immigration law and sentenced to 40 days in jail and barred from the country for a year. His crime was entering Indonesia under a tourist visa. Indonesian immigration law requires working journalists who plan to report from the country to apply for a press visa, and they take this very seriously. Press visas are frequently denied, especially for access to a war zone like Aceh in North Sumatra. A defense based on ignorance, especially when you are filing dispatches while on a tourist visa, rarely wins such a case. Through the Internet it is now possible to review online many countries' laws and their implementing regulations, even those of the most far-flung. You'll be expected to have done your homework and to keep your documents on hand and in order.

Other perils are similar to those you would face in the United States. Don't discount these, because Murphy can and will strike when you least expect it. Chances are, for example, that you will travel in an automobile no matter where you go on business. Your risk of getting into an automobile or other accident that causes serious injury may be lower in much of Europe than the United States, but it is certainly higher in the developing world. If you suffer a serious personal injury in a poor country, you may not receive adequate medical attention even at the nation's best facility nor safe blood if you require

a transfusion. In some countries drivers are automatically arrested if they cause a fatal accident, and in others, particularly remote areas, they may be beaten or killed on the spot by angry locals, particularly if a child's life is lost in the crash. Always travel with insurance that guarantees immediate medical evacuation in case of emergency to a location with world-class medical facilities. Try not to be the driver in unfamiliar places. And obtain a policy rider that pays for legal assistance wherever you may be.

If you travel abroad on business, and certainly if you live and work abroad, you will want to entertain yourself after hours. While many urban areas in the developing world are far less dangerous than a handful of notorious city neighborhoods in North America, some seemingly harmless amusements can land you in the morgue. A South Korean diplomat was found dead last year in one of Asia's favorite fleshpots. He had been drugged in a bar, robbed, and dumped by the side of the road, where he asphyxiated in his own fluids.

Stories of expatriates who try to score illicit drugs locally are also legion. Hundreds are in jails around the world serving sentences up to life, and in a number of jurisdictions—including many rich countries—the mandatory penalty for drug possession or use is death. You do not want to end up in a poor country's hoosegow. Conditions are frequently so crowded you may not be able to lie down to sleep. In many such places food is provided to inmates by their families or not at all. The U.S. government can and will do little to help. — GM ■

THE RESPONSE BY MANY COMPANIES WORKING IN CORRUPT ENVIRONMENTS IS TO TEAM UP WITH A LOCAL PARTNER, A SALES AGENT, OR REPRESENTATIVE, OR TO SUBCONTRACT PORTIONS OF A PROJECT THROUGH LOCAL ENTITIES THAT DO THE DIRTY WORK OF PLACATING POWERFUL PEOPLE WHO HOLD THEIR HANDS OUT.



and shows no signs of abating. Why is this so? Despite widespread reform in places around the globe over the past decade, populations are increasing quickly in many poorer countries, and real incomes have actually dropped in a number of places over the past several decades. In such places, when people have a clear shot at money, they take it.

DOES THIS MEAN THAT WHEN IN ROME, you should always do as the Romans do? In general, yes, because it's the best way for an outsider to succeed like an insider. But definitely not in the case of corruption. If you acquiesce to our minister's request for campaign assistance, you will have violated the u.s. Foreign Corrupt Practices Act (FCPA) of 1977. This law, drawn up in the wake of a large scandal involving commercial airliner sales in Japan, prohibits Americans from bribing foreign government officials to win business. For a while this law placed Americans at a distinct disadvantage to their competitors from the European Union, who until 2000 could deduct from corporate taxes bribes paid to win business as a legitimate business expense.

As a sign of how severe this issue has become, it is now stan-

dard practice for u.s. companies to require American employees operating offshore to sign an acknowledgment of the FCPA and to be warned that any potentially illegal activity by the employee will be reported by the company itself to law enforcement officials.

But what is the actual state of play beyond u.s. borders? The FCPA does not prohibit the payment of commissions, agent percentages, finder's fees, or the like to private individuals, and in the quarter-century since the FCPA's passage, many government-owned companies around the world have been privatized. This removed government officials from moral hazard, but they have been replaced by other decision makers who also frequently view foreign companies as milk cows.

The response by many—if not most—u.s. companies working in corrupt environments is in fact to team up with a local partner, a sales agent, or representative, or to subcontract portions of a project through local entities that do the dirty work of placating powerful people who hold their hands out.

As these kinds of arm's length transactions are not prohibited by the FCPA, they have become usual and customary. Typically, a local agent receives some percentage of revenue on a

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contract, perhaps 5 to 25 percent of revenue on a deal's successful completion. What happens to that money is the agent's decision alone, but there is plenty of incentive to get the deal done. Not surprisingly, in many places where use of local representatives is common practice, accounting and reporting standards are also lax, cash is still king, and brown bags change hands regularly.

Theoretically, the payment of bribes and kickbacks happens out of sight and out of mind. Yet Americans working abroad in large companies often find themselves caught between company pressure to achieve quarterly revenue and profit goals, the long arm of the law, and their own beliefs about the deleterious effects of bribery in the short and long run. Agents offer the prospect of closing successful business deals and creating plausible deniability before the law.

Running afoul of the FCPA is nothing, however, compared to what can happen if you get entangled in a dodgy legal system. The case of Jude Shao, MBA '93 (reported in the August issue), is not unusual in most of the world's jurisdictions. Shao is imprisoned near Shanghai and serving a 16-year sentence for two tax-related offenses, crimes he denies committing. He says a tax auditor offered to return his import company's books and drop an audit if the company posted a \$60,000 bond. Shao saw the offer as a thinly disguised demand for a bribe and refused. Many postcolonial countries labor under remnants of legal systems put in place by their former occupiers early in the last century, and in others the legal system is a rubber stamp for whatever political or ideological decision already has been made by people in power. Shao was not granted what are considered basic protections against judicial abuse, including the right to prepare and conduct his own defense; to confront his accusers; to have access to records—including his own—that would bear on accusations made against him; to outside legal counsel and representation; to appeal; and perhaps most important, to be judged by his peers rather than a judge who may or may not be impartial. As an entrepreneur, he also did not have the resources or clout of a large multinational company behind him that could bring immediate pressure at high levels to secure his release.

SO, IF YOU ARE THE ONE seated in front of the minister looking for campaign finance, how do you react? And how will this all unfold? If you blow him off—big temptation—you will have committed a social *faux pas* sure to ripple out and stigmatize you with future customers. Inside your own company, you may be perceived as having blown a major deal, even though you did the right, ethical thing. Patience is often the wisest counsel. First, ask for his. Say you will have to check with your predecessor on what was promised and also notify your superiors of this urgent need. Take your leave graciously, and always be soft-spoken and polite. Not many world cultures are confrontational. Besides, you need to stall only for a month. The minister, his reputation soiled, will be voted out of office at the election. In his place comes a reform-minded young technocrat. Unfortunately, he decides to rebid your project, and the whole cycle starts again. ■



ABOUT THE AUTHOR
 Gregg Marshall, MBA '94, lives in Singapore and is Asia managing director for Network365, a Dublin, Ireland-based mobile payment solutions provider. He was formerly a U.S. diplomat and consular officer and has worked outside the United States for 21 of the past 25 years.

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Early life lessons led him to a career
in finance for the masses. By EDWARD WELLES

Eric Tyson for Dummies

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ERIC TYSON HAS a B.S. from Yale and an MBA from Stanford Business School, but his biggest life lesson occurred back in junior high school when his father, an engineer, lost his job. “It was a difficult family time,” he recalls. Compounding the angst, Tyson’s father had been dispatched with a lump sum from his retirement plan, which he promptly plowed into the stock market. As the older man set about trying to chart, time, and trade the market, his son, then 12, took a different tack. Eric did a science fair project on the variables that influenced the stock market. His conclusion? Unlike his father, an investor shouldn’t try to overanalyze the market. It will only impoverish you. Better to buy good stocks for the long term and relax. >>>

PHOTOGRAPHS BY **Beth Perkins**



W

WHILE TYSON'S FATHER eventually landed a new job, the meaning of that memory did not escape his son. "I've seen a lot of family members and friends struggling to make the right financial decisions," he now recalls. The case of his father "was one of many examples of otherwise well-educated people making bad financial decisions."

That experience, as it turned out, would set Tyson, now 41, on his future course in life. His deep interest in numbers and personal finance developed to the extent that he accompanied his father to the local library to pore over *Value Line* reports while his peers were out playing ball with their dads. Later, as a budding management consultant between college and business school, he worked with clients in the financial services industry. After graduating from the Business School in 1989, he opted to become a personal financial counselor, charging clients on an hourly basis for advice.

The sum total of that training is a quiet self-confidence when the subject is money. "I have a pretty good sense of the financial issues that people are struggling with and how to get them the right answers," says Tyson. It's an assessment now shared by countless others who have heeded his advice and made Tyson one of the most widely read authors on personal finance that you may well never have heard of.

In the past decade he has written or coauthored eight books in the "Dummies" series, bearing such titles as *Personal Finance for Dummies*, *Investing for Dummies*, and *Home Buying for Dummies*. Tyson's books, many of them now in their second and third editions, have sold more than 4 million copies. At one point in 1999 he boasted no less than four books on *BusinessWeek's* best-seller list.

Kathy Welton, a 1978 Stanford graduate and Tyson's longtime publisher at IDG Books, recalls the response to his books as "phenomenally positive." At one point IDG had an entire office filled with reader response cards clipped from the books. Welton, who read much of that correspondence, says she was struck by the range of enthusiastic readers, from college students to corporate CFOs, eager to snap up Tyson's next offering. "Eric's very good at connecting with the needs of his audience," she says. "He's passionate about what he does, and he doesn't talk down to people." Welton adds that the publishing genius of Tyson's books lies in how the range of the audience fits that of the works themselves. They can either be read cover to cover in one sitting or get pulled from the shelf time and time again as reference sources. The result, says Welton, is trust and comfort. "Eric's books give people the feeling that they can take control of their financial lives."

Typical of his books is how Tyson's plainspoken prose turns dense and often potentially boring information into something that is not just readable and digestible but surprisingly educational. (In one example, he publishes a graph illustrating how a reduction in household spending of \$1,000 per year—just \$83 per month—adds up to savings of \$680,000 after 40 years.) What comes through in the information Tyson proffers is a common sense available to anyone willing to listen. "I don't have an ax to grind or anything to

sell," he explains. "All my energies are channeled into making the books useful."

While the rich will always be able to afford skilled, well-paid advisors to protect their wealth, Tyson says, the middle class is much more vulnerable because it lacks access to competent, *disinterested* advice. He notes that most people offering financial advice have a particular product to sell that subsequently will earn them a handsome commission. "The financial planning profession leaves a lot to be desired," he says. "I think that any transaction—like most financial transactions—that creates a potential conflict of interest is wrong." It is in this basic—and often overlooked—sense that Tyson believes that no one is really looking out for the financial well-being of most Americans. His books are meant to change that.

ERIC TYSON ARRIVES FOR OUR MEETING at a local greasy spoon in his hometown of Weston, Conn., where he orders a cup of tea; no cream, no sugar. Dressed in a turtleneck and jeans, he blends easily into the no-nonsense setting of scuffed linoleum and plastic furniture. He converses in a sympathetic manner that is immediately as engaging as it is calming. The money shrink is most definitely in.

Weston is one of those power, New York metro suburbs; Cheever country on steroids. It's 10 a.m., and Tyson's peers have long since hopped the train for the Big City and the Big Bucks. The scene seems

While the rich will always be able to afford skilled, well-paid advisors to protect their wealth, Tyson says, the middle class is much more vulnerable because it lacks access to competent, *disinterested* advice.

fitting as Tyson, the quiet iconoclast, has chosen not to follow the herd—even though he has had his chances.

After earning his B.S. from Yale in 1984, Tyson stepped onto the fast track, working as a budding management consultant with Bain & Co. That stint segued to B-school at Stanford, which he entered in 1987 with the expectation that he would return to the consulting game that much smarter and that much better paid. But Tyson passed on the brass ring. Instead, he went underground, relatively speaking, and taught a continuing education class at night in Berkeley while slowly building a client list of everyday people seeking commonsense advice about money.

Jim Collins, MBA '83, who also has spent time on the best-seller list as coauthor of *Built to Last* and author of *Good to Great*, taught Tyson at the Graduate School of Business, and he has since followed Tyson's progress up the best-seller lists. "Eric has taken a very democratic approach in wanting to contribute to the well-being of the average American," says Collins. "He has chosen to follow that passion all the way along. It's an unusual path for a Stanford MBA to take."

Tyson, it seems, regularly has opted for the less orthodox route since his stock market project back in junior high. In 1991, he contacted another folk hero of democratic capitalism, the creator of the discount brokerage industry, Charles Schwab, MBA '61. "I just wrote him a letter to tell him what I was up to and because I admired what he was doing," Tyson recalls. About a month later his phone rang. It was Schwab's secretary: "Hello, I have Chuck on the line." Schwab, as it turned out, told Tyson he liked what the younger man was doing and wanted to meet and pick Tyson's brain, as some of



Schwab's customers were actually seeking more financial services from the firm than just low commissions on their stock trades. One meeting led to another, and before long Tyson was being offered a job in Schwab's marketing department. But again, he passed up the security, the big desk, and the view to pursue his own path. "There were other things I wanted to do," he says simply, explaining that what he had in mind was more calling than career.

Fate subsequently rewarded Tyson for following his muse when he landed work doing benefits and financial counseling for employees at IDG Books in Foster City, Calif. IDG at the time was becoming increasingly well known for its tongue-in-cheek, and hot selling, Dummies series of books aimed at the burgeoning ranks of people ensnared in love-hate relationships with their personal computers. Soon enough, the light bulb went on. Isn't money just as mysterious, as maddening, and as ubiquitous as the PC? And didn't Tyson's series of lectures sound very much like chapters in a book?

IDG signed Tyson to write *Personal Finance for Dummies*. Published in 1993, it was the first noncomputer book in the series. It has since sold more than 1 million copies and is now in its fourth edition.

MEETING THIS BEST-SELLING AUTHOR in the flesh, you quickly understand that his success is nearly the antithesis of faddishness. He exudes awareness and sincerity, leavened with sufficient irony to save him from self-righteousness. The big numbers generated by his Dummies books impress him far less than the deeper meaning of those



Tyson has had as many as four books on BusinessWeek's best-seller list at a time. The books he has authored or coauthored have sold more than 4 million copies.

sales. "I make my living off the financial illiteracy of Americans," says Tyson, his tone appreciably more rueful than triumphant.

His is, above all, a soothing voice on a perennially loaded, and taboo, subject. (Tyson points out that more couples argue over money than they do over sex.) The man may be sincere and sensitive, but that doesn't make him a worrier. Call him a happy contrarian always in search of perspective. "The last three years have been a real wake-up call for a lot of people," he says in gauging the frail health of the current economy. The recession is as severe as that of the early seventies. But having said that, Tyson adds this would be the wrong time to get out of stocks, the hot housing market is not a bubble, and, no, Social Security will not go bust when boomers start retiring in droves.

Tyson's main money concerns are really deeper—and yet, strangely, more everyday.

"Spending and consumption are such a big part of our culture," he laments. "People entrap themselves financially by getting caught up in buying things they don't really need or can't afford." He recalls frequent counseling sessions in California where clients confessed their auto-related anxieties to him. "People would tell me that their coworkers would say to them, 'Your car is trashing the parking lot.' People are shamed into buying things they can't afford," he says, shaking his head.

Tyson recently experienced that firsthand when he walked into his local Volvo dealer intent on buying a used car. "The salesman kept trying to put me into a lease, and I kept telling him I wanted a secondhand car," Tyson recalls. "Finally, he looked at me and said, 'What are you, a socialist?'"

After moving East five years ago to be nearer relatives as he and his wife, Judy, an educational consultant, started a family, Tyson deliberately bought a modest house. "I knew I could afford something larger," he says, "but I wanted to have my mortgage paid off pretty quickly." He spends plenty of time with his 7-year-old twin sons and another son, age 5, but life is more than just attendance at a full slate of Little League games and family dinners. Tyson, ever the savvy quant, has lent his skills to the local community. Even with children in the school system, he opposed a recent expensive renovation of the local schools because he felt it would not measurably improve education while further jacking up already high local property taxes. Tyson's side lost. In the wake of a fight that Tyson calls "divisive," he has offered *pro bono* financial counseling to some local seniors on fixed incomes who might be forced to move because of the higher taxes.

Focusing his perspective on the right pressure points in order to make a real difference seems almost a Tyson trademark, and his Dummies success isn't about to dull that drive. Tyson's next literary goal amounts to the self-help equivalent of scaling Everest. "I want to write a book that helps people break bad financial habits," he says. To prepare, he has been reading the scientific literature on compulsive and addictive behaviors. "There's a lot out there that has been written on this subject, but no one has really translated it into layman's language," he says. Given Tyson's track record as the man who demystified money for the masses, he seems as good a bet as any to do just that. ■

Labor Economist Shaw Joins Faculty

ECONOMIST **Kathryn L. Shaw**, whose research focuses on understanding the sources of productivity gains within firms, has been appointed the Ernest C. Arbuckle Professor of Economics at the Business School. Shaw, who served on President Clinton's Council of Economic Advisers from 1999 to 2001, comes to Stanford from Carnegie Mellon University, where she won two teaching awards and served the university as chair of the faculty senate.

Shaw is also a research associate of the National Bureau of Economic Research and coprincipal investigator for a study financed by the Alfred P. Sloan Foundation on the "international differences in the business practices and productivity of multinational firms in advanced capitalist countries." Her research emphasizes the role of innovative human resource management practices, and she has been among the leading researchers in developing the new subfield of "insider econometrics," which uses data from within firms to study the impact of human resource practices.

In addition to Shaw, the Business School has appointed six new tenure-track faculty members. They are **Kenneth W. Shotts**, an associate professor, and assistant professors **Manuel A. Amador**, **Jerker C. Denrell**, **Yonca Ertimur**, **Wesley R. Hartmann**, and **Mark T. Soliman**.

Shotts, whose field is political economics, holds a courtesy appointment in the School of Humanities and Sciences. He earned his doctorate from the Business School in 1999 and has been an assistant professor at Northwestern University and a visiting scholar at the Woodrow Wilson School at Princeton. His research interests include electoral institutions, political leadership, and political economy, including statistical analysis of voting patterns.

Amador was awarded the Solow Prize for Graduate Student Excellence in Teaching and Research at the Massachusetts Institute of Technology, where he received his doctorate in economics this year. His research interests include international economics, macroeconomics, and political economy.

Denrell's field is organizational behavior. He earned a doctorate in economics from



Kathryn Shaw, who joined the faculty as a tenured professor of economics, formerly served on President Clinton's Council of Economic Advisors.

the Stockholm School of Economics in 1998 and has been a visiting scholar since at Oxford, the Wharton School of Economics at the University of Pennsylvania, and the Stern School of Business at New York University. He has published research on the economics of strategic opportunity and radical organization theory.

Ertimur, the coauthor of several recent articles on market responses to corporate accounting, received a doctorate from New York University this year. Her research interests include financial reporting and disclosure and the role of stock analysts as information intermediaries.

Hartmann, whose interests are marketing and industrial organization, received a doctorate this year from UCLA. He is studying the intertemporal effects of consumption on demand and the societal effects of conditioning prices on past purchases.

Soliman, a certified public accountant who has worked as an auditor and senior financial analyst, completed a doctorate at the University of Michigan this year. Finan-

cial statement analysis, including pro forma earnings, and accounting information and valuation are his research interests.

Hau Lee has been named the 2003 recipient of the Harold Larnder Prize given by the Canadian Operational Research Society to an individual of international distinction in operations research. Lee lectured on the evolution of supply chain management at the organization's June conference in Vancouver. Lee is the Thoma Professor of Operations, Information, and Technology at the Business School, and he codirects the Stanford Global Supply Chain Management Forum.

Sonya Grier is one of the inaugural class of scholars in a fellowship program to foster research related to national health. Grier, assistant professor of marketing and the Fletcher Jones Faculty Scholar at the Business School last academic year, is one of 18 scholars awarded the Robert Wood Johnson Foundation Health and Society Scholars Fellowship. In September, she began the two-year fellowship at the University of Pennsylvania, where she will research issues at the intersection of marketing and health.

Cited for his study of business tax reform and for leadership of one of Australia's major banks, Dean **Robert Joss** was awarded in June the Centenary Medal—presented by the Australian government to citizens who have made major contributions to the nation.

Joss, who holds dual U.S. and Australian citizenship, spent six years as chief executive officer and managing director of Westpac Banking Corporation, one of Australia's largest banks. He also was a member of a panel that made recommendations for changes in Australia's business taxation system.

In 1999 a report authored by Joss and two other business leaders appointed by the Australian government issued a sweeping

faculty publications

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The Effect of Information on Product Quality: Evidence from Restaurant Hygiene Grade

Ginger Zhe Jin and Phillip Leslie
Quarterly Journal of Economics (Vol. 118, No. 2), MAY 2003

call for major changes in business taxes in the nation. Many of these recommendations were later adopted into law. Joss also is credited with refocusing Westpac during his tenure as head of the bank by modernizing and streamlining operations, and restructuring the bank's culture to emphasize teamwork, customer focus, open communication, and community support. During his tenure, the institution's share price rose 375 percent.

Global corporations may be evolving from hierarchical structures toward networks of related affiliates, says Sloan Program director and faculty member **Bruce McKern**. As the editor of a new book, *Managing the Global Network Corporation*, McKern brings together field studies and theoretical work conducted by a group of researchers.

"The environment of global business is today far more complex and competitive than it has been in the past, and this has forced global firms to be more flexible and faster on their feet," he says. They have

devolved more responsibility and accountability to managers of business units, and leaders of these units have adopted more lateral management processes, which emphasize individual responsibility at all levels.

Prompted by an explosion in cross-border strategic alliances, joint ventures, and mergers, the research was commissioned by McKern during his tenure as president of the Carnegie Bosch Institute. It deals with the strategies of global network corporations, their organizational evolution, and their operating processes. It also covers innovation and knowledge transfer, integrative processes and socialization, adaptation of strategy and firm evolution, and the roles and competencies needed by managers in networked global companies. McKern says he agrees with other researchers in the book who say that the "organization man" view of the international manager is being replaced with the "individualized corporation" view, in which managers are relatively autonomous actors sharing a common vision of the corporation's future.

What dollar value will the market put on an improvement in a product feature? A research paper coauthored by the Business School's **Seenu Srinivasan** says that some customers who are on the fence in terms of purchasing the product should be weighted more heavily than others. The researchers also give a formula for the market value that when compared against the marginal cost is instrumental in deciding whether the improvement is profitable.

The paper "How Much Does the Market Value an Improvement in a Product Attribute?," by Srinivasan and Elie Ofek of Harvard Business School, has received the John Little Award from the Marketing Science Society for the best marketing article published in the journals *Marketing Science* and *Management Science* during 2002. The society is part of the Institute for Operations Research and the Management Sciences. Srinivasan is the Adams Distinguished Professor of Management and director of Stanford's Strategic Marketing Management Executive Program. ■

Gaming of Pharmaceutical Patents



In recent years some major pharmaceutical companies have settled patent disputes by simply paying manufacturers of generics to stay out of the market.

GENERIC DRUGS ARE OFTEN MUCH LESS expensive than their brand-name counterparts. So, while it's in the interest of the public for generic manufacturers to get their products to market as quickly as possible, it is not in the interests of the companies that first developed the drugs and hold the original patents. The 20-year-old Hatch-Waxman Act has been remarkably successful in increasing the number of generic drugs on the market by easing the Federal Drug Administration (FDA) approval process for generics.

Hatch-Waxman also provides the mechanism for resolving pharmaceutical patent disputes when a generic manufacturer believes that it can manufacture a bio-equivalent product that does not infringe on the original patent or when it believes that a patent is invalid. But in recent years some major pharmaceutical companies have settled such patent disputes by simply paying manufacturers of generics to stay out of the market. Others have taken advantage of loopholes in the act to game the system and even tie up potential generic entrants for many years. In June, the Senate voted overwhelmingly in favor of a bill targeting these abuses.

The recent Hatch-Waxman cases and settlements, and what to do about them, are the subject of a recent paper by Jeremy Bulow, the Richard A. Stepp Professor of Economics, who was chief economist on the Federal Trade

Commission (FTC) during the Clinton administration.

While he was at the FTC, the commission began to vigorously contest Hatch-Waxman settlements. Economists felt strongly that if antitrust laws exist, then firms should not be able to buy off potential competitors, and they argued that pharmaceuticals were an antitrust concern. "With the possible exception of high tech, the pharmaceutical industry has contributed more to human welfare in the past 50 years than any other. That is why the efficient, competitive functioning of this market is so important," wrote Bulow.

In addition, companies have taken advantage of two provisions in Hatch-Waxman. When a generic manufacturer files an application to sell a drug, it makes one of two claims: either that the generic does not violate any of the patents the brand has listed in the FDA's Orange Book of approved drugs or that the patents are invalid. The brand drug manufacturer is given notice of this application and then files suit against the generic maker. Hatch-Waxman then prohibits the FDA from approving the generic's application for a minimum of 30 months, unless the generic wins a conclusive verdict first.

Some brands have added additional patents to their Orange Book listing well after the litigation has started. So, for example, a company could have lost a case in district court and then—while appealing the decision—added a new patent to its list, thereby forcing a new filing by the generic and a restart of the 30-month clock. Paxil's clock has been restarted five times in this manner.

The other provision is the 180-day rule, which holds that the first generic to file an application will get 180 days of exclusivity as the only generic manufacturer of that product. The clock starts either when the generic enters the field or when a generic wins in appeals court. The trick there has been for the brand to pay off the first generic to stay out of the market until the disputed patents expire. If the brand does not file suit against a subsequent filer, the FDA still cannot approve the second firm's application because the 180-day clock never starts. This has been referred to as the "cork in the bottle" strategy.

Some drug companies have developed a more sophisticated smokescreen. Schering-Plough paid \$60 million to the generic company Upsher-Smith as part of a deal in which Upsher agreed to put off its efforts to introduce a generic and licensed one of its products to Schering. Schering then argued that the \$60 million was for the license for the product, and that the negotiated postponement of Upsher's entry was based on the weakness of Upsher's legal case. The economists involved in the case were skeptical, to say the least.

Bulow supports an FTC proposal to allow brand-name companies only one 30-month stay when the firm

claims patent infringement. He also suggests the 180-day exclusivity rule should be extended to the first company that manages to get a product approved and to market, not the first to file an application.

Furthermore, he argues, generic drug companies that make any kind of deal involving postponing their entry into the market should have to forfeit their right to any exclusivity. “There should not be any cash payment allowed unless a generic company can show that the amount it was given was less than the amount it would have received from an outside party,” he says.

The stakes, says Bulow, are high. In one case, a brand with annual sales of over \$750 million kept a generic off the market for over six years. But more important are the implications for society. “If Coke and Pepsi were to merge, the price of soda would go up, but the effect on the larger social welfare wouldn’t be particularly important,” he says. “But artificial price increases for pharmaceuticals can have very severe consequences.”

The real function of generics is not to provide a superior product but to make the patent laws work properly by giving innovators exclusivity for a time. If companies with invalid patents are able to buy as much exclusivity as those with strong patents, then the cost to society of providing the strong patents with any given level of exclusivity will effectively be raised. In the long run it is likely that the patent laws will be designed to provide less protection for the companies that really deserve it. As a result, incentives for innovation would be reduced. “The bottom line,” Bulow concludes, “is you should not get to pay your competitors to stay out of the market.”

— ANNE FIELD

“Gaming of Pharmaceutical Patents,” Jeremy I. Bulow, GSB Research Paper #1804, 2003. (<http://gobi.stanford.edu/ResearchPapers/Library/RP1804.pdf>)

Consumer Pricing

Portable Phone Numbers Benefit Consumers

WHEN YOU THINK ABOUT HAVING TO change your home, business, or cellular telephone number, does a chill run down your spine and through your pocketbook? Envision the hassles: having to notify everyone in your phone book, change your stationery, put a forwarding message on your old number that will expire. Or even worse: run the risk of losing important phone calls.

Such considerations are known as switching costs, and they are aggressively exploited by companies in areas such as computers, banking, telephony, and more. The game is to lure you in with attractive introductory offers and then zap you with higher rates, new fees, and fewer perks once you are so locked in that switching to a new firm would be a real pain in the neck—or the wallet.

Companies that can distinguish between new and old customers will likely price their products and services higher for the locked-in crowd, according to previous research. It hasn’t been clear whether a firm that can’t tell who’s who in its customer base—or one that has been prohibited by regulation from engaging in price discrimination—will price higher or lower across the board. Brian Viard, assistant professor of strategic management, has found evidence to support the idea that lower switching costs actually translate into lower prices for consumers.

Theoretically, pricing by discrimination-prohibited firms whose customers incur switching costs could go either way, higher or lower, depending on the nature of the market, he says. “If there are enough new customers coming into the market, firms will compete to grab them and will therefore price their products or services lower overall. If, however, there aren’t enough new customers, then firms focus on exploiting the customers they already have who are locked in and price higher.”

Viard’s study begins to fill in this research gap by looking at 800-number pricing before and after such numbers became portable. “In May 1993, regulations permitted customers to take their numbers with them even if they switched telephone service providers,” Viard explains. “That significantly reduced switching costs for these customers, which were considerable in the case of companies that relied heavily on 800 numbers, such as American Airlines.”

By studying several hundred AT&T telephone contracts with big 800-number users, Viard found that after portability, the cost of 800 numbers fell. “This means that when switching costs were high, prices were higher. Lower switching costs led to lower prices,” he says. “This is the intuitive answer, but theoretically it could have gone the other way. Again, if switching costs ever led to lower prices, it would be in a high-growth market where there were lots of new customers. The fact that the 800-number market was growing quickly during this period means that this finding is very conservative and that we can pretty much expect lower switching costs to lead to more competitive markets across the board.”

The significance of such research, Viard says, lies in its public policy implications. “If switching costs do lead to higher prices, regulators will want to institute rules to reduce such costs for the consumer.” In fact, he notes, such a decision has recently come up in the cellular telephone industry. “The FCC has ruled that cellular companies must institute cell number portability by November,” he says. “Number portability will lower consumers’ switching costs, which my work suggests will lead to lower prices. If the costs of portability implementation are not too great and you care about consumers, you should be in favor of it.”

— MARGUERITE RIGOGLIOSO

“Do Switching Costs Make Markets More or Less Competitive?: The Case of 800-Number Portability,” V. Brian Viard, GSB Research Paper #1773, 2003. (http://gobi.stanford.edu/ResearchPapers/detail1.asp?Document_ID=1774)

If there aren’t enough new customers in the market, firms focus on exploiting the customers they already have who are locked in.

Pitching Ideas Hollywood Style



IN THE WORLD OF HOLLYWOOD MOVIES, the most important 20 minutes of a film may take place during the pitch meeting. The film *Alien* originally was pitched as “*Jaws* on a Spaceship,” and that image sold.

What makes a studio executive or producer bite on an idea? And what makes a successful pitch? Those are two of the questions raised by Rod Kramer, professor of organizational behavior at the Business School, and Kimberly Elsbach, a professor at the University of California, Davis.

Kramer and Elsbach wanted to study how organizational decision makers assess the creative potential of others. “We could evaluate how engineers assess the creativity of other engineers, but we thought pitching in Hollywood might be more interesting and attract a little more attention,” says Kramer, a psychologist and one-time screenwriter.

What the authors found is that contrary to conventional wisdom, the studio executives who make the decisions to greenlight a picture in Tinseltown often have a real passion for films and are very smart when it comes to knowing what’s marketable. They’re experts at eval-

uating creativity, and their reputation rides on how well they do it. Yet the decision to buy an idea is made quickly—sometimes in a 20-minute meeting. “So I was interested in how complex their judgments are and what kinds of things they weigh,” Kramer says. “And then the questions are what kind of writers are they impressed by and what kind of ideas attract their attention?”

For instance, what is it about the movie industry that produces both great films and disasters? “All of us when sitting in the audience think, ‘Who could have thought this was a good idea?’” Kramer says. But the pitcher of that idea was probably very good at his work—and at persuading the catcher on the other end to buy it.

The researchers found that the more passionate the person pitching the idea, the more effective he or she was. And the better the pitcher was at drawing in the person on the other side of the table, the more likely he or she would succeed. “Our analysis of creativity assessment in Hollywood pitch meetings suggests that judgments of creative potential involve two processes,” wrote Kramer and Elsbach. “In one process, catchers categorize pitchers—using behavior and physical clues—into a small set of relatively well-established prototypes based on creativity or uncreativity.” In the other, catchers use clues about their engagement with the pitcher to evaluate whether the idea is creative and has merit.

“A lot of naive pitchers we talked to assumed what was important was for them to be passionate and to get their concept across clearly,” Kramer says. “That’s important, to be on fire about an idea. But the other thing was to what extent the catcher was engaged and also felt creative.” Kramer says the second part of the process is a seduction. The catcher has to feel like he is drawn in and contributing.

Kramer suggests that while much of the study was industry-specific to Hollywood, managers looking for creative people would be wise to listen to employees who are passionate about their work and persuasive in communicating ideas. “Although we focused on how executives in Hollywood evaluate new ideas, there are many other areas—such as venture capital and product innovation—in which success may depend on the effectiveness of the initial pitch. In many instances you have just one shot at getting your idea across and it has to be right,” he says. The project fits in with his ongoing research into how organizations make decisions about allocating their time, attention, and money.

— JOYCE ROUSTON

“Assessing Creativity in Hollywood Pitch Meetings: Evidence for a Dual-Process Model of Creativity Judgments,” Kimberly D. Elsbach and Roderick M. Kramer, Academy of Management Journal, Vol. 46, No. 3.

What is it about the movie industry that produces both great films and disasters?

When Should You Sell the Factory?

IT MAY NOT BE AS POETIC AS HAMLET'S FAMOUS line, but to build or to buy is a question that becomes more crucial for manufacturing executives every day. Should your company keep control of its supply chain and manufacturing facilities when it needs to expand—and risk getting stuck with expensive capacity it can't use? Or should it outsource—and if so, to whom and for how much?

In an economy that mercilessly penalizes inefficiency, outsourcing production seems like the obvious choice. Indeed, it often is, which is why contract manufacturing of electronics and pharmaceuticals has long since passed the \$100 billion-a-year mark. But solving the build vs. buy equation poses difficult strategic and tactical questions for outsourcing original equipment manufacturers (OEMs), says Erica Plambeck, assistant professor of operations, information, and technology.

In research with Terry Taylor of Columbia University, Plambeck demonstrates that:

- Outsourcing to contract manufacturers (CMs) may ultimately harm some OEMs (and their market development) by reducing incentives to innovate.
- Pooling manufacturing resources among OEMs is sometimes a better strategy than outsourcing to CMs.
- Sophisticated new approaches to negotiating contracts between OEMs and CMs can significantly improve margins for both parties.
- The classic manufacturing model is a vertically integrated firm; production is carried on in-house, along with activities that stimulate demand, such as R&D, product design, and marketing.

However, Plambeck notes, “because each firm fills its demand from its own production capacity, inefficiency in the use of capacity can result. For example, the pharmaceutical industry is characterized by long development cycles (roughly 12 years) and intense time pressure. Consequently, a company that wants to manufacture its own product must make a large capital investment in a plant before the drug has completed regulatory reviews. If the drug fails, the plant may have little value.”

One response: Separate demand creation from production—the essence of contract manufacturing.

The flaw in this response, Plambeck argues, exists when the CM has much more bargaining power than the OEM. “If the bargaining strength of the OEM is sufficiently high, the level of innovation effort (and resulting market size) will increase due to outsourcing. On the other hand, if the OEM has little bargaining strength, then the OEM—anticipating that much of the value created by his investment innovation will be expropriated by the CM—will invest less in innovation,” she wrote.

This is occurring in the biologics industry as firms delay or kill drug development projects because pro-

duction capacity is scarce and they anticipate paying a very high price.

There is another alternative to going it alone. An OEM can retain production capacity by pooling resources with other similar firms through supply contracts or a joint venture. Although it has received less attention in the business press, this type of outsourcing is widespread, Plambeck says. In electronics, the OEM outsourcing market in 2002 totaled some \$115 billion, 53 percent larger than the CM outsourcing market.

For example, AMD and Fujitsu last April set up a joint venture to produce flash memory. The new memory chip company, FASL LLC, is an expansion of their joint venture that will enable the two to better compete with Intel in the competitive market.

After analyzing the results of outsourcing, the researchers conclude that OEMs will innovate more when their manufacturing capacity is pooled. Here's why:

First, for any fixed level of capacity, an increase in market size leads to a more efficient use of that capacity. Therefore, pooling reduces production expenses, which encourages the OEMs to invest more in innovation. Second, innovation increases the expected market size and its variability because designers and marketers are likely to design more variations into the product. When capacity is pooled, the additional resources make variability less risky.

Consider the problem faced by biopharmaceutical companies. Manufacturing capacity is constrained, and the lead time to build new capacity is three to five years, making negotiating an effective contract difficult. To solve this, Eli Lilly and other drug companies are entering supply contracts with Lonza, a biologics manufacturer. Contracts stipulate the start date (usually about three years hence), the volume of fermentation capacity to be purchased each week (though there is some flexibility), and a price per unit of volume.

Lonza estimates the size of the market for the drug and the therapeutic dosage requirement (hence the volume of fermentation capacity that will be needed).

“Thinking ahead, understanding that a contract will be renegotiated is key to a successful agreement,” Plambeck said in an interview. “But if the parties fail to anticipate renegotiation, they will reduce the buyer's minimum order to avoid overproduction.”

If instead the initial agreement includes a larger minimum order quantity and the understanding that the quantity may have to be renegotiated later, both parties have more incentives to innovate, she said.

Using data and mathematical models, Plambeck and Taylor find that renegotiation significantly improves total expected profit for the CM and buyers when contracts are designed correctly in anticipation of renegotiation.

— BILL SNYDER ■

“Sell the Plant? The Impact of Contract Manufacturing on Innovation, Capacity, and Profitability,” GSB Working Paper #1750, 2002 (<http://gobi.stanford.edu/ResearchPapers/Library/RP1750.pdf>) and “Renegotiation of Supply Contracts,” GSB Working Paper #1764, 2002 (<http://gobi.stanford.edu/ResearchPapers/Library/RP1764.pdf>), Erica Plambeck and Terry Taylor.

Original equipment manufacturers will innovate more when their manufacturing capacity is pooled.

News-makers

WHO'S IN THE NEWS | A Roundup of Media Mentions



Steve Luczo took his company off the market with VC funding.

He Went Against the Grain and Won

During the crazy stock boom years, Seagate CEO **Steve Luczo**, MBA '84, was frustrated that Wall Street investors saw so little value in his company's disk-drive business. The company's stake in the software company Veritas was actually trading at a higher value than Seagate stock. The solution, Luczo thought, was to take the company private, but he would need investors besides himself who were willing to go into a cyclical business. In August 2000, he identified Silver Lake Partners, a venture capital partnership that invested \$382 million. Two years later, according to *Fortune*, Silver Lake's investment was worth \$1.8 billion when Seagate was taken public again.

"Our business is an odd one," Luczo said. "If you're behind in technology, the answer isn't that you cut

expenses or capital. It's that you add expenses in the form of R&D and add capital. This isn't intuitive to the guys buying bottling plants and whatnot."

Goldilocks's New Plan Is Ju-u-u-ust Right

Among the foreign food brands finding success in America is Goldilocks, a Filipino bakery and restaurant founded when two sisters began baking cakes to go with fairy tales in 1966. Run now by their children, Goldilocks employs 4,000 in the Philippines, 25 in Canada, and 800 in the United States, where **Mary-Ann Ortiz-Luis**, SEP '00, is vice president for finance. The daughter and niece of the founders, she started work in the bakery as a child but then spent a decade as a pediatrician in Manila before the family business drew her back.

Ortiz-Luis and several relatives decided to improve efficiency by centralizing their operations in Northern and Southern California. All the goods are baked and distributed to their stores and other retail outlets such as Wal-Mart, Costco, and Marriott. "Thai, Chinese, and Japanese cultures have been recognized, but not Filipino culture," Ortiz-Luis told the *Oakland Tribune*. "If we can mainstream our brand, we can be recognized as a separate Asian entity."

Seed Money to Sprout 100 New Schools

The Bill and Melinda Gates Foundation recently gave \$22 million to the San Francisco-based NewSchools Venture Fund, cofounded by **Kim Smith**, MBA '98.

Smith, who also helped start Teach for America, said the grant will be used as seed money to develop at least five charter management organizations that will then be expected to create 20 new public schools each over a decade, according to the *San Francisco Business Times*. "It's an opportunity to build a system where the governance, management, and the teachers, parents, and students come together," Smith said. "It's a charter environment, so everyone chooses to be a part of it. In a public school district, it's a struggle to get the constituencies aligned."



Eric Zitzewitz, assistant professor of strategic management, was interviewed by CNBC and others in September for his work on mutual fund trading practices.

Late Trades Leave Trail in Mutual Fund Data

After New York State Attorney General Eliot Spitzer announced his investigation of late trading practices in mutual funds, Stanford Business School faculty member **Eric Zitzewitz** decided to check one of his mutual fund data samples for evidence. What he found surprised him: evidence of illegal after-hours trading in 16 of 104 mutual funds. The results produced

a clamor among media wanting to interview him.

In one interview with CNBC, he was careful to point out that he had no evidence that the fund firms themselves had knowledge of illegal activity. "It could just be a broker was placing these trades across a number of firms, and they were sneaking them in."

In 2002, Zitzewitz studied market timing in mutual fund trades, a practice that is not illegal under most circumstances, but which permits day traders to take some profits at the expense of long-term investors. The practice was dramatic in international funds because many of the funds set their share price at 4 p.m. Eastern time—or 14 hours after the Tokyo exchange closed, for example. That means frequent traders can gather information about the share price before it is formally set.

Long-term investors lose more from the legal practice than the illegal one, Zitzewitz told CNBC and numerous other media who interviewed him. "Market timing costs the average shareholder in international funds about 1 percent of assets per year or \$1 out of every \$100. The late trading costs about another nickel, or \$1.05 total," he said.

Crossover Zeitgeist

Jim Collins, MBA '83, is a crossover artist, according to *Newsweek*. By that the magazine means that his business book *Good to Great* has developed mass appeal with more than 1 million hardcover sales. The book is about how 11 companies transformed themselves from good to great performers. *Fortune* asked Collins to write

a cover story, “The 10 Greatest CEOs of All Time,” and later named him to its shortlist of five “zeitgeisters—people who have an uncanny ability to influence what others think.”

Venture Capital on Rise

Silicon Valley’s pessimism has given way to new venture capital funds, according to a recent article in the *Los Angeles Times*. “It’s a great time for investing in early-stage companies that will mature in three to five years,” said **Larry Kubal**, MBA ’82, managing partner of Labrador Ventures. The firm recently raised \$100 million for its fifth investment fund—\$10 million more than its last fund launched at the end of 2000.

“In the bubble, all the vcs felt very smart,” Kubal said. “Then for the last three years we all felt foolish. No one’s IQ has changed. Egos have. The pendulum always swings too far in the venture business.”

Do What You Do Best

Since **David Levin**, MBA ’87, took over as CEO of privately held Symbian Ltd. in London, the company’s operating system software has caught on with cell phone makers and consumers. “Meanwhile, rival Microsoft is still having trouble getting traction in a market it views as critical to its future,” according to *BusinessWeek Online*. Levin credited his predecessors with developing a strong product and said his contribution has been “mostly a perceptual turnaround.” The company gave up trying to make a “soup-to-nuts operating system” for all hand-held devices, he said. “Nobody knows yet what consumers really want,” and Symbian has found it can keep 85 to 95 percent of the computer code unchanged as it accommodates the desires of different cell phone manufacturers. Levin’s own prediction for the future? Smart cell phones are not replacements for personal computers, but they “will eat into the markets for cameras, games, and PDAs.”



Doctor’s Specialty: Ailing Hospitals

In just two years Dr. **Andrew Agwunobi**, MBA ’01, brought one of Atlanta’s large private hospitals back from the brink of bankruptcy, according to the *Atlanta Journal-Constitution*. Now Agwunobi, a native of Scotland is heading Grady Health System, Georgia’s largest public hospital system. Grady faces a \$20 million deficit, and in newspaper interviews and reports from county supervisor meetings, Agwunobi has prescribed structural changes that include making more of the hospital’s operations transparent to the public. “Sunlight helps to cure festering wounds that covering up doesn’t help,” the doctor said.

Stop and Smell the Gardenias

Fragrance, texture, and sound are easily overlooked keys to designing a spectacular garden, according to **Stephen Suzman**, MBA ’74, the owner of Suzman Design Associates, a 20-year-old San Francisco Bay Area landscape design firm. In an interview with the *San Francisco*

Chronicle in his flower-filled Castro District garden, Suzman said that smell is the most primal of our senses, and it evokes strong memories. For example, the heavy perfume of gardenias in his family’s Johannesburg garden is one of his earliest memories. For noses in heavy San Francisco shade, however, he suggested *Daphne odora* and *Rhododendron fragrantissima*. If you live in the sun, try lemon verbena, scented geraniums, and freesias.

Companies Seek Seasoned Consultants

In the wake of corporate scandals and a recession, firms are forcing management consulting firms to rethink their business model, *Fortune* magazine claimed recently. That model relies on smart, young MBAs to give strategy analysis advice under the supervision of partners who make bigger salaries. Today companies want smaller teams of more seasoned consultants, the magazine said, admitting it may be a temporary trend. **John Donahoe**, MBA ’86, worldwide managing director of Bain & Co., said that to satisfy clients’ demands for seasoned pros, the firm brought in 20

new partners over 18 months, some poached from competitors. Donahoe defended young consultants’ number crunching skills, however. “Rather than say we know the answer on day one because we’ve done it five times before, we’re focused on developing customized strategies for our clients.”

The World’s Her Stage

Why not supplement Hollywood with Bollywood? That’s what stage, film, and TV actress **Jennifer Siebel**, MBA ’01, has decided to do, according to the *Times of London* and the *Economic Times of India*.

Siebel was in gossip columns not long ago for dating actor George Clooney. They are just friends now, she told *Parade*, because “our careers left little time for a relationship.”

After business school, Siebel studied at San Francisco’s American Conservatory Theater, then moved to Hollywood, where she costarred in the television show *Presidio Med* and the film *Waiting for Anna*.

Siebel is breaking into producing in India, where she said she also plans to costar in a Hinglish movie “about an American girl who, after flying down to India as part of a *Survivor*-type reality show, loses her way.” ■

Actress Jen Siebel is now producing a movie in India.



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MARCH 6: Business Education Conference

MARCH 13: Health Care and Biotechnology Symposium

MARCH 14-19: Executive Education "Leading Change and Organizational Renewal," at Harvard Business School

MARCH 17-19: Executive Education "Strategy for Nonprofit Organizations"

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