AN MBA GOES TO WASHINGTON  When work is more than a job, and compensation is more than a paycheck • The Google IPO: A Dutch auction works, if you let it • Quantifying marketing’s ROI • A man on a mission: Jack Bonné ’63, survivor of the ill-fated voyage of the St. Louis
ONLINE:

www.gsb.columbia.edu

The Individual, Business and Society:
This new curriculum trains students to evaluate thoughtfully the choices and trade-offs they will face in their careers.
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CEBiz: The Columbia Center for Excellence in E-Business disseminates research on how information technology transforms business.
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DEAN’S MESSAGE

Dear Alumni:

On July 1, I became the 11th dean of Columbia Business School. I have great respect for our community of accomplished alumni, outstanding faculty and top-caliber students. Throughout my deanship, I will work to further the School’s great legacy.

A great business school bridges theory and practice. The dominance of leading university-based business and management schools in MBA education traces to those institutions’ role both in generating transformational ideas and in developing ideas in response to opportunities in industry, commerce and finance. A strong bridge between theory and practice has traffic running in both directions. A strong bridge between theory and practice gives great schools of business a prominent place within both the university and the world of affairs.

Sunil Gupta’s research, for example, helps businesses quantify the impact of marketing investments on firms. Gupta, the Meyer Feldberg Professor of Business and a highly popular teacher, writes about his research for this issue of HERMES magazine. Professor Laurie Hodrick also writes to offer a timely example of the interplay of theory and practice: Google’s unprecedented use of a Dutch auction to float 19.6 million shares in its initial public offering.

We highlight in these pages the rewarding experience of many Columbia Business School alumni in applying one’s intellect and skills to serving the federal government. In fact, moving between the public and private sectors is something that many alumni do throughout their lives. Their entrepreneurial, flexible Columbia education lends itself to this kind of diverse career success.

Finally, we profile investment manager Jack Bonné ’63, who capitalized on his intellect, skill and sheer luck to make a new life for himself in New York after escaping Nazi Germany and the ill-fated refugee ship the St. Louis.

I hope you enjoy this issue of HERMES. I look forward to collaborating with our alumni to strengthen the Columbia Business School brand and address needs in business and society at large.

With regards,

Glenn Hubbard
Dean and Russell L. Carson Professor of Finance and Economics
New Initiative Addresses Trade-Offs and Choices

On August 25, Dean Glenn Hubbard kicked off a new initiative by leading a panel discussion of the Sarbanes-Oxley Act for incoming MBA students. One of three fall orientation sessions devoted to ethical issues, the event was part of a new curriculum titled “The Individual, Business and Society: Tradeoffs, Choices and Accountability” (IBS), developed with support from the Sanford C. Bernstein & Co. Center for Leadership and Ethics.

COMPETING DEMANDS
The curriculum’s goal, Hubbard told students, is to help you think about the trade-offs you’re going to face on two dimensions: when what you believe as an individual is in conflict with what your firm believes is best, and when your firm’s interests are in conflict with those of society.” The IBS initiative consists of two components: cases taught within the framework of the MBA core curriculum and special sessions in which faculty members and business leaders explore ethical issues.

At a second event on August 26, corporate leaders representing the pharmaceutical and paper industries discussed the trade-offs between social responsibility and profitability on a panel moderated by Geoffrey Heal, the Paul Garrett Professor of Public Policy and Business Responsibility. In three sessions held on August 28, management professor Michael Feiner ’66 led students in a case discussion dealing with a clash of personal values in the workplace.

ISSUES IN CONTEXT
The IBS curriculum evolved from the infusion approach devised last fall, under the auspices of the Bernstein Center, to integrate ethics modules throughout the core curriculum. Building on that foundation, the IBS curriculum continues to present ethical issues in context. The macroeconomics course, for example, examines global income inequality.

“Columbia Business School seeks to equip students not only with the fundamentals of management, but also with the ability to consider thoughtfully the sometimes competing demands of business, individuals and society at large,” said Hubbard at the IBS’s inaugural event, at which SEC commissioners Paul Atkins and Harvey Goldschmidt joined him in assessing the costs and benefits of the 2002 Sarbanes-Oxley Act. For a summary, see page 4.

SOCIAL RESPONSIBILITY VS. PROFITABILITY
At the event on corporate social responsibility, former Merck chairman and CEO Roy Vagelos talked about the choices pharmaceutical companies make between pursuing profits and promoting public health—goals that are sometimes, but not always, in conflict. Michael Balduzio, president of Shorewood Packaging and senior vice president of International Paper, described how his company balances environmental concerns with economic imperatives.

Paul Glasserman, senior vice dean and the Jack R. Anderson Professor of Business, told students, “This is the beginning of a topic that will be coming up again and again.”

For more information about the IBS curriculum, visit www.gsb.columbia.edu/ibs.
The Sarbanes-Oxley Act: Too Little, Too Far or Just Enough?

On August 24, commissioners Paul Atkins and Harvey Goldschmid of the Securities and Exchange Commission (SEC) joined Dean Hubbard in a panel discussion of the costs and benefits of the Sarbanes-Oxley Act. The event inaugurated the School’s new curriculum, “The Individual, Business and Society: Tradeoffs, Choices and Accountability” (IBS), which equips students to think critically about the conflicts and trade-offs they will face during their careers.

The 2002 Sarbanes-Oxley Act, which set new standards for corporate governance and financial disclosure, illustrates the trade-offs involved in government regulation of the economy. The law was designed to protect investors from unscrupulous managers, but some fear that the costs of increased transparency and accountability could stifle economic growth and discourage firms from taking risks.

“The consequences of getting this wrong are very large,” said Hubbard, a former policymaker. “The integrity and liquidity of U.S. capital markets is important for the world economy. If we’re too heavy-handed in dealing with the problem, we will intrude too much. If we’re too light-handed, we may reduce the transparency of information.”

Goldschmid blamed the recent wave of scandals on a permissive environment in which managers and directors felt too insulated from liability. He stressed that even a strong, independent board of directors is heavily dependent on auditors and lawyers. Thus, many of the new law’s provisions are focused on strengthening auditor independence and improving the accuracy and accessibility of financial information.

RESTORING INVESTOR CONFIDENCE

Hubbard served as chairman of the President’s Council of Economic Advisers from 2001 to 2003, a period when the U.S. economy was rocked by accounting scandals. Noting that investor protection relies on a combination of legal institutions, external market forces and internal governance, he pointed out that many of the recent reforms in corporate governance occurred first in the private sector. In the policy realm, reform efforts have focused on improving information disclosure and avoiding conflicts of interest.

“Sarbanes-Oxley is the most important piece of legislation in the securities area since the New Deal and provides a fundamental framework for the current healing process,” said Goldschmid. “It has gone a long way toward restoring investor confidence.”

IMPORTANT OF INTERNAL GOVERNANCE

“If you don’t trust the numbers, the cost of capital goes up,” Goldschmid said. Echoing Hubbard’s comments about the importance of internal governance in the private sector, he said that the most serious failure contributing to the scandals was the failure of self-regulation in the accounting profession.
Atkins noted that Adam Smith was the first economist to describe the agency problem—the inherent tension between shareholders and managers—of limited liability companies. Smith advocated sole proprietorships and partnerships, in which the interests of owners and managers are combined, as the best forms of organization.

"Sarbanes-Oxley strengthens the role of directors as representatives of stockholders and the role of managers as stewards," said Atkins.

In addition to imposing a higher standard of accountability on top executives, Sarbanes-Oxley enhanced the SEC’s power to bring offenders to justice. "Enforcement is critical for making the system work," explained Goldschmid. "The number of enforcement actions has dramatically increased."

**RISKS AND BENEFITS**

Atkins warned that the SEC, which has executive, legislative and judicial functions, must be careful not to misuse its power. "The five commissioners are not directly accountable to the voters," he said. "We have to tread lightly and have a lot of evidence for what we do."

Both commissioners acknowledged that Sarbanes-Oxley entails significant costs and risks and that firms must expend considerable effort to comply with its certification requirements.

"I think you can say that Sarbanes-Oxley does contain many advances in corporate governance, but it also represents a formerly unimaginable incursion of federal government into corporate governance," said Atkins.

The biggest risk, as Hubbard noted at the outset of the discussion, is that the new law will dampen economic activity by intruding too far into the private sector. "We must not frighten off good people from serving as directors, and we must not intimidate firms into avoiding risk taking," cautioned Goldschmid.

Atkins said that an assessment of the law’s impact is premature. "Beauty is in the eye of the beholder," he said. "It’s too soon to tell what the benefits are."

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**Chazen Institute Gets New Academic Director**

On October 1, Charles Calomiris, the Henry Kaufman Professor of Financial Institutions, became academic director of the Jerome A. Chazen Institute of International Business. He assumes this leadership role from Professor Elke Weber, who led the institute from 2002 to 2004 and oversaw, among other initiatives, the launch of the Chazen Web Journal.

Calomiris will build on the inherent strengths of the Chazen Institute to enhance its connection with leading practitioners on global issues ranging from risk management and emerging-market economies to brand management and behavioral finance. He is a leading authority on financial institutions and an adviser, teacher and academic researcher in the areas of banking, corporate finance, financial history and monetary economics.

"Columbia Business School’s vision, and the Chazen Institute’s, is to provide students with the tools, diverse experiences and background that will help make them flexible problem solvers in the global marketplace,” says Calomiris. "The diversity of the experiences of faculty and students is a key resource that nurtures the curriculum, research and classroom experience at the School."

Founded in 1991, the Chazen Institute supports a rich variety of research initiatives, programs and events that bridge theory and practice for students throughout the course of their education and beyond.
Quotable: "The federal government is larger than any private-sector corporation, but there is no reason [it] can’t operate as smoothly as the best-managed corporations in the private sector. ... I see it as part of my mission to make this happen."

M. Patrick Ellsworth ’99, foreign-service officer with the U.S. State Department, on why he—like many Columbia MBAs—chose to leave a successful position in the private sector to enter government service ("An MBA Goes to Washington," page 12)

VC and the Developing World

Alan J. Patricof ’57, a father of venture capital, cofounder of one of the world’s leading VC firms and a member of the School’s board of overseers, spoke to students in late summer at a David and Lyn Silfen Leadership Series event about the industry he helped build.

Patricof told students of his early days in venture capital, when it was a cottage industry largely associated with wealthy families. Today, he said, thousands of firms cover a vast array of industries.

Apax Partners, of which Patricof is vice chairman, has operations in eight countries and more than $12 billion under management. The firm has financed and developed numerous public and private companies, including Apple Computer, Office Depot and Cadence Systems.

Patricof encouraged MBA students to look to the developing world for their next business opportunity and urged support for the UN’s Millennium Project, which aims to reduce the level of poverty worldwide by 2015. World poverty, he said, “needs brainpower,” and it’s “something we’ve all got to do, or we’re all in trouble.”

“The next decade” for venture capital, Patricof summed up, “will be the decade of the developing world.”

Remembering N. T. Wang

Nian-Tzu "N. T." Wang, a leading expert on East Asian economics and an adjunct professor of economics, died on August 26 at the age of 87. Wang was a senior research scholar at the Weatherhead East Asian Institute at Columbia University’s School of International and Public Affairs (SIPA) and director of the China-International Business Project, a joint initiative of Columbia Business School and the institute.

Wang, who received his BA from Columbia College and his MA and PhD from Harvard, in 1949 joined the Business School, where he taught an economics class focusing on China.

Wang went to work for the United Nations in 1953. During his 28-year career there, he became chief of the survey section of the Secretariat and then director of the information analysis division of the Center on Transnational Corporations. He retired in 1980 and returned to SIPA to develop a multidisciplinary platform for research, teaching and academic publishing on issues relating to business in the Asia-Pacific region.

An honorary professor at 10 universities, Wang lectured at educational institutions around the world and served as a consultant on economic development to governments, businesses and organizations, including the World Bank and the International Finance Corporation. He received the New York Governor's Outstanding Asian-American Award, among many other awards.

Wang wrote four books on finance and economics and an autobiography, My Nine Lives (Writers Club Press, 2001). He is survived by his wife of 62 years, Mabel U., five children and three grandchildren.
The Leverage of the Irish

At the invitation of Ireland's deputy prime minister, Executive Education faculty member Rita McGrath served this year as a member of Ireland's Enterprise Strategy Group, a commission of 16 international experts who advised the nation's government and business community on enhancing Ireland's competitive advantage.

McGrath brought to the commission her expertise in innovation, entrepreneurship and corporate growth, as well as her background in public policy. It was an exciting opportunity, McGrath says, for her own "cutting-edge ideas from research to have practical and significant real-world impact."

The commission's final report offered guidance on, among other issues, how the government can work with private-sector interests to "nurture entrepreneurial clusters," as well as how Ireland can better promote and support indigenous enterprise.

McGrath accepted the invitation to join the commission, in part, because of her belief that "the policies we developed have a high probability of implementation."

Indeed, the government of Ireland is already devising plans for acting on the group's recommendations.

A Class Apart: The Class of 2006

This year's incoming class is as diverse as it is accomplished: the 506 students count among their ranks the former first lady of Peru, a member of the 2000 U.S. Olympic rowing team, a high school science teacher and the director of marketing and promotions for Playboy. Representing 65 countries and 54 languages, almost one-third of the class is international, with China providing more students than any other country outside the United States.

Thirty-six percent of the class are women, and 10 percent are underrepresented minorities.

Among the group, 67 have master's degrees, 7, PhDs, 6, JDs, and 4, MDs, and 125 graduated cum laude or higher from their undergraduate institutions. The class shows strong interest in entrepreneurship and community involvement, says Linda Meehan, assistant dean and executive director of admissions and financial aid.

The Amen Doctrine of Enlightened Capitalism

Robert Amen '73, president of International Paper (IP), spoke to operations management students in late summer about some of the choices his company faces.

Regarding toxic emissions, he said, "The big enterprises should set a standard—we don't wait for society to set a standard." He illustrated IP's commitment to sustainable forestry and asserted the company's loyalty to its American employees despite the allure of cheaper labor overseas.

Amen encouraged students to consider the responsibilities of corporations toward the communities where they do business. In a Russian town where IP has a presence, for example, the company financed the rebuilding of a hospital.

He concluded by invoking the "Amen Doctrine": "Build a sustainable, competitive business model that maximizes the returns in total to constituents without violating key societal needs."
School Welcomes 12 New Faculty Members

Glenn Carroll
Professor
Management
Professor Carroll researches organizational theory, industrial development, strategic management and organizational and industrial evolution. He was a professor at UC Berkeley’s Haas School of Business (1998–2000) and at Stanford (2000–04). Internationally recognized for his contributions to organizational sociology, he received his PhD from Stanford in 1982.

Bogaçhan Çelen
Assistant Professor
Finance and Economics
Professor Çelen concentrates on microeconomic theory, game theory and experimental economics. He received his PhD from New York University in 2004.

Maria Guadalupe
Assistant Professor
Finance and Economics
Professor Guadalupe researches labor economics, applied econometrics and the economics of personnel and organizations. She received her PhD from the London School of Economics and Political Science in 2004.

Oded Netzer
Assistant Professor
Marketing
Professor Netzer studies relationship marketing, consumer choice modeling as a way of understanding consumers’ preferences, conjoint analysis and Bayesian methods. He received his PhD from Stanford in 2004.

Nicolás Stier
Assistant Professor
Decision, Risk and Operations
Professor Stier studies combinatorial optimization and approximation algorithms and simulation. His research focuses on algorithms for in-car route guidance and computation of the price of anarchy of related systems. Stier received his PhD from MIT in 2004.

Olivier Toubia
Assistant Professor
Marketing
Professor Toubia examines new-product development, market research, idea generation, adaptive experimental designs and preference measurement. He received his PhD from MIT in 2004.

Lihua Wang
Assistant Professor
Management
Professor Wang researches interorganizational relationships, strategic alliances and mergers and acquisitions. She received her PhD from the Kellogg School of Management at Northwestern in 2004.

Neng Wang
Assistant Professor
Finance and Economics
Professor Wang researches real options consumption, saving and wealth distribution, corporate investment and finance, real estate and portfolio choice and asset pricing. He was an assistant professor at the Simon School of Business at the University of Rochester from 2002 to 2004 and received his PhD from Stanford in 2002.
Graham & Dodd Breakfast Seminar: Not to Be Missed

The 14th annual Graham & Dodd Breakfast Seminar drew a record number of alumni, students, scholars and investment practitioners—from Lee Cooperman ’67 and Mario Gabelli ’67 to Mason Hawkins and Tim Russo—to hear keynote speaker Bill Miller, CEO of Legg Mason Funds Management, and explore key issues in value investing. Widely regarded as the premier event in the industry, the seminar is an initiative of the School’s Heilbrunn Center for Graham & Dodd Investing.

Among the 307 people at the University Club in Manhattan on October 6—a small sample of the thousands of Graham and Dodd disciples—were alumni spanning six decades, including the newest generation of value investors who have learned the discipline from Bruce Greenwald, director of the Heilbrunn Center and the Robert Heilbrunn Professor of Finance and Asset Management.

“I think it’s a tribute to what Ben Graham started,” said Greenwald, who joined the School in 1991, “that I’m starting to get serious complaints from people in this room about the number and quality of competitors in the value investing world.”

Hinting at the increasing challenges facing value investors, Greenwald introduced Miller, portfolio manager of Legg Mason Value Trust, the only mutual fund to outperform the S&P 500 for the past 15 years, and one of Business Week’s “heroes of investing.” He spoke on “Adapting Value Investing to a Decidedly Non-Value Investing Environment.”

“Valuation anomalies relative to history are, I think, at all-time lows,” Miller said. “But my view is that we’ll be doing well if we can just recognize change, as opposed to trying to forecast change.”

He spoke optimistically about the U.S. equity market and also advised investors to apply value-investing principles abroad. “If you widen your search space, then you widen your opportunities,” Miller said. “While we’re looking at opportunities domestically, we try to see if we can find comparable companies overseas. Looking around for parities is a great guideline, I think.”
Google’s IPO
A Dutch auction works, if you let it

On August 19, 2004, Google issued 19.6 million shares using a modified Dutch auction. The use of a Dutch auction to float such a large number of shares in the United States is completely unprecedented. Professor Laurie Simon Hodrick, who has done extensive research on Dutch auctions, analyzes the lessons learned from the Google Dutch auction initial public offering (IPO).

by Laurie Simon Hodrick

Much of the analysis throughout the Google IPO process has concluded that the Dutch auction is a flawed way to float shares. I strongly disagree. Executed correctly, the Dutch auction provides an efficient and effective mechanism that endogenously determines a share price where supply equals demand. So why is criticism of the Google Dutch auction rampant?

Regulatory and Market Challenges
Critics of the Dutch auction argue that it is flawed because Google encountered regulatory and market challenges during the IPO process. It is important to note that many of the hurdles faced in the Google IPO would still have been problematic had Google instead chosen to use a standard firm commitment underwriting. Specific missteps, such as the failure to register employee share distributions with the SEC and the Playboy magazine interview, as well as a deteriorating equity market, as evidenced by both numerous canceled IPOs and a decline in technology stock valuations, would all have detracted from the Google IPO irrespective of the auction mechanism chosen. These challenges, and not the Dutch auction, were sources of downward pressure on the offer’s demand.

The Offer Price
Critics also argue that the Dutch auction is flawed because Google reset its offer range from $108–$135 per share to $85–$95 per share. I consider the fact that Google reset its price range to be a strength of the Dutch auction, not a weakness. Rather than forcing Google to commit to a clearing price, the Dutch auction provided Google with the ability to set a price such that supply equaled demand, based on investor demand as revealed through the bidding process.

If a Dutch auction allows firms to set a market clearing price, why did the Google price pop from $85 per share to $100.34 per share on the first day of trading on the Nasdaq? Although the Dutch auction gave Google the ability to set a market clearing price for its shares, the modified Dutch auction as described in the prospectus did not require Google to do so. Google chose to go public at a price with unsatisfied demand. Further, if Google had been willing to commit to how its clearing price was to be determined, investor uncertainty would have been reduced.

Small-Investor Participation
Critics further argue that the Dutch auction is flawed because it failed to democratize the IPO process, denying promised access to the smaller investor. These critics blame
the complexity of the Dutch auction. In fact, many investors that historically had been precluded from participating in hot IPOs did have the possibility of buying into the Google IPO. While the offer was not accessible to everyone, the limitation on small-investor participation arose at the underwriter level and was based on the underwriters’ interpretation of SEC restrictions that protect small investors from making unsuitable investments. The barrier to entry was not the auction’s complexity: small investors who were provided with access typically did not find the bidding complicated. Further, the fact that many of the trades on the first day were small lots contradicts the assertion that all small investors were denied access.

A Lesson from Stock Buybacks
Firms in the United States have successfully used Dutch auctions to repurchase their shares since the early 1980s. The firms pioneering this method of repurchase also faced investor confusion about the auction at first. My research shows that, over time, the auction design was improved and the market learned to appreciate the advantages of the mechanism so much that the Dutch auction has actually supplanted the fixed-price tender offer, which parallels a standard IPO offer, as the most common way that firms buy back significant blocks of shares in the United States.

The Future of Dutch Auction IPOs
Had the Google IPO been viewed as an unambiguous success, there is no doubt that it would have been followed by a flood of additional Dutch auction IPOs. Given the controversy now surrounding its outcome, what can we expect in the future? I expect to see noteworthy Dutch auction IPOs executed in the future, though at a slower rate of adoption than if the outcome had been an indisputable triumph. In my opinion, the future use of the Dutch auction for IPOs was never predicated on the success of this particular deal. A lesson from the history of firms using Dutch auctions for stock buybacks is that improvements will be made in the execution of future Dutch auction IPOs. What potential issuers should learn from the Google IPO, most of all, is that a Dutch auction works, if you let it.
An MBA Goes to Washington

WORKING IN THE GOVERNMENT IS A KIND OF CALLING

Whether going straight from the Columbia campus or after years on corporate campuses, our many alumni who work in the public sector seem to do so for one reason: to promote the greater good, whether they are overseas or in the White House, in Republican or Democratic administrations, defense strategists or diplomats.

HERMES spoke with just a few of them: Erskine Bowles ’69, M. Patrick Ellsworth ’99, José Fourquet ’96, Senator Frank Lautenberg, BS ’49, Joel Molinoff ’98 and Brian Roseboro ’83.

BY DIANA KATZ Having grown up in a hardworking family, fought in World War II and attended college on the G.I. Bill, Frank Lautenberg, BS ’49, graduated from Columbia Business School with dreams of starting a company.

With two partners, he founded Automatic Data Processing (ADP) and shepherded it from a tiny start-up to a public company with a complete portfolio of HR and employer services. Lautenberg was just getting started.

While still heading ADP, he became commissioner of the Port Authority of New York and New Jersey and witnessed the large-scale improvements brought about by PATH trains, new bus terminals and river-crossing facilities.

“I saw that there were things that could be done by government that could make an enormous difference in people’s lives,” he says. In 1982, Lautenberg left ADP, which by 2004 would become the world’s largest payroll and tax-filing processor, and set his sights on representing New Jersey in the U.S. Senate. He wanted to serve the public good with the skills he had honed as an executive.
Patrick Ellsworth ’99, who became a foreign-service officer with the State Department after working for Booz Allen believes his work fulfills what he considers “a personal obligation to serve the public.” He recently completed his first posting, a two-year stint in the U.S. embassy in Kiev, Ukraine. In addition to working with the embassy’s management team, he reported on economic development and promoted the economic interests of the United States.

“Economic policy shapes the world order,” says Ellsworth. “With the United States being the only superpower in today’s world, I believe we have a great responsibility to promote democracy and free markets.”

A sense of being called is nearly ubiquitous among alumni in government. Lautenberg, after 18 years in the Senate, chose not to run for a fourth term in 2000. But when Senator Robert Torricelli of New Jersey dropped out of the 2002 election, supporters urged Lautenberg to come out of retirement. He was reelected in a landslide. “I tried to leave once, and I heard that siren call that called me back,” Lautenberg says with a laugh. “And I came running.”

**Leaving Your Comfort Zone**

Brian Roseboro ’83, President George W. Bush’s under-secretary for domestic finance in the U.S. Treasury, didn’t just feel called to public service—he was called.

Roseboro was a director with American International Group’s risk management division when the White House called in 2001 to say the president was considering him for a Treasury post and that someone had “highly recommended” him.

Today Roseboro oversees domestic financial markets, financial institutions and fiscal policy, reporting to the president and Secretary John Snow. The scope of his responsibility is enormous, but Roseboro always has sought opportunities that are “challenging and different—and a bit risky in terms of whether I could do it.” A rule he has followed throughout his career: “Get out of your comfort zone.”

**Business, Beltway Style**

At its worst, the nation’s capital can be “polarized and paralyzed by politics and partisanship,” says Erskine Bowles ’69. He spent two decades in investment banking before President Bill Clinton asked him to head the Small Business Administration in 1993. “When you run a federal agency,” Bowles says, “it’s like you’ve got 535 directors in the Congress, and they control every little line item in your budget.”

The federal government can present an especially frustrating and challenging climate for MBAs, who come to work trained to make decisions, focus on objectives, lead teams and solve problems. Progress is easily stymied by the sheer size of government and the number of stakeholders. Political infighting can bring the process to a standstill. President John F. Kennedy once called Washington “a city of Southern efficiency and Northern charm.”

In the private sector, explains Lautenberg, “the decision making is fundamentally yours. It’s quite different building a consensus and trying to convince others in a peer group that the position you’ve taken on legislation is correct.”

As Roseboro sees it, “It’s so easy anywhere, but particularly here in Washington, to get diverted by process, as opposed to getting things done.” The issues he deals with at the Treasury range from the “epic challenges” of terrorism and economic cycles to the finances of airlines, the Postal Service and such government-sponsored enterprises as Fannie Mae and Freddie Mac.

Although Roseboro often feels as though “there’s a bunch of pots on the stove, and you just check to see which ones are boiling,” his skills in overcoming those challenges are what have made his tenure so successful. Having such enormous responsibilities “calls upon you to develop management skills that allow you to effectively get through it.”

**Finding Real-World Solutions**

If government challenges MBAs in ways that the private sector does not, many find that the challenges peculiar to Washington are what make the work so rewarding. MBAs are often especially eager to effect fundamental change that makes Washington work better.

“The federal government is larger than any private-sector corporation,” says Ellsworth. “But there is no reason [it] can’t operate as smoothly as the best-managed corporations in the private sector. . . . I see it as part of my mission to make this happen.”

Bowles transformed the Small Business Administration by restructuring the agency and making its products more effective for small-business owners: he improved a program that provides owners with a working-capital
credit line; slimmed the agency's loan application from hundreds of pages to a single sheet; and aggressively marketed the agency's services to women and minorities.

The goal, says Bowles, was to “increase the chance that more people would have a chance at the American dream.” He was so successful that in 1994 President Clinton asked him to join his executive office.

“We face so many very serious problems today, whether they're domestic or economic or international,” Bowles says. “What I think we need in Washington is people who can bring people together and find common-sense, real-world solutions.”

**The Need for the MBA Skill Set**

Fundamental business skills—in negotiation, management, finance, marketing and even entrepreneurship—work in Washington as well as they do on Wall Street. Although conventional wisdom holds that politics is art and business is science, much of politics and policymaking is business. The MBA skill set is highly valuable—indeed, essential—across the spectrum of government agencies and functions.

When the National Security Agency (NSA) was looking for a tech-savvy MBA to start up and lead a new strategy and business management team, it hired Joel Molinoff '98, previously a vice president with JPMorgan's e-business group.

The NSA was in many ways a logical next step in Molinoff's career because it offered “operations and management experience in a cutting-edge technology organization.” But Molinoff, who was living in New York City on September 11, also “thought that someone with my background could be helpful in supporting the war on terror.”

Specialized divisions in the NSA—“America’s code makers and code breakers”—protect U.S. information systems and gather different kinds of intelligence. Molinoff's strategy and business management team manages strategic planning, financial operations and resource management activities for Data Acquisition, a unit of the NSA's Signal Intelligence Directorate that gathers and processes foreign electronic intelligence and has a multibillion-dollar budget. Molinoff's responsibilities include “making investment decisions, being able to evaluate business units for efficiency gains, tying budgetary decisions to performance and establishing repeatable processes for managing programs.”

“There is tremendous opportunity for MBAs” in the NSA, Molinoff says. “Only a small percentage have MBAs or corporate management experience. Part of my mandate is to apply corporate best practices to the work we do in Data Acquisition to improve the group's overall effectiveness and efficiency.”

He adds, “Although there are many business challenges analogous to those experienced by private-sector companies, measuring profit and loss, performance and success all require different methods of evaluation. This is particularly interesting given that the product is something as unstructured and variable as intelligence.”

**Getting to Yea**

Bowles became White House chief of staff in 1997. Admired on both sides of the aisle, he was most noted for negotiating a balanced budget—something that hadn't been seen in Washington in 30 years. He did it by relying on the skills he had perfected as an MBA and an investment banker.

"Nobody believed it could be done," Bowles recalls. "I believed it had to be done." He spent "months and months locked in conference rooms" with Newt Gingrich and Trent Lott, then Tom Daschle and Dick Gephardt. "It wasn't easy," Bowles says. "The two sides were really far apart."

"In the investment-banking business you’re always working to get to yes," Bowles explains. "I had to earn trust, just like you have to earn the trust of a buyer and seller in order to get something done." Running for senator in North Carolina in 2004, Bowles has pointed to his negotiation and consensus-building skills as among his major political strengths.

José Fourquet '96, whom President George W. Bush appointed as U.S. executive director for the Inter-American Development Bank (IDB) in 2001, says that as an MBA, "I had the ingredients for how to make good decisions."

"When analyzing a complex financial issue, I felt confident that I was one of the more knowledgeable people at the table," he says. "I had a very solid academic background in finance. Even if there was something that I had never seen before, I could work through it. It was intellectual firepower."

Ellsworth names Turnaround Management as a Columbia course that directly prepared him for his work at the
embassy in Kiev. Encompassing every critical aspect of running a business, the course taught him “how to walk into a situation that is failing and assess and fix the situation with confidence and speed.”

Ellsworth was responsible for managing embassy operations that affected 600 staff members and projects that required navigating a “labyrinth of legal and financial issues.” In addition to meeting financial, budgetary and regulatory objectives, he led the search for a new embassy site. Additionally, Ukraine is considered a hardship post because of its lack of strong infrastructure and worries about Chernobyl, among other reasons.

Ellsworth restructured practices and implemented changes that saved the U.S. government hundreds of thousands of dollars a year. He says he enjoyed having a job that allowed him to do the type of restructuring he did at Booz Allen while giving him exposure to the geopolitical issues that fascinate him.

Initially attracted to the State Department by Colin Powell’s emphasis on strong management and strategic organization, Ellsworth says his first post provided excellent opportunities to use his MBA. He is now preparing, with intensive Chinese lessons, for his next post in Hong Kong.

**Getting What You Came For**

The most satisfying compensation for leaving the private sector, according to many alumni, is the very reward they had sought: the sheer opportunity to serve the public.

If working for the public good is what makes his job so demanding, says Roseboro, it is also what makes his work fulfilling. “I’m working for the taxpayer,” he says. “And that makes it worthwhile and gives you the confidence to stand for principle on things. I started in public service, went to the private sector and now I’m back in public service.” The cross-pollination that results, says Roseboro, “brings an updated, fresh perspective on how to do things—methodologies, approaches. As I envision it, this is the way it should be.”

“When you work in the White House you have a chance to do more good than you could ever imagine,” says Bowles. “I knew that I had really done something that mattered, on a scale that you can’t imagine anywhere else. It gives enormous satisfaction.”

Lautenberg’s accomplishments during his 20-and-counting years in the Senate—during which he led the ban on smoking on commercial airlines and the raising of the age of majority to 21, as well as other landmark legislation—have undoubtedly saved many lives.

When working with the IDB, Fourquet wanted firsthand knowledge of the impact he was making in poverty-stricken areas of Latin America. He regularly visited the people whose lives were transformed by his work. After all, he says, “the decisions we made affected half a billion people in Latin America and the Caribbean.”

Fourquet took his first such trip to Chiapas, Mexico, a remote region devastated by the international coffee crisis. Responding to a burgeoning market for organic coffee, the bank provided loans to build a factory for processing and packaging coffee according to organic standards. Because of the IDB’s commitment, many families were saved from hunger and poverty.

“Some of these people drove eight or nine hours to be able to see me and thank me,” Fourquet says. “Without the loan they wouldn’t be able to feed their families.”

Fourquet resigned from the IDB in May to pursue an opportunity with Lehman Brothers. As the new managing director in charge of Lehman’s Miami office, he advises Latin American families, which he sees as a continuation of his work on behalf of the region.

Fourquet is sure that he would not have been offered the position without his experience at the IDB. That said, he cautions, “You really have to want [to work in the government] for the right reasons, because when it’s all said and done, it has to be because you want to serve your country and, in my case, your president.”

His work in Washington, says Fourquet, was “super-intense” but “as intensely fun as it was sacrificing. So far it was one of the highlights of my life.” And the best reward for leaving the private sector to work for the federal government, he says, is this: “There is no better way to leave the world better than you found it.”

*From the Editor: HERMES invites graduates of the School who have left the private sector for government service to send us your story. Your responses may enable us to run a follow-up to this article in a future issue.*
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Marketing METRICS
HARD NUMBERS ON SOFT SCIENCE

With companies spending hundreds of billions of dollars on marketing each year, executives, business school students and the SEC all want to evaluate the impact of intangible assets on firms’ market values. Professor Sunil Gupta shows a quantifiable link between spending and returns and argues that marketing will become even more important as markets mature and competition intensifies.

BY SUNIL GUPTA

When I started my MBA program at the Indian Institute of Management, having just earned an undergraduate degree in engineering, I had no idea what marketing was. Clearly, neither had I any intention of pursuing a career in this field. But all that changed after I took a marketing course with Professor Labdhi Bhandari, PhD ’76, who happened to be a graduate of Columbia Business School. Marketing, I realized, is paramount—arguably more important than any business function other than innovation. Peter Drucker, one of the most influential management gurus, said, “Innovation and marketing are the only two valuable activities of a firm. The rest are costs.”
Every year companies spend billions of dollars on marketing. In 2003, General Motors spent more than $3 billion on advertising alone. Total advertising spending in the United States reached almost $146 billion during that year. And worldwide, advertising expenditures exceeded $400 billion—more than the GDP of Thailand, Hong Kong and New Zealand combined. Yet the value of marketing has been seriously questioned by many firms. What, they ask, does millions or even billions of dollars really buy?

**Big Gains, Bigger Costs**

As markets mature and competition intensifies, marketing has become more critical even in such industries as high tech and pharmaceuticals, which historically have been dominated by R&D. Take the case of Lipitor, Pfizer’s blockbuster drug for reducing cholesterol, one of a group of drugs known as statins. It was launched almost 10 years after the first statin, Mevacor, was introduced by Merck. At the time of Lipitor’s launch, four drugs were available in the market. Zocor, also from Merck, was the undisputed leader, with worldwide sales of almost $2 billion.

Not only did Lipitor miss the first-mover advantage and consequently face major competitors, but its clinical trials showed only slight superiority over other statins. Surely Lipitor had no chance of succeeding. Yet, with an astute marketing strategy and its highly skilled sales force, Pfizer managed to make Lipitor the best-selling drug in the entire pharmaceutical industry. It currently has annual sales of about $10 billion.

Despite success stories like Lipitor, marketing has been subject to increasing skepticism by business school students. MBA students find marketing soft and fuzzy. Their sentiments are doubly felt by many company executives who have difficulty showing returns on marketing spending. It is easy for marketing executives to ask for millions of dollars for advertising or improving customer satisfaction, but it is much harder to show how this investment affects the firm’s profits or shareholder value.

Consider the case of Hoover, a company so well known for its vacuum cleaners that in the British vernacular, you Hoover your dining room carpet. In the early 1990s, the U.K. division of Hoover was evaluating its options for growth. To increase sales, executives decided to offer customers a short-term incentive. In the summer of 1992, Hoover offered a sales promotion: anyone who bought £100 worth of products would be entitled to two free airline tickets to travel from the United Kingdom to Europe. Company executives were so encouraged by consumer response and sales growth that they decided to sweeten the deal in December. Consumers who spent £250 on Hoover products would get free air travel to the United States.

The response was phenomenal. More than 200,000 customers applied for the promotion within a few months. While sales skyrocketed and customer growth was unprecedented, the impact on Hoover’s profits was disastrous. The company took a charge of £48.8 million against its earnings, and many senior executives were fired.

**Eyeballs, Stickiness and Other Measures**

This case may be an extreme example, but Hoover is not the only company that has relied heavily on sales promotions. Since the 1980s companies have spent an increasingly large portion of their budget on short-term discounts for the obvious reason that the impact on sales is immediate. But an equally obvious question—whether these promotions are truly beneficial to the company—follows. In 1988, I developed a model to find out how much of the sales increase resulting from short-term discounts is truly incremental and how much is borrowed from the future. In other words, if

We found that, on average, a 1 percent change in customer retention improves customer and firm value by almost 5 percent. In contrast, a 1 percent improvement in a company’s cost of capital improves its value by only 0.9 percent.
Coca-Cola offers a promotion, some consumers may switch from competitive brands but others, die-hard Coke fans, may simply stock up their favorite brand.

Even if a promotion generates a substantial incremental volume in the short run, the long run can tell a very different story. Using an eight-year-long data series from a consumer packaged-goods company, we found that the long-run effects of promotions on sales are negative: they amount to about two-fifths of the magnitude of the positive short-term effects. The models we developed could be used for optimal allocation of resources between advertising and temporary price discounts.

While consumer-goods companies were becoming more sophisticated over the years, and many even adopted this kind of analytical thinking, another phenomenon happened during the late 1990s, the Internet boom. As the dot-coms flourished, financial analysts found it difficult to use traditional models to value these firms. For example, it is hard to use the discounted cash flow approach for valuing a firm that has negative cash flows or to talk about a firm’s P/E ratio when it has no E.

This led many analysts and academics in finance and accounting to focus on the number of customers, customers’ “stickiness” on the Web and other nonfinancial measures. But when many high-flying Internet companies were driven into the ground, the financial community blamed the Internet bubble itself on the use and popularization of such nonfinancial measures as “eyeballs” and “page views.” Finance had been doing just fine, they thought, until marketing influenced it and caused problems.

Today the business world is increasingly facing another reality that echoes the phenomenon that developed during the bubble years. Intangible assets increasingly form a very large part of any company’s market value. Some recent studies show that for every dollar of asset value indicated on the balance sheet of a company, three to four dollars in intangible assets are typically not reported. This led the Securities and Exchange Commission to appoint a task force to encourage companies to measure and report these intangible assets. Two of the intangibles highlighted by the task force are brands and customers.

From the Four Ps to the Big P

Are customers truly the critical intangible asset of a firm as suggested by the SEC, or is the focus on customer-based metrics misguided? After all, in many people’s view, this customer focus led to the Internet bubble. In the last several years, my research has shifted from understanding the impact of the four Ps (product, price, promotion and place) to measuring and managing customers as assets.

Customer management requires an assessment of each customer’s lifetime value, which is the present value of all current and future profits generated from a customer over the life of his or her business with a firm. This concept has been used for many years in database marketing for tactical marketing decisions, such as how much money to spend on acquiring a customer.

If customers are the key generators of revenue and profit—the big P—then the cumulative value of all current and future customers should be a strong proxy for the firm’s market value. In a recent research paper, my colleagues and I showed this link. Not only does this finding provide an approach to valuing firms with high growth potential and limited or negative current income, it also shows what drives customer and firm value. We found that, on average, a 1 percent change in customer retention improves customer and firm value by almost 5 percent. In contrast, a 1 percent improvement in a company’s cost of capital improves its value by only 0.9 percent.

This finding not only makes the impact of marketing more quantifiable but also highlights marketing’s critical role in improving a firm’s market value. Along with my research colleague, I have put many of these ideas into a forthcoming book. We have also modified Columbia Business School’s core marketing course to reflect many of these ideas. Our marketing course now highlights our finding that marketing does matter—because it creates value not only for a firm’s customers but for shareholders and the firm itself.

Smil Gupta is the Meyer Feldberg Professor of Business, with expertise in marketing strategy, pricing and customer management. He is frequently consulted for commentary by the business press, and his research has won numerous awards, most notably the Journal of Marketing Research’s O’Dell Award in 1993 and 2002. In 1999, he was selected as the best core course teacher at the School. His new book, Managing Customers as Assets, will be published by Wharton Publishing/Financial Times in 2005.
The Voyage of the
AN ALUMNUS COMMEMORATES HIS SURVIVAL

by Stefanie Condle ’01

The Friday after Black Monday, the stock-market crash of 1987, Jack Bonné ’63 attended Sabbath services with his wife at their local temple in Connecticut. Because Bonné, founder of Gateway Asset Management, is an investment manager, several of his friends asked him afterward how he was doing and whether he had survived the crash. “I was speechless because in my mind, the concept of survival is far removed from mere pieces of paper fluctuating in value,” Bonné says. It’s no wonder that Bonné, who escaped from Nazi Germany with his family on the eve of World War II, has been able to meet the ups and downs of the investment business with equanimity for four decades.

As an eight-month-old baby, Bonné was the youngest passenger aboard the SS St. Louis during its famous journey from Hamburg to Cuba in May 1939. Most of the ship’s 937 passengers—Jewish refugees hoping to immigrate to the United States by way of Cuba—had no choice but to return to Europe after they were refused entry by both Cuba and the United States. About half of them perished during the war.

In the late 1930s, as the United States was emerging from the Great Depression, unemployment was high and so was anti-immigration sentiment. A quota system limited the number of immigrants from each country, and the number of applicants from Germany far exceeded the supply of visas.

In September 1938—two days after Bonné’s birth—his father went to the United States, leaving his family behind in Germany. “He took a ship from Hamburg to Ellis Island, but his immigration number hadn’t come up yet,” Bonné says. Someone suggested to Bonné’s father that he go to Cuba to wait for his U.S. visa. In Havana, while arranging for his family to travel to Cuba, he was advised through some political connections to obtain Cuban immigration visas for them.

As a result, Bonné and his mother and sister were among the 28 St. Louis passengers who were allowed to disembark in Havana. In October 1939, the family received their U.S. visas and moved to New York. Bonné’s sister, Beatrice Sichel, who celebrated her fifth birthday on the ship, still has memories of the five months the family spent in Havana.

Most of the ship’s passengers had purchased landing permits that the Cuban government refused to honor because of a complicated web of greed and political intrigue. After President Franklin Roosevelt denied the refugees’ pleas for asylum and negotiations with several Latin American countries fell through, the St. Louis returned to Europe. Great Britain, France, Belgium and the Netherlands offered the passengers haven, but as the German occupation spread across Europe, hundreds of them ended up in concentration camps.

Organized by the Nazis as a propaganda ploy, the voyage of the St. Louis was designed to show that Jews were unwelcome not just in Germany, but throughout the world. A few weeks before the ship arrived in Havana, the German government sent agents to Cuba to stir up anti-Semitic sentiment on the island. Banking on the isolationist, anti-immigration mood in the United States, the Nazis correctly guessed that if Cuba refused to admit the refugees, the United States would not open its doors either.

In May of this year, Bonné and 11 other St. Louis survivors gathered in Cuba to commemorate the 65th anniversary of their journey, which was documented in a 1974 book,
St. Louis

Voyage of the Damned, and a 1976 movie of the same name. A Miami pastor organized the reunion in an effort to reconcile the Christian and Jewish communities and seek forgiveness from the St. Louis survivors.

During the week that the ship was anchored outside the harbor, from May 27 to June 2, 1939, the Havana waterfront became a familiar sight to the passengers. Many of them were women and children whose husbands and fathers were waiting for them in Havana. Each day, relatives of the passengers would ride out into the harbor on small boats to wave and shout greetings to loved ones on the ship.

The reunion’s first full day, Friday, May 28, began with a visit to the harbor—an emotional experience for those who remembered looking at Havana from the side of the ship during that long, agonizing week. One of the survivors read Kaddish, the traditional Jewish prayer for the dead, and then each reunion participant tossed a rose onto the water.

On Friday evening, the group attended an ecumenical memorial service at a synagogue, where a local rabbi read Kaddish and a Catholic bishop gave a speech asking the survivors for forgiveness. Although the current Cuban regime has no connection to the St. Louis incident, a government representative delivered an apology on behalf of the Cuban nation.

A final gathering on Saturday offered “an opportunity for sharing, healing, storytelling,” Bonné says. “There were a number of people there for whom, even after 65 years, the wounds were still pretty raw. For some of them, they also had to deal with the guilt of those that didn’t make it.”

Jorge Díaz, pastor, brought the final meeting to a close by sounding the shofar, a ram’s horn traditionally used on the Jewish High Holidays. Originally used as an alarm or summons, the shofar is now sounded as a wake-up call to rouse worshipers to take stock of their lives, improve themselves and repair the world.

As the youngest St. Louis survivor, Bonné considers it part of his life’s mission to help keep the story alive as a reminder of the dangers of apathy and indifference in the face of oppression. “As we ended the concluding service,” he says, “Our battle cry as a group was ‘Never again!’”

Photos from left to right: visitor’s permit issued by the HAPAG company allowing passengers from the SS St. Louis to disembark at the port of Antwerp; picture postcard of the SS St. Louis; Jack Bonné in Havana during the summer of 1939; typewritten English translation of a message sent by the members of the SS St. Louis Passenger Committee to the Joint Distribution Committee in New York, thanking it for its efforts to find places of refuge for the Jews on board the ship.

Images of the permit, postcard and message used with permission from the United States Holocaust Memorial Museum, www.ushmm.org.
Corporate Social Responsibility
Corporate Profits vs. Social Goals

by Geoffrey M. Heal

Should corporations worry about their social impact? Or should they just go for profits and trust that everything else will fall into place? Consider Apple, Intel, and Microsoft: In 20 years they created an industry affecting everyone in the developed world, changing lives and businesses, creating billions of dollars in value for shareholders and tens of thousands of jobs for new employees.

These companies contributed massively to society and did so in the cause of making money for their shareholders. They illustrate well Adam Smith's classic remark: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." If companies make products that consumers value and price them affordably, making money in the process, what is the need for corporate social responsibility?

Tobacco companies sell a poison that is slow acting and addictive, so they can actually make money while killing their customers. Clearly, this is a different case from the tech sector. What about auto and oil companies, which help us experience freedom by means of personal mobility, while polluting the environment and changing the climate? What differentiates the tech sector from tobacco, oil and autos?

To understand this, we have to see when the interests of corporations are fully aligned with those of society as a whole and when they are in conflict, and for this we have to go beyond Adam Smith, to the concepts of private and social costs. Markets work well for society, aligning corporate and social interests, when a firm's private and social costs are the same, as is the case with the tech sector. But when these costs are different, markets don't do such a good job, as is the case with tobacco and, to a lesser degree, oil and autos. This explains the conflict between corporations and society in these sectors.

Discords can arise, too, over issues of fairness. What is a fair wage for unskilled labor in Vietnam, or for that matter in the retail sector in the United States? As Nike and Wal-Mart know, these are controversial issues. Markets may be efficient, but there is no presumption that they are fair.

Corporate social responsibility needs to be an important part of corporate strategy in sectors where inconsistencies arise between corporate profits and social goals, or else discord can arise over issues of fairness. A corporate social responsibility program can make executives aware of these conflicts and commit them to taking social interest seriously. It can also be critical to maintaining or improving staff morale, to the stock market's assessment of a company's risk, and to negotiations with regulators.

The payoff to anticipating sources of conflict can be very high—indeed it can be a matter of survival, as societies penalize companies perceived to be in conflict with underlying values. Asbestos was the tobacco of the 1950s: Where is that industry today?

Geoffrey M. Heal is the Paul Garrett Professor of Public Policy and Business Responsibility. His research includes studying ways of controlling the impact of economic activity on the environment and ways of valuing the economic services provided by environmental assets. He teaches the core course Managerial Economics.