

Summer 1998

Wharton

A L U M N I M A G A Z I N E

WHEN 'THE BIG ONE' STRIKES

RISK MANAGEMENT
IN THE
INSURANCE INDUSTRY

Alumni Directory Update

Beginning this month, representatives of Harris Publishing will be telephoning alumni for the verification phase of the alumni directory project.



Your cooperation with this phase of the project will ensure that the most accurate information about yourselves will be published in this worldwide directory of the School's 70,000 alumni.

You will also have the opportunity to order your personal copy of the book when your Harris representative telephones. We suggest that you don't delay in ordering your directory, because only prepublication orders received at that time will be guaranteed.

The Wharton Worldwide Alumni Directory will be published in early 1999.



Wharton Alumni Weekend 1999

In Philadelphia

Friday, May 14; Saturday, May 15; Sunday, May 16

- Five-year MBA Reunion
- Executive Education Sessions
- Dinners
- Wharton Town Meeting
- Picnic Lunch and Parade
- Farewell Brunch

Registration materials will be mailed in late winter.

For more information, call Alumni Affairs at 215-898-8478.



COVER ARTICLE

America's insurance industry holds approximately \$250 billion in equity. The capital markets represent a \$19 trillion investment pool. Herein lie the seeds of a whole new approach to catastrophic risk management.



Illustration by
Brian Rea

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KOO FAMILY GIVES \$10 MILLION FOR NEW EDUCATIONAL FACILITY

Leading Taiwanese businessman Chen Fu Koo and his sons, Chester Koo, WG'79, and Leslie Koo, WG'81, have given \$10 million to help support the planning and construction of a new 300,000 square foot, state-of-the-art academic facility at Wharton.

"This generous gift from Dr. C.F. Koo, along with his sons, Chester Koo and Leslie Koo, will help us create a new global learning environment, incorporating the latest in educational and communications technology," says Wharton dean Thomas P. Gerrity. "We are extremely grateful for the continuing commitment and support the entire Koo family has given to Wharton over the years."

Chen Fu Koo's achievements in business and diplomacy span more than six decades. He is the founder of one of the largest financial and industrial groups in Taiwan, R.O.C. In the early 1950s, he assisted the Taiwanese government in its privatization program and built a large and diversified conglomerate whose member companies include many industry leaders in financial services, manufacturing, high-tech and broadcasting. These and other service sectors have helped fuel Taiwan's rapidly-growing economy.

In addition to building his own business, Koo has made other direct contributions to the economy in Taiwan—

first as the creator and chairman of the Taiwan Stock Exchange, and then as economic ambassador for Taiwan as it built trade bridges around the world. Koo has also been a leading force in encouraging and facilitating economic cooperation in the Pacific Basin region and around the world. Most recently, he was elected International President of the Pacific Basin Economic Council and presided over that organization's annual meeting held in Mexico City last year.

As the founder of one of the largest financial and industrial groups in Taiwan, Koo has acted as domestic policy adviser to the Taiwanese government and has been a leading force in working toward the improvement of relations between Taiwan and China. He participated as the R.O.C. representative in the historic Cross-Straits talks in 1993.

The Koo family has strong and longstanding ties to Wharton. Chen Fu Koo was awarded the school's Dean's Medal in 1991; his two sons earned their MBA degrees from Wharton; and the family has endowed two professorships at the school, supported the development of Wharton executive education programs in Taiwan, and each year provides three \$25,000 scholarships to Taiwanese students to attend Wharton. ▼



JEFFREY

When Viva Jeffrey, WG'99, worked as an auditor at Arthur Andersen in Chicago, she volunteered for a nationwide program that provided

TAX ADVICE, FREELY OFFERED

free income tax assistance to low-income families.

Last spring Jeffrey, with the help of 40 other MBA students, was able to replicate that program for 29 families in Philadelphia. Because of the volunteers' assistance, these families received refunds totaling \$15,000, mostly through tax credits for which they didn't realize they were eligible.

"Many of the people we worked with asked us to explain the taxes and the forms. They wanted to learn. And they had trouble believing we were doing this for free. They were extremely grateful," says Jeffrey, a University of Illinois graduate who is spending the summer at BCG in Boston.

Jeffrey and other volunteers met with the families on three Saturday mornings in a west Philadelphia high school. They advertised their service through flyers mailed to community groups, churches and schools, and contacted the local radio stations and newspapers for service announcements. The program was sponsored by the *Wharton Journal* and Arthur Andersen.

Jeffrey will organize the same project next year and then recruit a team to carry it on after she leaves. She doesn't foresee any problem. "When I first asked for volunteers, the response was overwhelming," she says. "Wharton is a great environment for this kind of effort." ▼



CALIBERSM
LEARNING NETWORK, INC.

WHEN LONG-DISTANCE LEARNING IS UP CLOSE AND PERSONAL

Managers whose backgrounds are in technology may find that their lack of business skills is holding up a long-awaited promotion.

Business school graduates who have been out in the field for 10 or 15 years may realize they need a way to catch up on the latest management tools and strategies.

Organizations struggling to keep ahead of the competition may realize that several of their departments require concrete, real-time skill development which doesn't intrude on the daily demands of the business.

For individuals and organizations interested in high-quality management education but for whom an on-campus program is simply not an option, Wharton Executive Education this spring announced the launch of Wharton Direct.

It's a new network of highly-interactive business courses led by

Wharton faculty and delivered simultaneously in executive learning centers across the country.

Offered in conjunction with Caliber Learning Network, Inc. of Baltimore, Md., the program represents the first time a major business school has combined the most effective elements of the live classroom with the most advanced satellite and on-line technologies to create a national learning network for working professionals. Students can take the courses without leaving their own local area.

"Collaborating with Caliber allows us to reach high-potential managers who do not have access to Wharton's on-campus offerings," says Robert E. Mittelstaedt, vice dean, Executive Education and External Affairs. "The course will combine the best features of traditional education with the advantages of technological innovation."

It works like this: A digital satellite system will allow responsive real-time audio and video communication between instructors in Philadelphia and students in the distant learning centers. Students will be able to interact with Wharton faculty in Philadelphia through networked e-mail available at their desktops, as well as through live dialogue via video-conferencing.

Typically courses will run for three hours, once a week, for five to eight weeks. Students will continue to access the learning network between sessions to conduct research, complete projects and confer with peers and faculty.

The first group of programs offered will be the Working Knowledge Series, a collection of applied foundational courses for mid-level managers and technical professionals. The courses, which will begin in September, will focus on specific essentials of strategy, finance, marketing and operations. Between 300 and 350 professionals are expected to participate in each of the Working Knowledge Series programs.

"Some people are able to learn in a solitary environment with some help from technology," notes Alison McGrath Peirce, senior director of executive education at Wharton. "But most require a community of learners, commitment to a time and place, and interaction with professors and other participants."

Wharton Direct, which will offer certificates rather than degrees, is intended to supplement, not take the place of, the School's executive education courses on campus which currently enroll more than 9,000 participants each year.

Caliber Learning Network, Inc. is a joint initiative between Sylvan

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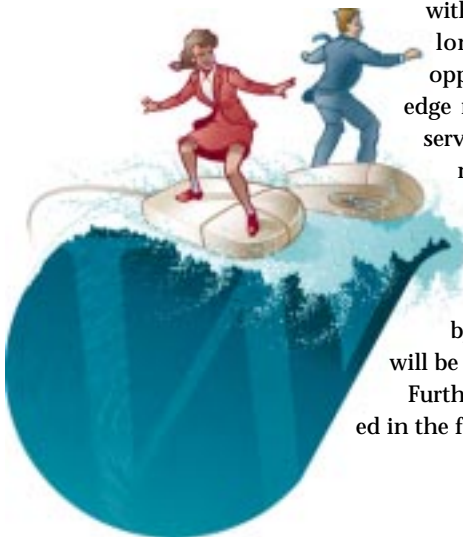
CATCH THE WAVE: ACCESS THE ONLINE WHARTON ALUMNI COMMUNITY

The Wharton Alumni Virtual Experience (WAVE), an online community to promote effective networking for alumni, will be launched this fall.

WAVE will offer participants the opportunity to locate and share information with other Wharton alumni. It will also provide lifelong career management information and job opportunity listings, as well as access to cutting-edge research conducted at Wharton, among other services. The privacy and security of personal information from alumni will be protected by individually authenticated passwords.

Wharton worked with a beta test group of alumni in the final development of WAVE. An announcement describing the services offered by WAVE and specifying the actual launch date will be mailed to all alumni.

Further details on how to access WAVE will be included in the fall issue of the *Wharton Alumni Magazine*. ▼



HOLD THE MUSTARD ON THESE BUSINESS PLANS

Looking to invest in a new kind of asset-backed security? Or how about a good deli sandwich in an unusual kosher café?

Meet Star Bonds, Inc., and Abe & Isaac's — winners of two Wharton Entrepreneurial Center awards for the best business plan created by an undergraduate team.

Abe & Isaac's, subtitled "The Oy Vey Café," is the brain-child of Jackie Kamali, W'99, and Josh Styne, C'99, two high school friends who grew up on Long Island and took Miles Bass's Management 231 class, "Entrepreneurship: Implementation and Operations."

Styne describes Abe & Isaac's as "an ethnic Planet Hollywood/Hard Rock Café" with a number of entertaining features, including television screens with clips from Jewish comedians, recording artists, movie stars and other notables.

"The idea is not to make people who aren't Jewish feel uncomfortable, but to make them laugh and get in with the whole 'schtick' aspect," notes Styne, a member of Mask & Wig at Penn who is working this summer for a Los Angeles production company.

The 75-page business plan, which won the Gloeckner Award, "is something we actually talk about implementing in the future," Styne adds, describing himself as the "creative side" of the venture and Kamali as the "numbers side ... Long-term we would like to tie the venture in with a Jerry Seinfeld-type celebrity."



Meanwhile, the other business plan winners also have their eyes on celebrities. The Trilogy Award went to Andrea Fraser, Craig Meyers and Jeremy Kraus, all W'98, whose Star Bonds, Inc. would create a new type of security backed by the contract and endorsement revenues of sports stars.

Consider, for example, a Michael Jordan bond. "We would take Jordan's contract with the Chicago Bulls and his contracts with Gatorade, Nike and other companies whose products he endorses, and bundle them up into a security

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ILLUSTRATION / CLARE SCHAUMANN

A SALUTE TO EXCELLENCE IN TEACHING

It is one of Wharton's most anticipated spring rituals — the presentation of awards to those professors who have earned the highest teaching ratings from students in both the undergraduate and MBA programs.

On the undergraduate level, the 9th annual David W. Hauck Award for Outstanding Teaching, the most prestigious in the undergraduate division, is given to two recipients for their ability to lead, stimulate and challenge students, knowledge of the latest research in their field and a commitment to educational leadership.

The 1998 recipients are Patrick Harker, UPS Professor and chairman of Operations and Information Management, and Kenneth Kavajecz, assistant professor of finance.

The Excellence in Teaching Awards recognize outstanding teaching and exceptional commitment to undergraduate students.

Winners this year include Suleyman Basak (Finance), Gordon Bodnar (Finance), Jamshed Gandhi (Finance), William Hamilton (Management), Patrick Harker (Operations and Information Management), Lorin Hitt (Operations and Informa-

tion Management), Kenneth Kavajecz (Finance), Robert Inman (Finance), William Laufer (Legal Studies) and Philip Nichols (Legal Studies).

Recipient of The Marc and Sheri Rapaport Undergraduate Core Teaching Award is Nicholas Souleles, assistant professor of finance.

The Wharton Evening School Outstanding Professor of the Year award was given to Francis LaMay, lecturer in finance.

In addition, Lorin Hitt, assistant professor of operations and information management, won one of eight

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Campus NEWS

TAKING STOCK, PART II

When the first edition of Finance Professor Jeremy Siegel's book, *Stocks for the Long Run*, was published in May 1994, the Dow Industrial Average was at 3700. "Few forecasters were predicting further gains in equities," Siegel says. "No one expected that just seven months later, stocks would embark on one of their greatest bull-market runs in history."

Siegel has now published a second edition that updates material from 1994 but covers new topics as well, including: "Age Wave" investing and the fate of the baby boomers' huge accumulation of assets, the Dow 10 and similar yield-based strategies, the impact of investor sentiment on stock returns, and the link between the Federal Reserve's interest-rate policies and subsequent movements in stock prices.

"I still believe stocks are the best long-term investment," notes Siegel. "But clearly the margin is going to be far less than what it was earlier on."

"I don't want to give people the impression that stocks can't become overpriced," he adds. "They can. But I don't believe it's hit that point yet, especially for the long-term investor. For the short-term investor, I suggest a little more caution." ▼

- Robert B. Goergen, WG'62, chairman and CEO of Blyth Industries, Inc., delivered this year's MBA commencement address on May 17.

Former president Jimmy Carter spoke at Penn's 242nd commencement, held May 18 on Franklin Field.

- Faculty from Wharton, the University of Chicago Graduate Business School and the London School of Business have teamed up to write *The Complete Finance Companion: The Latest in Financial Principles and Practice from the World's Best Finance Schools*.

The book, published in June, is divided into three modules: corporate finance, investments and financial markets.

The Complete Finance Companion is available from Financial Times Pitman Publishing in Alexandria, Va., 703-519-2172.

- A new two-week executive education course entitled *The Essentials of Management* offers a grounding in the

fundamentals of marketing, finance, operations and leadership.

Participants are introduced to key management concepts in week one, spend the next several weeks applying those concepts to their workplace, then return to the classroom for week two to share experiences with instructors and classmates.

The course is targeted to mid-level managers in information technology, operations and research, and development, and executives approaching upper-management positions.

- The mighty Wharton Wildmen hockey team is already promoting the annual alumni Wildmen game planned for next year's New York Follies weekend in February 1999.

The outgoing leadership says it apologizes to alumni for "dropping the puck this year" by failing to book ice for a 1998 event.

Alumni interested in details of the 1999 game plan are invited to visit <http://dolphin.upenn.edu/~wildmen> ▼



PHOTOGRAPH / JERRY MILLEVOI

SETTING A RECORD: The MBA Class of 1998, led by class gift drive co-chairs Jeff Given and Makiko Sonobe, raised \$179,126 for their class gift. The record-setting amount does not include two \$25,000 alumni challenges and a \$30,000 gift from the *Wharton Journal*.

The total money pledged is \$259,126.

More impressively, 651 students contributed to the gift, 86 percent of the class — another record. Of that total, 173 qualified for the Young Franklin Society (gifts of \$500-\$999) and 17 for the Benjamin Franklin Society (gifts of \$1,000+).

The \$259,126 will help fund a class of 1998 Communications Center. ▼

TAKING COMMAND OF A NEW CAREER IN THE NAVY

As a program manager at Naval Air System Command in Washington, D.C. for the last five years, Fred Lanes, WEMBA'98, fielded questions from congressional staff members on proposed mergers in the defense industry.

At the time, Lanes was also enrolled in Wharton's Executive MBA program and happened to be taking a course on mergers and acquisitions, with specific emphasis on divestitures among U.S. defense companies.

"From the very beginning, I was applying what I learned at WEMBA to my job in Washington," says Lanes, who was recently promoted to captain, U.S. Navy. "Over the past year we transitioned our team from a matrix to a core competency-aligned organization; a course in managerial organization helped that process. And an advanced corporate finance class last semester enabled me to better evaluate a proposal from one of our defense firms ...

"When I decided I wanted to get into the business side of the Navy, it was at the peak of the dollar spending era," notes Lanes, who spent 15 years as an active duty navy officer flying jets off aircraft carriers. "By the time I actually got my first position, the budget had started to decline

and the pressure was on to cut costs. The luxury of having all the money you needed was no longer there."

He enrolled in the WEMBA program and was selected as one of five Gruss Fellows from the class of 1998. The Gruss Public Management Program — established four years ago by Martin Gruss, W'64, to promote better leadership and management at all levels of U.S. government — covers one-half of the student's total expenses, including tuition, room and board, and books.

In addition to the fellowships, the Gruss program funds a public policy lecture series which brings distinguished senior government executives to Wharton, and an executive education seminar on strategic leadership and change management that is offered to senior congressional staff.

Lanes earned a BS from Union College in Schenectady, N.Y., and then attended flight school in Pensacola, Fla. before getting a masters of science operations research from the U.S. Naval Academy Postgraduate School in Monterey, Calif. His naval experience included five years flying the EA-6B prowler, a carrier-based electronic and missile attack aircraft.

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LANES

PHOTOGRAPH / HARRY KALISH

Hold These Dates!

Below is a list of student conferences scheduled for this fall in Philadelphia:

Women in Business Conference Friday, October 9, 1998

8 a.m. to 6 p.m.
Hyatt Bellevue Hotel, Philadelphia

Theme: The Next Century of Women: Lessons from the Past And Learnings for the Future

Contact:
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amy22@wharton.upenn.edu

Kelly Haveron,
kelly22@wharton.upenn.edu

<http://dolphin.upenn.edu/~wwib>

Wharton Asian Finance Conference Friday, October 30, 1998

9 a.m. to 6 p.m.
Wyndham Franklin Plaza Hotel,
Philadelphia

Theme: Asia's Financial Landscape: Challenges and Opportunities

Contact:
Terence Lai
terenc21@wharton.upenn.edu

Or, after Sept. 1, Asian Finance Conference
216 Vance Hall
3733 Spruce St.
Phila., Pa. 19104-6362

Phone: 215-573-4343
Fax: 215-573-8999

Investment Management Conference Friday, November 6, 1998

8:30 a.m. to 5:30 p.m.
University Museum, Philadelphia

Theme: Investing for the Next Millennium: A New Paradigm

Contact:
Tobias Welo,
tobias20@wharton.upenn.edu

European Conference Friday, November 13, 1998

Theme: The Impact of European Integration on Business in Europe

Contact:
Will Houston,
will32@wharton.upenn.edu

Entrepreneurial Conference Friday, December 4, 1998

"Entrepreneurship on the Verge of the New Millennium"

Contact:
K. Blair Carnahan,
kevin27@wharton.upenn.edu

Julian Lai-Hung, julian20@wharton.upenn.edu

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Contact the MBA students listed above for information about each specific conference.

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CATASTROPHE



AND THE CAPITAL MARKETS

INSURERS FACED WITH CRIPPLING LOSSES FROM A MAJOR HURRICANE OR EARTHQUAKE ARE TAKING A CLOSER LOOK AT “THE MOST INNOVATIVE IDEA IN INSURANCE IN THE LAST 200 YEARS”

The scenarios are not pleasant: An earthquake that swallows up Los Angeles or a hurricane that destroys Miami and the southern half of Florida.

The image is enough to send tremors through the U.S. insurance industry — with good reason. In the past few years, catastrophic events have occurred with more frequency and severity — and at greater cost to insurers — than ever before: Hurricane Andrew in Florida in 1992 (insurance claims, \$15.5 billion); the Northridge, Calif., earthquake in 1994 (insurance claims, \$12.5 billion) and the Kobe earthquake in Japan in 1995 (insurance claims, \$1 billion but costs of uninsured repairs estimated at \$100

billion). In the aftermath of Hurricane Andrew alone, nine U.S. insurance companies filed for bankruptcy.

Up until now, property and casualty insurers have protected themselves by buying policies from reinsurance companies designed specifically to cover losses from a catastrophic disaster. But these kinds of disasters have traditionally been defined as anything involving claims up to \$1 billion. The magnitude of events since 1992 clearly exceeds that figure.

“Insurance companies got a big shock with Hurricane Andrew,” says Neil Doherty, Ronald A. Rosenfeld Professor of Insurance and Risk Management. “They realized that a

single catastrophic event could lead to phenomenal bankruptcies.”

Just look at the numbers. America’s insurance industry holds approximately \$250 billion in equity. Yet given substantial increases in populations and property values in hazard-prone areas, “it’s not unrealistic to expect that one major catastrophe could result in \$70 billion or even \$100 billion of claims,” says Howard Kunreuther, Cecelia Yen Koo Professor of Decision Sciences and Public Policy and Management, and co-director of Wharton’s Risk Management and Decision Processes Center.

Other experts estimate that a repeat of the earthquake that destroyed Tokyo in 1923 could result today in damages of between \$900 billion and \$1.4 trillion.

“When the question is raised as to whether the insurance industry can pay for ‘the big one,’” says Peter Burns, project director of Wharton’s Catastrophic Risk Management program (see box), “the answer is clearly no.”

According to a growing number of experts, relief for the insurance industry lies in securitizing catastrophic risk — i.e. packaging it in the form of securities which are sold to private investors ranging from pension funds to hedge funds to sophisticated individuals.

The more popular offerings include catastrophe (“cat”) bonds (also known as Act of God bonds), cat options and catEPuts (catastrophe equity puts), but there are other approaches as well, such as reverse convertible debt and a catastrophe insurance risk exchange. Taken together, these various instruments — all of which offer different combinations of risk and reward to investors, depending on how they are structured and priced — are seen as potentially revolutionizing the insurance industry’s approach to catastrophic loss.

The idea is to shift the risks, and costs, of a major catastrophe from the backs of insurers/reinsurers to the heftier shoulders of the capital markets.

Once again, the numbers tell the story. “Say a major hurricane strikes Charleston, S.C., and causes \$80 billion in damages,” says Doherty. “That would obviously have a very adverse effect on the industry’s \$250 billion equity pool. The capital markets, however, represent a \$19 trillion investment pool. What would be devastating for the insurance industry would be a drop in the bucket for the markets. So why not invent capital market instruments that would be a better way of spreading the losses incurred by that hurricane?”

The point has not been lost on many of the parties involved, including insurers, reinsurers, investment banks, commercial banks and brokers. Swiss Re, Goldman Sachs, Lehman Brothers and Merrill Lynch have all worked

on cat bond issues; Goldman Sachs and Lehman Brothers recently opened insurance arms; and large international reinsurers are establishing their own capital markets divisions.

“The financial services market is undergoing a convergence that will involve commercial and investment banks getting into insurance, and insurers getting into the banking and investment business,” says Norman L. Rosenthal, W’73, WG’76, PhD’78, a Philadelphia-based consultant and chairman of a capital markets advisory board at insurance broker Aon. “These are trends that will lead to the more efficient use of capital and new ways to better manage risk.”

“The traditional view of insurers is that they underwrite people,” says J. David Cummins, Harry J. Loman Professor of Insurance and Risk Management. “They look at your risk characteristics and they either want to insure you or not, for a set premium. But what we are talking about here are totally anonymous financial contracts. It makes no difference who the buyers and sellers are as long as they meet the solvency criteria of the exchange. It’s what makes this capital markets approach the most innovative idea in the insurance industry in the last 200 years.”

Faced with the grim prospect of severe loss of surplus or even insolvency, the insurance industry has been transforming the way in which it absorbs risk. Among its strategies: new catastrophe reinsurers in Bermuda that are better equipped to handle cat losses; increased consolidation among reinsurers; new state insurance programs in Florida (the Florida Catastrophe Fund), California (the California Earthquake Authority) and Hawaii; an insurance swap market (CATEX) to allow for better geographic diversification of disaster risk, and various excess-of-loss reinsurance programs around the world to better diversify claims.

Within the context of these various loss containment strategies, capital market instruments play an interesting role. On the one hand, some experts see them as forever changing the industry’s approach to risk management. On the other hand, they are also considered a complement to, rather than a substitute for, more traditional defenses.

The reinsurance industry, notes Anthony M. Santomero, Richard King Mellon Professor of Finance and director of the Financial Institutions Center, “is defined by long-entrenched customer relationships. Most capital market instruments like cat bonds are just the opposite. They are simple, specific, single-period assets ... It’s clear that reinsurers see cat bonds both as competitors but also as complements — i.e. a potential way for them to expand their own capacity to take on risk.”

If reinsurers knew, for example, that they were covered for a huge catastrophe — either because they can lay off some of the risk they have assumed or can arrange for their customers to be able to access the capital markets directly — “they would be freed up to write more conventional reinsurance,” Santomero says.

In any case, most experts agree, it’s too soon to say exactly how these financial instruments will evolve. It was only five years ago that the Chicago Board of Trade (CBOT) first introduced catastrophe (cat) options as a way to tap into the capacity of the capital markets. Investors “trade on an industry-compiled index of cat losses that is based on events such as hurricanes, earthquakes, windstorms, ice storms, anything that could cause major losses,” says Cummins. “If no disaster occurs, the investor makes money. But if the index goes above a certain level agreed on in the contract, it triggers the option.”

The market for this instrument, however, has tended to grow slowly, for several reasons. “The liabilities on the options could be high if a huge hurricane occurred,” notes Doherty. “Also, investors are used to looking at such criteria as a company’s balance sheet or anticipated changes in interest rates. They are not experts on storm occurrences.” Finally, insurance companies themselves haven’t always seen cat options as a good bet. “After all, it’s not the insurance company’s own loss that determines whether it gets paid, it’s the whole industry’s losses,” says Doherty. “If one particular company got hit harder than others, the payback might not be sufficient to cover its claims.”

The next major innovation — and one that seems to be enjoying a recent surge in popularity — was cat bonds. Six issues worth a total of \$1.1 billion have been offered since 1994. The latest was a \$100 million bond issue in November from Tokio Marine & Fire, the biggest a \$477 million issue from USAA in June 1997.

The idea is that investors buy bonds from an insurance company (or more accurately, from a reinsurance company set up offshore specifically for this transaction). If no major catastrophe occurs during an agreed-upon time period, investors get their money back with interest high

enough to reflect the riskiness of the investment. If a catastrophe of a certain size does occur, the insurance company can use the investors’ money to pay out claims. In that situation, and depending on how the issue is structured, investors lose all or part of their principle and/or interest.

“We expect a substantial growth in the next couple of years in the cat bond area,” says Robert H. Litzenberger, WC’66, managing director, Goldman Sachs, and co-leader along with Merrill Lynch and Lehman Brothers on the \$477 million USAA bond issued in June 1997, “mainly because there is very limited capacity for supercat events in the reinsurance industry.

“USAA’s exposure to hurricanes is generally on the East coast, particularly in southeast Florida,” says Litzenberger. “The company views the cat bond issue as a way of purchasing more reinsurance protection than it normally would. It is a complement to their insurance package, not an alternative.”

The one-year \$477 million USAA bond issue has two layers of debt, a principle protected part and an unprotected part. If a certain category of hurricane hits the East Coast and causes at least \$1 billion of damages (the figure can vary depending on how the bond is structured), the protected class is guaranteed its principle back but loses its interest for up to 10 years. The unprotected class starts to lose principle at a \$1 billion loss to USAA and loses its entire principle for losses in excess of \$1.5 billion.

The USAA bond, which ran out in June during a year of no major hurricanes, paid a return of about 11 percent to its investors.

The issue was “several times oversubscribed,” says Litzenberger. “The original intent was to have a \$100 million issue. Based on initial investor response, USAA increased the amount of risk coverage to \$400 million and demand for it was about \$1 billion ... Relative to high yield debt issues that have similar levels of principle risk, such as BB rated debt, it had a high coupon.” (The \$477 million issue included \$400 million of risk protection; the remainder was principle protected).

“There is an interesting story connected with the issue,” notes Litzenberger. “The reason there are more intense

SIX CAT BOND ISSUES

WORTH A TOTAL

OF \$1.1 BILLION

HAVE BEEN ISSUED

SINCE 1994.

THE BIGGEST WAS A

\$477 MILLION ISSUE

FROM USAA

IN JUNE 1997

hurricanes in southern Florida than in New England is because the water temperature is higher. This was an El Nino year, which produced higher ocean temperatures, but El Nino also tends to produce shearing winds that break up tropical waves before they can form into hurricanes. This had happened during the previous El Nino in 1982. Some investors knew that, increased their holdings and decided to bid up the price of these bonds because they figured the hurricane risk would be less than usual. Also, after the hurricane season ended last fall, many people sold out and took their profits.”

Goldman was co-leader with Swiss Re on the smaller, \$100 million Tokio Marine & Fire issue, also oversubscribed. This bond was not indexed to the actual losses from a catastrophic event, as the USAA bond was, but to the location and intensity of an earthquake in a precisely defined area around Tokyo.

Peter Bouyoucos, WG'85, head of Morgan Stanley's insurance capital markets group, is another proponent of cat bonds. His group's overall focus has been to develop broad-based capital market risk transfer alternatives to the reinsurance of property, life and credit exposures.

Two years ago, Morgan Stanley was senior underwriter for what would have been a path-breaking \$1.5 billion cat bond issue — larger than all the other issues combined —

“THE RISKS WE ARE TRYING TO PACKAGE ARE NEW AND DIFFERENT. EVERYONE HAS NEEDED TIME TO GET UP THE LEARNING CURVE.”

the visits he has made to hundreds of investors in the U.S., Europe and Asia. “The risks we are trying to package are new and different. It means that everyone has needed time to get up the learning curve ...

“The difficult part about these deals is getting across the finish line,” Bouyoucos adds, “because at the moment there isn't an absolutely compelling need for insurance companies to issue bonds given the affordability of more traditional means of reinsurance.

“Three years ago, in the aftermath of Hurricane Andrew and the Northridge earthquake, the availability of reinsurance was tight and prices were high. But since then, there have been very few catastrophes of any real magnitude. Consequently prices have come down about 15 percent per year over the last three years. As the prices come down, the

for the California Earthquake Authority. Investor Warren Buffet's National Indemnity Co. showed up at the last minute and insured the risk instead.

Since then, Bouyoucos and his group have made progress on a number of other deals to take advantage of what he predicts will be an upturn in the market. “The pipeline of projects we have, and I am sure our competitors have, is significantly greater than the number of deals you have seen,” Bouyoucos says, noting the time he has spent with ratings agencies and risk modeling firms, and

In January 1997, the Wharton Financial Institutions Center and the Risk Management and Decision Processes Center initiated a multi-year research project on “Managing Catastrophic Risks.”

Their timing couldn't have been better. “Up until now, people have looked only at bits and pieces of this whole issue,” says Peter Burns. “Our program is unique in that it takes a holistic view of the subject. We use models to help measure risk, look at the impact of public policy on mitigation and insurance regulations, study the role of reinsurance and analyze how you create and finance capital market instruments,

which comes back full circle to the use of models to structure and price investment vehicles.”

The success of the cross-disciplinary program, which includes faculty from Wharton's finance department, insurance and risk management department and operations and information management department as well as doctoral students, draws upon critical input from the government and industry.

The “Managing Catastrophic Risks” project has eight financial sponsors: American Reinsurance Co., CIGNA Property and Casualty, E.W. Blanche Co. Reinsurance Intermediaries, General Reinsurance, Morgan Stanley & Co.,

Sedgewick RE Reinsurance, State Farm Fire and Casualty Co., and USAA Property and Casualty.

Research Associates include Applied Insurance Research, Inc., Ernst & Young, LLP, EQECAT, Inc., Institute for Business and Home Safety, Insurance Service Office, Inc., Reinsurance Association of America and Risk Management Solutions, Inc.

Last December, the program was featured as part of a Public Private Partnership Forum (PPP2000) on natural hazard management held in Washington and sponsored by 19 federal agencies and a variety of private organizations.

amount of available capacity has increased. So from a competitive perspective, trying to develop a new marketplace has been a little more difficult...

"For now at least, reinsurers and the capital markets can reasonably coexist," Bouyoucos adds. "The ability of reinsurers to provide protection for their longstanding relationships with insurers can be increased through capital market instruments as needed. In fact, reinsurers, through their ability to aggregate and transform risk, may be the ultimate source of capital market securitizations.

"At the end of the day I expect that companies who want to optimize their risk management program will be looking at all different types of alternatives. The right answer will be a combination of the capital markets, traditional reinsurance and risk financing."



If cat bonds are considered high-risk, why are investors so interested? "Because it's what financial people call zero beta asset," says Cummins. "The bond is uncorrelated with the market, so it is a great instrument for diversification. Taken in a small enough proportion it actually improves your risk return profile."

Yet cat bonds, as innovative as they seem, aren't for everyone, including some insurers. First, because cat bonds are so new, there are no standards or ratings for evaluating the quality of a particular instrument. "Once these bonds are rated as other financial instruments are, they are likely to be more popular with investors," notes Kunreuther.

Second, "some insurers say they value their relationships with their reinsurers, and they are reluctant to give them up," says Cummins. "That may be true, but in addi-

tion to the fact that there isn't enough capital to cover catastrophes, the reinsurance market is cyclical. It goes through periods of high prices; high prices are most likely to occur after a Hurricane Andrew type of event, which is when an insurer needs lower prices the most."

Then there is always the chance that a particular investor or class of investors might buy in shortly before a huge earthquake hits San Francisco. It's one reason these bonds are billed as only appropriate for sophisticated investors. "Anybody would be foolish to put half their wealth in a single cat bond," notes Litzenberger. "But when you talk about two to three percent of your portfolio, that's a relatively small and controlled exposure."

In a recent study of catastrophe hedging instruments, Doherty looks at the more familiar reinsurance strategies as well as some of the newer instruments like cat options, cat bonds and CatEPuts.

Each of these approaches, Doherty says, offers a different combination of credit risk, basis risk (the potential mismatch between the payout on the contract and the hedging insurer's actual losses) and moral hazard (the natural incentive of the insurer to exercise less control over underwriting and loss settlement because of reinsurance protection).

"It is incumbent on the primary insurers to determine exactly what tradeoffs they want to accept," Doherty says.

While Doherty himself believes that no particular instrument will dominate the market, the choices at the very least "offer insurers a richer portfolio of risk management strategies ... Just like with derivatives, the evolution of the market will bring a broader, not narrower, array of instruments to bear."

Meanwhile, some observers are also predicting an eventual "unbundling of insurance products, with insurers

Wharton faculty involved in the project include Howard Kunreuther, Celia Yen Koo Professor of Decision Sciences and Public Policy and Management; and Paul Kleindorfer, Universal Professor of Decision Sciences, Economics, and Public Policy and Management. Both men are co-directors of the Risk Management and Decision Processes Center.

Other faculty include J. David Cummins, Harry J. Loman Professor of Insurance and Risk Management, and executive director of the S.S. Huebner Foundation; Neil A. Doherty, Ronald Rosenfeld Professor of Insurance and Risk Management, and Anthony San-

tomero, Richard King Mellon Professor of Finance and director of the Financial Institutions Center.

Their research agenda focuses on five areas:

- Measuring catastrophe risk and using computer simulation models to enhance understanding of a company's or individual's exposure to natural disaster risk
- Identifying the best ways to encourage pre-disaster mitigation as a way of reducing risk and losses
- Studying how federal and state governments can improve society's ability to reduce and finance disaster losses
- Estimating the capacity of the insur-

ance and reinsurance industry to sustain cat losses and the degree of default resulting from a natural disaster

- Analyzing how capital markets can assist in financing disaster risk; designing and pricing new catastrophic risk securities.

Much of the work with computer modeling is being done by Kunreuther and Kleindorfer. With the help of three natural hazard modeling firms — Applied Insurance Research, EQECAT and Risk Management Solutions — the two professors are examining the impact that mitigation measures would have on three cities — Oakland and Long Beach, Ca., both earthquake

retaining marketing, underwriting and settlement services, while risk-bearing bypasses the reinsurance industry and is being provided more directly from the capital markets,” Doherty notes. “I have some mixed feelings about this. It makes sense in some cases and not others. Once you start separating out parts of the contract, for example, you start changing incentives, which can be disastrous. It’s an area to look at with caution.”

Up until recently, insurers, reinsurers, financial institutions, government agencies and disaster-prone communities had to rely on historical data to estimate the likelihood of an earthquake or hurricane and also the level of damages.

That is no longer the case. Today, a number of firms offer sophisticated catastrophe models that, when measured against actual events, have proven to be remarkably accurate.

A catastrophe model uses data bases and computer programs to analyze the impact of different scenarios on hazard-prone areas. The information can be presented in the form of expected annual losses based on simulations over a long period of time or in the form of damages caused by a specific event (a worst-case disaster scenario.)

The impact of modeling on capital market instruments is already evident. For example, prices for cat bonds are now based in part on very detailed simulations of the effects of hurricanes and earthquakes in catastrophe-prone states such as Florida and California. “Using historical data, engineering studies, and so forth, these companies can simulate

tens of thousands of events to eventually come up with estimates of how much damage would be done and what it would cost,” says Cummins, who along with Doherty is using simulations created by Boston-based Applied Insurance Research, Inc. for a study of basis risk.

“Until recently, insurers and reinsurers had a comparative advantage in information on catastrophic events,” Doherty adds. “But now a number of modeling firms have developed models that combine seismic and meteorological information with data on the construction, siting and value of individual buildings.

“More importantly, these models are now available to other companies and investors, which means the comparative information advantage of insurers and reinsurers is being eroded and the door is being opened to new players.” Adds Cummins, “we feel that the more information out there about the effectiveness of derivatives, the better for everyone.”

A key component of the research agenda is work being done by Kunreuther and colleague Paul Kleindorfer, Universal Professor of Decision Sciences, Economics, and Public Policy and Management, on risk mitigation measures (RMMs) — actions that reduce or eliminate the losses to individuals and their property from natural hazards. They can include everything from installing hurricane shutters and roof bracing to strapping down a water heater and bolting a structure’s side walls to the foundation.

Mitigation, Kunreuther notes, affects both the reinsurance market and capital market instruments. For example, insurers who successfully encourage homeowners to adopt mitigation measures should benefit from lower reinsurance costs because of the anticipated reduction in losses

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prone, and Miami/Dade County, hurricane prone.

The main question being asked is, “What effect would adoption of mitigation measures by property owners have on their own welfare as well as the solvency of insurers?”

“We constructed a series of residential homes in three model cities and then set up small, medium and large insurance companies,” says Kunreuther, noting that commercial and other structures may soon be modeled along with the residential ones. The researchers asked what would happen to an insurer’s business — and its target level of insolvency — if it turns out that a certain percentage of the homes adopted a

variety of cost-effective mitigation measures, e.g. bolting house foundations in an earthquake area or reinforcing roofs in a hurricane area.

Once those mitigation measures are modeled in, “we take a look and see how this changes the insurer’s business. For example, the insurer may now be able to write more policies for that insolvency level, which in turn would affect the company’s profitability. We ask a variety of questions related to the insurer’s portfolio.”

These models are “tools to help indicate how well mitigation is likely to work,” says Kunreuther. “We have shown that when mitigation is widely adopted, it will substantially reduce loss-

es, increase insurers’ ability to write coverage, lower the premiums charged and reduce the chances that insurers will become insolvent from a catastrophic disaster. We are also looking at the impact that state insurance regulation of prices will have on the availability of coverage in hazard prone areas ...

“Broadly speaking, we are analyzing the role of public-private partnerships in dealing more effectively with low probability-high consequence events than we have in the past,” Kunreuther adds. “We are asking questions such as: What role can the private market play? Where is there a need for public sector involvement? Our hope is that this research will provide us with insights and answers.” ▼

RESUSCITATION NEEDED

**VERTICAL INTEGRATION, MANAGED CARE
AND PHYSICIAN PRACTICE MANAGEMENT
COMPANIES ARE THE WRONG REMEDIES
FOR OUR AILING HEALTH CARE SYSTEM,
SAYS PROFESSOR LAWTON R. BURNS**



Wall Street, medicine and academia crossed paths recently in a meeting between a certified financial accountant at Salomon Brothers and Lawton R. Burns, associate professor of health care systems at Wharton.

The subject was physician practice management companies (PPMCs) — Wall Street-financed firms that buy, organize, and consolidate physician practices ostensibly to gain economies of scale, provide administrative support and capital for growth, and improve physicians' bargaining position with health care buyers.

Salomon Brothers underwrites the securities for many of these PPMCs. Burns, for his part, recently published two industry analyses suggesting that PPMCs are a bad deal for both physicians and investors.

It's not often that research by health care scholars is turned into an interview published by an investment bank for its clients (*Salomon Brothers PPM Perspective Series — Wharton Professor Interview*). But then Burns, who is also the director of research at Penn's Leonard Davis Institute, has always taken both an academic and a practical approach to health care. After earning his PhD from the University of Chicago in 1981 — writing his dissertation on hospital management — he taught in the hospital administration program at Chicago's business school. During this same time period he received a fellowship from the Kaiser Foundation to go through the MBA program.

He then worked for the Hospital Corporation of America (HCA) as assistant to the administrator at one of their flagship hospitals in Texas. “It was an opportunity to see first-hand how for-profit hospital systems really worked,” he says. A year later he landed a similar position with the head of Jackson Park Hospital, an inner city non-profit hospital on Chicago’s South Side.

In 1985 Burns returned to academia in the College of Business at the University of Arizona before coming to Wharton in 1994.

In Burns’ view, many of the changes taking place in health care these days — including the advent of managed care organizations and the rise of integrated delivery systems — suggest a marketplace whose most recent surgical procedures have been botched. “Treating physicians and hospitals like commodities to be bought and sold is totally antithetical to the tradition of health care delivery in this country,” says Burns.

The physician practice management industry is one example. The PPMC is typically capitalized by private venture firms or Wall Street through initial IPOs or secondary offerings. Investors are attracted by the lure of rapid revenue growth and high earnings while physicians, faced with escalating overhead and the ever increasing complexity of billings/collections procedures, are drawn by the promise of investment capital, managerial expertise and administrative relief.

Under the usual PPMC arrangement, physicians sell the tangible assets of their practices to the physician practice management companies — often in exchange for stock — and sign long-term contracts in which they agree to work as salaried employees. But as Burns points out, stock prices are volatile. Two of the biggest names in the PPM industry — MedPartners and Physicians Resource Group — have seen their stock prices plummet by as much as 60 percent and 80 percent, respectively, in the last year. Several months ago, one of the first PPM firms, Florida-based Coastal, was bought out by its original founder at \$1 a share, down from a high of \$40.

“Meanwhile doctors have sold the tangible and intangible assets of their practices, most of which have taken years to build up,” says Burns. “All that value is washed away. Now they are salaried physicians with no equity.”

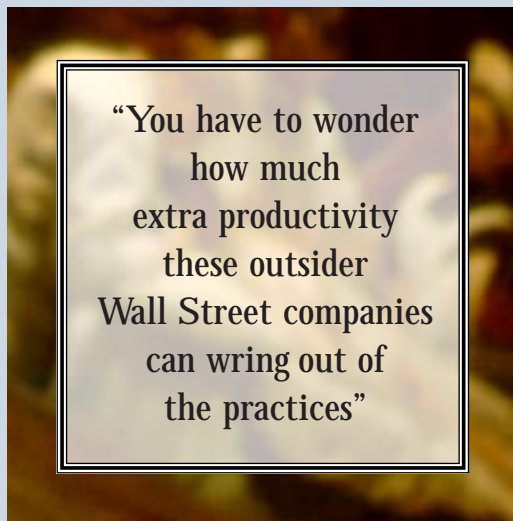
At its worst, the PPM industry, which Burns estimates at anywhere from 100 to 150 firms, “could be a huge pyra-

mid scheme where the name of the game is to buy up practices, and buy up other companies that are buying up the practices. To Wall Street investors it looks like earnings are going through the roof.

“At some point, however, in order to keep up those earnings, the PPMCs are going to have to roll up their sleeves and do the hard work of making the physicians’ practices more productive than they were. Yet my experience has been that physicians are already good at watching the bottom line. They are not wasteful people. So you have to wonder how much extra productivity these outsider Wall Street companies can wring out of the practices. At the most, all they can do is pool purchasing orders and reduce overhead by maybe five percent. This is not a sustainable strategy long-term.”

So what’s the appeal here? “There are more than 700,000 physicians in the U.S.,” says Burns, “and only a fraction of them have been acquired. Investors believe there is still a huge upside potential from buying and consolidating these practices.”

Burns clearly doesn’t. “Whenever I hear the words economies of scale in health care, I wince,” he says, “because the evidence for it is very weak. Health care is a labor intensive industry; the bigger the organization the more labor. You aren’t necessarily gaining efficiencies by increasing the scale. It’s a point that almost no one in the industry appreciates.”



In addition to PPMCs, Burns is well-known for his expertise in integrated health care delivery systems. This spring, he and several colleagues completed a two-year study of six integrated delivery systems in the state of Illinois, looking specifically at the managerial process issues that arise when physicians and hospitals suddenly join forces. “What you are doing,” says Burns, “is taking professionals (the doctors) and making them work in bureaucracies. The two groups mix like oil and water ...

“Often the emphasis is placed on putting together the merger rather than on managing the post-merger process,” Burns adds.

In their research Burns and his colleagues have found a series of nine polarities — seemingly opposite or contrary issues that need to be managed after a merger. “For exam-

ple, by acquiring physician practices and putting physicians on salary, these systems basically allow the physicians to avoid all risk and uncertainty; yet at the same time, the system wants to accept managed care contracts and get everyone to work in a risk-based environment,” says Burns. Another example: “The systems want to act as a unified corporate entity yet their constituent hospitals don’t necessarily want to cooperate with one another, share risk with one another, or subsidize the operations of one another.”

In another recent research study, Burns and several colleagues looked further at the conditions that have given rise to integrated delivery systems. Along the way, they corrected a basic consulting firm model, established in 1993, that identified four stages of development in the health care market.”

According to that model, the typical health care market in stage one has very little managed care and all the providers are fragmented. In stage two, managed care arrives in the community and hospitals begin to consolidate; in stage three, managed care picks up steam, hospitals continue to consolidate, and physicians start forming large networks and begin to align with hospitals. In stage four, fully integrated health care organizations exist in which huge HMOs now deal with equally huge physician/hospital integrated systems.

“What we found is that the level of managed care penetration is not really closely tied with horizontal consolidation or vertical integration among providers,” says Burns. “Providers are integrating not because managed care is here but partly because they think it will come and they want to be prepared for it. Some providers are integrating because their competitors are and they don’t want to be left as the only free-standing institution in town. All this common sense wisdom about integration — how easy it is to do, how great the benefits are, what causes it — just isn’t true.”

The federal government has allowed many hospital mergers to go forward “on the theory that the welfare losses that result from developing a local monopoly are outweighed by the efficiency gains and the lower costs of health care,” Burns notes. “I would dispute that. No one has been able to link all these mergers and acquisitions and integration strategies with patient outcome ...

“People say we will get economies of scale and make things more efficient which of course will lead to higher quality of care. But actually there is no evidence of this.

“The most benign thing I can say about these strategic initiatives is that they will have no effect on how patients are treated. As one of my colleagues once said at a conference, ‘When was the last time a patient said they wanted integrated care?’”

As skeptical as Burns is about integrated delivery systems, he is perhaps more critical of the managed care juggernaut that has swept through health care in the last five to ten years. Burns, not surprisingly, isn’t swayed by the claims of managed care companies about higher quality and lower costs. “The evidence today on managed care shows that the technical/clinical quality of care is no better and may, in fact, be a little bit worse in managed care for patients with chronic conditions. The one consistent difference is the consumer’s satisfaction with acceptable care in an HMO. Most people think they have a harder time getting in to see the doctor on a timely basis.”

He agrees that costs, at least initially, are lower for members of HMOs, for several reasons. “First, there is mixed evidence that HMOs favorably select risks in the population and try to enroll mainly healthy people. I believe that to be partly true. Second, by merging with other HMOs and increasing market share, these organizations can dictate to doctors and hospitals the prices they are going to get for providing health care services.”

Third, over the past three years, HMOs have lowered their premiums to gain additional market share. However, in the process, they have sustained losses “which they now have to recoup. They are doing that by raising their premiums. Fourth, savings occur as employers move their employees from indemnity (fee-for-service) plans into managed care. However, these savings can be realized only once.”

So overall the ability of managed care to control health care costs is limited because many of those cost savings have already been achieved over the last three years. Furthermore, Burns adds, the costs of health care are predicted to rise anywhere from six to eight percent over the next six years.

“My feeling is that HMOs are really a bounty hunter for the employers, essentially taking money out of the hides of doctors and hospitals, passing some of it onto the employers in terms of controlling the costs of premiums, but also using that money as a huge income transfer to the HMOs themselves, building up their own war chests for mergers and acquisitions, erecting new facilities, increasing executive salaries and compensation and so forth ...

“Neither managed care nor integrated health care, at least in the short and middle term, is going to solve the problem of rising health care costs or improve the quality of health care.”

So what will? “I don’t have the answer to that, but I think a better place to look is along the supply chain involving pharmaceuticals, hospital and medical supplies, equipment manufacturers and the like,” Burns says. “You might be able to develop some collaborative partnerships between the suppliers and the users of health care products,

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1998

Reunions



A record-tying 12 days of rain in Philadelphia ended shortly before Reunion Weekend, letting the sun shine in on three days of glorious weather for more than 800 returning alumni and guests.

The May 15-17 weekend included three Executive Education sessions — “How to Improve Your Leverage in Negotiations,” “Leaders Under Fire” and “Perspectives on the Market” — along with welcoming remarks from Penn President Judith Rodin and a report on the School’s strategic goals from Wharton Dean Thomas P. Gerrity.

Alumni had an opportunity to learn more about the career services available on campus and the new technologies already in place to help them stay in touch with each other and with the school.

Throughout it all, graduates socialized, reminisced and networked in a variety of venues, beginning Friday night with a cocktail reception and continuing Saturday with continental breakfast, a picnic lunch on the Quad and festive evening dinners. The Classes of 1963, ‘68, ‘73, ‘78, ‘83 and ‘88 gathered at the College of Physicians while the Class of ‘93 met at the Horticulture Center in Fairmount Park. Farewell brunches on Sunday concluded the planned events.

On the following pages we highlight some of the activities of Reunion Weekend and profile six Reunion year graduates.

Henning
Schulte-Noelle

WG
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Global Expansion in the Insurance Industry

In 1996, Henning Schulte-Noelle, chairman of Munich-based Allianz AG, was named “Manager of

the Year” by *Manager Magazin*, Germany’s leading business publication.

The award is based on strategic achievement, customer orientation, shareholder value and management style, among other criteria.

In the two years since the award was announced, Schulte-Noelle and the company he joined in 1975 have shown no signs of resting on their laurels. In February, for example, they purchased 51 percent of Assurances Generales de France (AGF) for \$5 billion, an acquisition that

positions Allianz — with around \$60 billion in premium volume — as the largest insurer worldwide, at least for the moment, and ranks the company among the top five players in key insurance markets throughout eastern and western Europe.

By any measurement, Allianz, with close to 100,000 employees, is an impressive powerhouse. Founded in 1890 to insure international commerce, the company today is a global alliance of more than 200 subsidiaries (in approximately 60 countries), joint ventures and affiliates that offer a range of insurance products and services, including life, health, property/casualty and asset management. In the industrial insurance business, Allianz has a share of more than 20 percent of the global Fortune 500 companies and leads in the business of major infrastructure projects, including the Eurochunnel, Hong Kong Airport and Petronas Towers Kuala Lumpur.

During the past six months, Allianz has opened two new companies, Allianz Asset Management — offering pension fund management and personal financial services — and Allianz Risk Transfer — offering new alternative risk transfer solutions.

Schulte-Noelle is widely credited with consolidating the

Friday:

A reception
and dinner at
Hoover Lounge
and terrace



PHOTOGRAPHS / JERRY MILLEVOI

company's position within Germany while also pursuing aggressive expansion on the continent and overseas. "Before our acquisition of AGF, we were among the top five players in Germany, Austria, Switzerland, Italy, the Czech Republic, the Slovak Republic and Hungary," notes Schulte-Noelle. "Now we will achieve this ranking also in France, Ireland, Spain and Belgium. It positions us as a true global company with a strong European home base."

Allianz also has significant operations in the Asia-Pacific area (Singapore, Hong Kong, Japan, Indonesia, the Philippines, Australia, Thailand and China, among other countries) and Latin America (Mexico, Chile, Venezuela, Argentina and Brazil).

"With AGF we can get access to the South Korean and Malaysian insurance markets, both very difficult to penetrate, and Laos," Schulte-Noelle says. "We can also strongly improve our presence in Brazil." Despite the recent Asian financial crisis, he still sees "tremendous growth potential in this region, especially in the life insurance sector."

Allianz also wants to develop its large activities in the U.S. where total premium volume already amounts to about \$7.8 billion. More than 9,400 employees are on the payroll of companies like Fireman's Fund, Allianz Life and others.

"In the past six years, we have continuously pursued a double-track strategy: expansion *and* consolidation," Schulte-Noelle adds. "The advantage of having a strongly decentralized corporate structure is that the head office can concentrate on group strategy and portfolio policy while operative activities are carried out in the local markets."

Allianz sees itself as a winner in the European Union. "We are already active in all the relevant markets in Europe where we not only have access but generally play a leading role through well-rooted local operations. The individual European markets still differ one from the other as far as legal and fiscal systems are concerned."

The coming of a unified currency, moreover, is clearly advantageous for Allianz. "We will definitely benefit from the Euro," Schulte-Noelle states. "Insurance companies are submitted to the so-called 'congruency principle' which means they should invest their assets in the same currencies that they have liabilities in. This will dramatically change with the Euro. Our freedom to invest in France, Italy, the Netherlands or any other country of 'Euroland' will be much greater. We can therefore clearly improve the mix of our investments, exploiting the larger European capital markets by further diversifying by industry and country."

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Susan
Levosky

W'
88



Movies, 24 Hours a Day

Susan Levovsky traces her love of independent films to

Philadelphia's Ritz movie house which she visited weekly while an undergraduate at Wharton.

Today she is director of business planning and development at Sundance Channel, a 24-hour premium television service that showcases about 250 films each year, including features, documentaries, foreign films, short films and animation. Sundance Channel, located in midtown Manhattan, is a joint venture of Showtime Networks, Inc. (owned by Viacom), Polygram Filmed Entertainment and Robert Redford's Sundance Group.

"The movies are run uncut, uncensored and without commercials," notes Levovsky. "The idea is to broaden distribution for independent film makers and to support the diversity of ideas that they bring to the genre. The emphasis here is on first-run titles," including the world premiere of Todd Solondz' *Welcome to the Dollhouse*, which won the Sundance Film Festival's grand jury prize in 1996. A programming department in the company's 40-person operations decides which films to run.

Sundance Channel, which reaches about 12 million U.S. households via cable, wireless cable and direct-to-home satellite, also shows such high-profile independent titles as *Fargo*, *The Usual Suspects*, and *Get Shorty*.

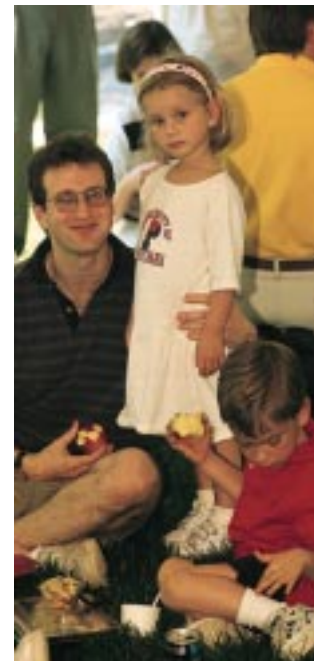
After attending Wharton, Levovsky worked at Arthur Andersen for two years, consulted for a television and film studio in Los Angeles and then earned her MBA from MIT's Sloan School. From 1993 to 1995 she was a manager in global corporate strategy with MasterCard International.

In 1995, she joined Showtime's business development group as a consultant hired to write the business plan for Sundance Channel. After the launch on Feb. 29, 1996, she was named director of business development.


Levosky is responsible for developing new ancillary businesses for the channel, and executive produces the channel's web site, a monthly web magazine that offers the latest news in independent films. She also does webcasting, which includes running daily updates of film festivals using "live"

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Saturday:
Picnic on
the Quad



WG' 68 Alfred R. Berkeley III



Bullish on Nasdaq

Being president of the Nasdaq Stock Market, says Alfred Berkeley, "is like ice hockey. It's as tough a sport as there is, it's fast, it's competitive, teamwork is required, and occasionally you get checked hard into the boards. When that happens, it's important to straighten up and start skating again."

The sports metaphor is particularly apt for someone who likes competition as much as Berkeley. Before his appointment as president of Nasdaq in 1996, he was a managing director and senior banker at Alex. Brown & Sons, Inc. where he specialized in technology and communications companies. "The culture there was extremely competitive in the best sense of the word," says Berkeley. "I loved it."

The challenges at the helm of Nasdaq may be different but they are no less rigorous, especially in light of the proposed American Stock Exchange/Nasdaq merger. That deal — approved by Amex members in June and awaiting government approval this fall — is expected to increase the already intense competition between Nasdaq and the New York Stock Exchange.

Berkeley, however, doesn't quite see it that way. "We are a totally different animal" he says. "We are closer to the newer, completely electronic markets — the foreign exchange markets, the bond markets and the oil markets — than to the NYSE. Computerized markets are the model of the future, not an old-fashioned physical place.

"The NYSE and Nasdaq both happen to trade equities but Nasdaq is set up to bring in competition at every level. We believe passionately that encouraging competition improves the market for investors. A new competitor has to innovate in order to gain order flow. This creates liquidity that is unparalleled.

"And it has paid off," says Berkeley. "One out of six new jobs comes from Nasdaq companies. That is what this game is ultimately all about. We contribute disproportionately to the economic well-being of the country."

Berkeley describes Nasdaq as "the Ellis Island of markets ... It started with companies that nobody wanted to deal with and dealers that the traditional

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Jennifer
Daniels

WG'
83



A Doctor Who Treats the Community

Jennifer Daniels is in the news once again. She is opposing a \$30 million Avenue of the Arts project in downtown Syracuse, N.Y., that would tie the renovation of two city elementary schools to creation of a downtown arts education center.

The local paper headlines the story, "Avenue of Arts Not Right Rx, Dr. Daniels Says."

Those six words sum it up. Daniels is a physician, a local activist, and she has very strong opinions about what is wrong and what is right.

What she considers wrong is a \$30 million project "that uses public money to totally redo private property," says Daniels. "The city has an \$18 million deficit and the schools have a \$15 million deficit, so the money would have to be borrowed anyway. That will mean higher taxes, fewer services and a much tougher time for people who live in Syracuse."

What's right for Daniels was her decision seven years ago to open a family medical practice in the low-income section of town where she spent much of her childhood. Immediately upon her arrival there, she led a campaign to clean up the neighborhood — repair the sidewalks, repave the streets and replace drug fronts with single family homes. Six years ago she established a \$1,000 scholarship that is awarded every year to a local high school senior.

Daniels earned a biology degree at Harvard and a joint MD-MBA degree from the Penn medical school and Wharton. She spent three years as a physician in small towns in Wisconsin and North Dakota to pay off a national health service corps obligation, then returned to Syracuse and completed a two-year family practice residency at St. Joseph's Hospital Health Center. Shortly after, she bought a vacant city block and set up her own practice.

"I treat the dispossessed and underserved ... the patient population that other doctors don't want to see," says Daniels, who is the only African-American physician in solo practice in Syracuse. She hasn't forgotten the difficulties that people in her neighborhood had finding doctors who would care for them. "Money wasn't the issue," she says. "It was that doctors were disrespectful. They didn't want blacks in their practice."

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Penn president Judith Rodin and Wharton dean Thomas P. Gerrity (top right) welcome alumni, many of whom attended Executive Education sessions led by Professors Michael Useem (bottom right) on leadership, Richard Shell (bottom left) on negotiation strategy and Jeremy Siegel (top left) on market perspectives.



The Wharton Annual Fund's Reunion class gift volunteers and Benjamin Franklin Society donors were honored during a cocktail reception (below). On the following two pages are photos from the Saturday night dinners.





Banking on Four Continents

Rodney Alan McLauchlan knows more than most what it means to work in a global economy.

He is chairman of Bankers Trust Global Banking Group, head of client management and chair of the firm's European and Asian Advisory Boards, among other responsibilities. He has lived on four continents and speaks five languages.

And, although based in New York since 1995, he recently was assigned oversight of the bank's Asian operations, primarily the restructuring and refinancing process necessitated by the region's current financial crisis. The assignment means spending approximately two weeks out of every four in Asia for the next six to eight months.

Previous assignments have included two years (1994-95) in Singapore and Tokyo, where he co-headed Bankers Trust's Asian operations, five years in London (1989 to 1994) where he was responsible for operations in Europe and the Middle East, and two years in Chicago (1987 to 1989) as head of Bankers Trust's Midwest office.

A native of Brazil and graduate of the Federal University of Rio de Janeiro, McLauchlan is a Trustee of the Royal Opera House at Covent Garden, a National Board Member of the Lyric Opera House in Chicago, and a director of the Brazilian American Chamber of Commerce. He commutes on weekends from Manhattan to his home in Florida.

"I work for a very international organization that has a strong presence in non-U.S. markets and that clearly values people with international backgrounds," he says. For managers who have a "marketing, client relationship role, as I have, it's especially important to function well in diverse cultures."

The most valuable aspect of the experience, McLauchlan says, "has been that it teaches tolerance — the ability to work and interact with people from so many different countries, not just on a professional level but a personal one as well." His international assignments, he adds, "dovetail nicely with my love of language, music and history."

At Bankers Trust, McLauchlan is also an executive vice president of Bankers Trust New York

Continued on page 28



Sebastian

Escarrer

WG'
93



Opening More Doors in the Hotel Business

It's been an extremely busy 18 months for Sebastian

Escarrer, CEO of Majorca-based Sol Melia.

In March 1997, Sol Melia, one of Europe's fastest-growing hotel empires, raised \$275 million through a public offering on the Madrid Stock Exchange. Last spring, in a second IPO, the company raised an additional \$200 million by spinning off its Melia Inversiones Americanas (MIA) unit. MIA will focus specifically on buying, building and developing hotel properties in Latin America.

That in turn frees up Sol Melia's real estate unit, Inmotel Inversiones, run by Sebastian's brother, Gabriel Escarrer Jr., W'94, to concentrate on the European hotel sector, including possible acquisitions in Rome, Paris, Milan, Prague and Budapest.

"Our goal is to become a European and Latin American company as opposed to our main competitors who are U.S.-based," says Escarrer. Latin America, he adds, "is the region where tourism demand is expected to show the most growth. Only about 5.5 percent of the hotel rooms worldwide are located there. The opportunities are tremendous."

Sol Melia's Latin American network already extends into Brazil, Colombia, Costa Rica, Cuba, the Dominican Republic, Mexico, Guatemala, Peru, Argentina, Uruguay and Venezuela. Potential new markets include El Salvador, Chile, Puerto Rico, Jamaica and Panama.

Altogether Sol Melia has 240 hotels in 25 different countries, mainly Europe and Latin America, but 12 also in Asia. "Right now there is no clear hotel leader in Europe, which for us includes Israel, Tunisia, Cyprus, Greece, Croatia, Egypt, Portugal, Turkey and Morocco," says Escarrer. Even Asia, despite its current crisis, offers opportunity "eight to 12 months down the road."

Running Sol Melia is part of Escarrer's heritage. His father, Gabriel Escarrer, founded the company on the island of Majorca in the 1950s, grew it into one of Europe's largest hotel empires over the next 40 years, and only recently turned the reins over to Sebastian. "My father is still chairman of the company and still very much involved," says the younger Escarrer, who was educated in Madrid and Paris

Continued on page 28



MAKING MEGA MERGERS WORK

Big Acquisitions Are Transforming Banking and Other Industries. Will These Deals Work? The Answer May Lie in Managers' Heads — and Policy Manuals

Two years ago San Francisco's Wells Fargo, one of the country's best-known banks, succeeded in its hostile takeover of First Interstate Bank in Los Angeles. That victory, as it turned out, was Pyrrhic.

Layoffs and branch closings soon sapped employee morale, while customers stayed away in droves after good checks bounced and deposits were lost.

The reason why this matters is that in mid-June, Wells Fargo merged again — tying the knot this time with Minneapolis' Norwest Corp. Though the combined company will form a financial-services giant with 2,900 branches sprawling across 21 states, lots of people are wondering, understandably, whether the merger will work this time or whether it will repeat the failures of Wells Fargo's earlier acquisition.

Harbir Singh, professor of management, has strong opinions about that — and with good reason. "There was enough noise about Wells Fargo's First Interstate acquisition to suggest that the consolidation was not working effectively," he says. Wells Fargo, however, chose to pursue the deal with Norwest. If this merger goes through, it will see the birth of an institution with \$181 billion in assets.

Wells Fargo and Norwest are hardly alone. In recent times, many banks have faced the same question: How can they ensure that their mergers will succeed? If this issue seems especially relevant now, it is because the past two months have seen a rash of massive mergers rock the financial services industry. Citicorp and Travelers Group, for instance, will soon come together to form Citigroup, a behemoth with \$700 billion in assets. Banks such as First Union, CoreStates, First Chicago, Bank America, NationsBank and Banc One have also declared their urge to merge. And these mega-deals are just the most visible signs of a prolonged process of industry consolidation. A decade ago the U.S. banking industry had more than 1,200 commercial banks. Today, notes Singh, there are about half that number.

How, then, can these banks make their mergers work? The answer may lie in a study that Singh recently completed with Maurizio Zollo, a Wharton PhD graduate who is now a professor at INSEAD in France. Titled "The Impact of Knowledge Codification, Experience Trajectories and Integration Strate-

gies on the Performance of Corporate Acquisitions," the study is the largest so far of post-acquisition management. Based on their findings of more than 500 bank mergers, Singh and Zollo conclude that past experience holds the key to managing a successful merger. Banks that have gained knowledge during past mergers, and turned it into codified procedures and routines, have the

best chance of acting decisively after they take over another institution. Risky as mergers always are, organizations that have systematic routines to manage the post-merger scenario have a better crack at success than firms that lack such procedures.

Three factors came together to make this large-scale study possible. First, Singh saw that as the provisions of the Glass-Steagall Act were scaled back, and barriers to inter-state banking fell, the banking industry would see a wave of consolidation. "If you compare the banking industry in the U.S. to other countries that do not have state-level restrictions, you find that the industry is dominated by a few, very large banks," he says. This meant that the banking industry would offer enormous opportunities for a major study of post-merger management. Secondly, Zollo was keenly interested in writing a thesis on this topic — which helped solve the manpower problem. Finally, the Wharton Financial Institutions Center, which has access to funds from the Sloan Foundation, agreed to financially support the research.

Singh and Zollo did their research in two phases. They started out by doing field surveys, interviewing some 45 executives in nine banks that had been actively snapping up other institutions. They followed this up by sending out questionnaires to 250 of the country's largest bank holding companies. In all, Singh and Zollo studied more than 50 banks and 577 acquisitions.

Their research showed that a significant shift had occurred in the way banks managed their mergers. Before 1990, when one bank took over another, it generally managed it as an independent affiliate, rarely making changes in its systems or even management team. As the banking industry began to consolidate, however, its standards of efficiency became increasingly more exacting. As a result, in mergers

that occurred after 1990, acquiring banks were under growing pressure to integrate the working of the acquired bank with their own. This let them reap economies of scale and squeeze other efficiencies out of combined operations. Says Singh: "A bank that doesn't integrate may find it easier to manage the institution it has taken over, but it may be unable to make its transaction viable."

The knowledge that allows banking industry executives to carry out such integration, Singh and Zollo discovered, is broadly of two types. The first, which they term tacit knowledge, consists of subjective experience and is largely in the heads of key executives. The second variety, which they call codified knowledge, consists of written procedures that a bank articulates in the form of routines, which can be swiftly put in place after a merger.

For example, procedures might spell out what the layout of a bank's branches would look like after an acquisition. Or, if one bank with 25 products has merged with another that has 30, norms might suggest how the two will be integrated. Still other policies might govern the bank's commercial lending policies or human resource issues such as hiring, training, outsourcing and even downsizing after the takeover. Banks that develop systematic procedures about such issues, over time, become better at managing their mergers. In contrast, the absence of such procedures, especially in a volatile, emotion-charged, post-merger environment, can wreak havoc — besides depleting the value of the merged company.

Codified procedures in particular are not just crucial; they are indispensable, Singh says. "If you need to do a lot of integration, you need to have procedures in place, even if you end up having to impose one firm's policies upon the other." Having codified procedures allows banks to accomplish a crucial task: It lets them reckon how much cash flow various activities will generate and factor them into financial projections.

But what if two banks are in relatively different businesses? Consider, for instance, Wells Fargo and Norwest. While Wells Fargo sells itself as "an urban bank for people on the go," and operates with minimal staff and a large network of ATMs, Norwest is a massive mortgage lender that depends on a large staff to nurture customer relationships. Would experience gained in managing acqui-

sitions in one type of bank be relevant in a merger with the other? Singh says that banks constantly face such challenges. "You have to decide how much of your knowledge applies to the current transaction, and how much is a useless legacy from the past."

Though Singh and Zollo focus on banking in their research, Singh says that their findings also apply to mergers in other industries. For example, take the impending union of Daimler Benz and Chrysler, which has caused an upheaval in the auto industry. Though this transaction is often touted as a marriage of equals, Daimler Benz is clearly the acquirer, Singh notes. Still, both companies face huge challenges, some of which revolve around issues of executive compensation. "Chrysler's CEO earns much more than Daimler's, and if that is true of the CEOs, you can assume that the salary differential goes several levels down," he adds. "How will that be handled? It's an interesting challenge."

Singh sees similar challenges in the mega-deals going on in telecommunications. A case in point: WorldCom's takeover of MCI, a transaction that some wags suggest is like MTV buying Masterpiece Theater. "When WorldCom bought MCI, it took over a company that was three times its size in terms of employees," says Singh. "How can you ensure that such a merger is going to work?"

The positive side of this deal, he adds, is that Bernard Ebbers, WorldCom's chief executive officer, had bought some 40 companies before taking over MCI. In the process, WorldCom became very good at combining assets. "Before the merger, WorldCom had a strong Internet backbone, and after the merger it has the best Internet backbone in the U.S. and Europe," Singh says. "But on the negative side, taking over MCI is different than any of WorldCom's past acquisitions."

Challenging as it is to decide what tacit and codified knowledge is relevant in such transactions, the problem becomes much more complex when mergers cross industry frontiers. For example, when American Home Products recently announced its intention to merge with Monsanto, it spelled the combination of a pharmaceutical giant with an agricultural and biotechnology company. Wall

Continued on page 26

Harbir Singh



"If you are not good at managing your merger, someone else is going to buy you — and create value."

RESEARCH WIRE

BELOW IS A SUMMARY OF RESEARCH PROJECTS RECENTLY COMPLETED BY WHARTON FACULTY.

WHY SOME ONLINE STORES CLICK

The success of companies like Amazon.com, whose sales have zoomed from zero to \$147 million in three years, show that some retailers have learned how to sell their products in cyberspace. But for every company like Amazon, the Internet offers countless examples of retailers who seem doomed to obscurity. What makes some online retailers click, while others flop? The stakes are high for companies that answer this question correctly, because online commerce is estimated to grow into a \$7 billion market by 2000, compared with \$1 billion in 1997.

A study by Gerald Lohse, assistant professor of operations and information management at Wharton, and Peter Spiller, a consultant with McKinsey & Company, offers some insights into these issues. Their research shows that nothing succeeds like simplicity, especially in the way that online stores present price and product information on their web sites. "Product lists account for 61 percent of the variance in monthly sales," says Lohse. Other crucial factors include a greater number of store entrances and a large selection of products, among others. Retailers who learn these lessons and use them to model their web sites will be best positioned to cash in on the coming boom in electronic commerce.

Gerald L. Lohse and Peter Spiller; Electronic Shopping: Quantifying the Effect of Customer Interfaces on Traffic and Sales.

BIG CHANGES ARE LOOMING IN PUBLIC HOUSING PROGRAMS

This is a crucial year for the future of public housing. After years of neglect, when public housing in most large U.S. cities turned into an urban nightmare, a consensus is now emerging that major policy changes must be made to overhaul the system. Several reform proposals are pending, and the Clinton administration and Congress will probably act on them this year.

In a paper that examines these issues, Susan Wachter, professor of real estate and finance at Wharton, and New York University's Michael Schill trace the origins of public housing and its evolution over time, assessing the impact of changes in federal housing policy. Their findings are a damning indictment of the failure of public housing programs — at least as they have been practiced so far. "Public

housing has worsened the concentration of urban poverty," says Wachter. Concentration of large numbers of poor people in the cities not only damages physical property, but it also breeds social problems.

In an effort to deal with these issues, public housing authorities have tried such programs as Hope VI, under which blighted homes are demolished and replaced by mixed-income housing complexes. The jury is still out, however, on whether such solutions will work. Says Wachter: "We need to create conditions in which market discipline is used to solve these problems."

Susan Wachter and Michael Schill; The Future of Public Housing

NO DROP-DOWN MENUS, PLEASE...WE'RE BRITISH

Conventional wisdom has long held that as consumers become more educated, their preferences become similar, especially with regard to technical products like computers. But that, it turns out, is not always true. Paul Green and Abba Krieger, professors of marketing, have recently completed a six-nation study that shows just the opposite: that the buyer's country is the single most important determinant of features that customers seek in mid-sized computer systems priced between \$25,000 and \$50,000.

The study used a technique called conjoint analysis, which requires respondents to make tradeoffs between various product features, and it covered 710 executives in the U.S., Britain, France, Italy, Germany and Japan. "What makes this study interesting is that it flies in the face of the hypothesis that says that as you become more educated and work in technical fields, this has a leveling effect with regard to preferences, tradeoffs and perceptions," says Green.

These findings have crucial implications for computer manufacturers, because they imply that buyers in Japan look for different features than do those in Germany or France. "The implication is that companies should try to find out these desired features and try to design variations on a central theme," says Green. "You would not want to tailor-make products for distinct countries because that would be wasteful from a production standpoint, but you could put in features that appeal to each locale."

Paul Green and Abba Krieger; A Cross-National Study of Buyer Tradeoffs in the Purchase of Mid-Size Computers

OUTSOURCING POSES NEW LEADERSHIP CHALLENGES

Almost everyone who has a mailbox gets an occasional letter from some bank pitching a credit card. What is rarely apparent to those who receive such offers, however, is that the bank often controls just the brand and the marketing. Practically everything else — from billing to cash collection — is subcontracted or outsourced to one or more vendors.

Banks are not alone. Outsourcing has exploded in the past few years: Information-outsourcing contracts alone shot up from \$11 billion in 1994 to \$33 billion in 1996. As nearly nine out of ten large manufacturing companies in the U.S. outsource at least one activity, this phenomenon poses new leadership challenges. Executives can no longer get results by issuing orders to subordinates; they must do so by negotiating and overseeing effective deals with vendors.

To examine these and other issues, Michael Useem, professor of management, with the assistance of Joseph Harder, conducted an interview study of the outsourcing activities of 25 companies and a survey of the outsourcing activities of 423 companies. Sponsored by A. T. Kearney Executive Search, the study shows that outsourcing requires managers to exercise lateral leadership. This, in turn, requires a combination of four capabilities: strategic thinking, deal making, partnership governing and change managing.

Describing the rules of thumb that companies use to decide what to outsource, Useem says, "If an activity is not part of your company's core competence, consider sourcing it out. It may also make sense to outsource an activity that is close to the core but you simply cannot do well." Outsourcing does have its risks, though. "The selection of your provider is crucial," Useem cautions. "If you choose the wrong provider, you can get into real trouble."



Michael Useem and Joseph Harder, Wharton Center for Leadership and Change Management; Lateral Leadership for Organizations that are Outsourcing

CAN THE PRICES OF STOCK MARKET SEATS HELP PREDICT FUTURE MARKET TRENDS?

A seat on the stock exchange provides its owner with access to the trading floor. As such, it offers a ringside view of goings on in the market. If this is true, shouldn't the prices at which stock exchange seats are bought and sold reflect varying expectations about the market's future performance?

They should and they do — according to a study by Donald B. Keim, professor of finance, and Ananth Madhavan of the University of Southern California. In a paper that

examines the market for New York Stock Exchange seats between 1973 and 1994, Keim and Madhavan document a strong relation between seat price movements and stock price movements. In addition, they find that the spread between bid and ask prices for seats reflects divergent views about future market activity and performance. "Ultimately, the difference between the buyer's and seller's valuation of a seat, as represented by the spread between the bid and ask prices, reflects differences in their expectations about future profitability," says Keim. And changes in this measure of divergence of opinion, Keim and Madhavan show, are related to future stock market returns.



Donald B. Keim and Ananth Madhavan; The Information Contained in Stock Exchange Seat Prices ▼

MEGAMERGERS *Continued from page 24*

Street's response to the declaration has been underwhelming; the stocks of both companies barely moved after the merger was announced in early June.

Could Singh's and Zollo's findings apply to such a deal? "I would argue that tacit knowledge would not apply," he replies. "Codified knowledge also would not seem relevant. For such a transaction to work, based on our study, it would have to be based on an under-valuation of assets." Singh adds that when two companies are in different industries, the value created by integrating their operations would be minimal. The way to make such mergers work might be to keep their operations relatively independent.

In addition to tacit and codified knowledge, corporate culture plays a seminal role in making or breaking mergers. The challenge, claims Singh, is not that companies that merge tend to be culturally distant; it is how they address that cultural distance. This implies that even if two companies are in the same industry, are located in the same region, and draw upon the same labor pool, they would still be culturally distant.

Singh's research into factors that make mergers work has had several spinoff possibilities for other studies. One project, which he is working on with Prashant Kale, another PhD student, concerns how companies gain knowledge as well as protect proprietary information in joint ventures. Singh also plans to extend the study to mergers in the insurance industry, as well as deals between banks and non-banks.

Meanwhile, he says, the rising tide of bank mergers will not abate anytime soon. "This will go on for a while," he says. "Banks that are unable to combine operations successfully will be on the block again. If you are not good at managing your merger, someone else is going to buy you — and create value." ▼

Mukul Pandya

SCHULTE-NOELLE *Continued from page 17*

Allianz is already the largest shareholder in big private banking players such as Bayerische Hypo und Vereins-Bank (no. 2 in Germany) and Dresdner Bank (no. 3), as well as in Munich Re, the world's largest reinsurer

"Generally speaking, cooperation is our pattern in working with banks, not only in Germany but throughout the world, wherever this makes sense and is allowed by local legislation," notes Schulte-Noelle. "We want to cooperate with, but not take over, banks. We feel we should focus on our core business and not pretend to be able to manage banks and also not pretend to have the resources to offer all financial services to everybody on a global scale."

Has the proposed Citicorp/Travelers merger — and the rapid convergence of financial services that it suggests — had any effect on Allianz's global strategy? Schulte-Noelle says no. "We have seen other examples of this strategy in the '80s," he says. "But this is not our way. We feel very much at ease with our cooperation strategy. We don't bear head costs and risks for global banking operations. But we have access to bank customers throughout the world. We now sell insurance products through more than 10,000 banking outlets and branches in Italy, Germany, France, Mexico, Spain, Poland and many other markets."

Schulte-Noelle was born in Essen, Germany, and studied law at the Universities of Tübingen, Bonn, Cologne and Edinburgh. He joined Allianz in 1975 as assistant to the head of the North Rhine-Westphalia regional office and was appointed chief executive of Allianz AG in 1991.

Schulte-Noelle says his biggest challenge in the year ahead will be the successful integration of the AGF group. Such an undertaking will surely call upon those qualities — including "management style" — that earned him the "Manager of the Year" award two years ago.

"My approach to managing," he says, "includes listening to people and making sure we constantly consider the impact of our strategy on shareholders, customers, employees and society ... I strongly support an entrepreneurial attitude, which should allow people to make mistakes.

"If we don't take risks," notes Schulte-Noelle, who likes to read history, play the organ and hike in the Bavarian Alps, "we don't achieve." ▼

BERKELEY *Continued from page 19*

markets didn't have room for. But a funny thing happens when you have bright hardworking people. Pretty soon after years of competition and innovation you get stronger than the protected elite. The NYSE's structure is very difficult for them to change and adapt because they restrict competition."

The NYSE, Berkeley adds, "sells prestige. We sell performance."

That performance will only be enhanced as the strengths

and capabilities of the Amex are merged into Nasdaq's own, Berkeley notes. "The merger made sense for a number of reasons. One is Amex's options market, which has about 25 percent market share. We can help this market grow and also we can bring together options and underlying equities in information services ...

"Another reason is the equities market. The Amex does about 30 million shares a day while we routinely do 600-700 million shares a day. In addition to growing their market, we theoretically have lots of computer capacity to dramatically lower their costs and pass those cost savings on to the investor."

In the meantime, Nasdaq will be developing a pilot system "that will incorporate the Amex's rules for trading instead of our own. We plan to put a voluntary limit order file in front, between the specialist and the public ... We think that will result in a lower-cost, more transparent, more efficient market for the investing public."

Berkeley grew up in Charlotte, N.C., graduated from the University of Virginia, and after attending Wharton, served in the U.S. Air Force from 1968 to 1972. That year he joined Alex. Brown & Sons as a research analyst, becoming a general partner in 1983.

He came to Nasdaq during a time when the exchange was mired in allegations of improper trading by its major dealers and insufficient monitoring by its parent company, the National Association of Securities Dealers.

Now new rules are in place, Berkeley says, and the biggest challenge these days involves "getting agreement from our various market constituents as to how much automation and/or regulation we should be pursuing ... The opportunities ahead are tremendous, provided we manage the pace of change and meet the demands of new technology in such a way that we lead the competition, not lose to it." ▼

DANIELS *Continued from page 20*

Daniels lives two blocks from her office. Her three children, ages 11, 8 and 5, are home-schooled by her mother.

Daniels' impact on the community has been documented not just in newspaper articles but in awards she has won over the past few years, including an Achievement Award and a Community Impact Award from two local newspapers, an Unsung Heroine Award from the National Organization for Women and an Outstanding Contribution to the City Award from former Syracuse Mayor Tom Young.

Recently she successfully opposed zoning changes that would have allowed the opening of a bar two blocks from her office, and helped vote down a mini-mall that neighbors feared would serve as a drug front. "It's always something," Daniels says.

Does she ever get discouraged? "When I do," Daniels adds, "I just swallow some vitamins ... and I do see progress. Things in this area are materially improving." ▼

LEVOVSKY *Continued from page 18*

interviews and audio and visual clips, and is working on the launch of a home video line of original programming for the channel.

For Levovsky, the job is a labor of love. She spent a year at New York's School of Visual Arts taking filmmaking courses, and recently completed her first screenplay called *Crossing the Line*. "It's about a nice Jewish girl who gets mixed up with the Jewish Mafia," says Levovsky. "Producers and other screenwriters have told me they think it's a very commercially viable property. I'm trying to decide if I should sell it off as a screenplay or actually try and produce it myself." ▼

MCLAUCHLAN *Continued from page 21*

Corporation, and a member of Bankers Trust's management committee and chair of the client committee. He is responsible for the firm's public relations and advertising, marketing service and risk management advisory functions. He joined the bank's Latin America group after graduating from Wharton in 1978.

McLauchlan's favorite overseas assignments have been London and Tokyo, his toughest was London. "When I went there in 1989 the economy was clearly turning downwards and then the Gulf War followed shortly after. Europe was in a recession and market conditions were very tough."

His current assignment in Asia is also difficult, but McLauchlan is upbeat about Asia's future. "Given the magnitude of the crisis, I don't see a quick resolution. But overall we are optimistic about the region," he says. "There are lessons to be learned and tremendous opportunities going forward." ▼

ESCARRER *Continued from page 22*

before coming to Wharton, did an internship at Coca-Cola and worked at IBM, First Boston and Hyatt International. "I believe our success has been due to my father's vision, experience and energy together with ideas I learned at Wharton in such classes as finance, marketing and multinational strategic management."

For example, shortly after taking over as CEO in 1994, Escarrer separated the real estate holdings of the company from the management operations, streamlined management controls and set up distinct geographic divisions. Recently he appointed classmate Monique Skruzny, WG'93, as CFO of MIA.

Escarrer does not rule out the possibility of a future alliance with an American hotel chain, although at the moment Sol Melia, which now totals 24,000 employees, is focusing on Europe and Latin America.

The hardest part about competing with U.S. chains, Escarrer adds, "is that they have acquired such a high level of professionalism from having had to compete in the worst — meaning the most competitive — markets. They are very fast learners. Also, American chains are based in one of the four great markets — the U.S., England, Germany and Japan — which means they have high levels of brand awareness already in place."

Internally, his biggest challenge is "to create an organization that is totally focused on client needs. That means creating benefits for our four main client groups: the consumer, our employees, the shareholders and, of course, the owners of the hotels we manage." ▼

CATASTROPHE *Continued from page 12*

from catastrophic events.

As for capital market instruments, "as you reduce your losses through mitigation, two things happen," Kunreuther says. "One, the need for these cat bonds is somewhat circumscribed because you have reduced the potential for catastrophic losses. Second, mitigation lessens the uncertainty surrounding these losses because of a better understanding of what may happen after a disaster. So it should not only be easier to price cat bonds, but the cost to insurers and reinsurers will also be lower because the damages and uncertainty have both been reduced."



at issues, while they cover a very small part of the worldwide catastrophic risk market, are most likely here to stay, and to grow.

"Obviously a big catalyst to this market would be another major storm," notes Frank S. Wilkinson, WG'65, executive vice-president of insurance broker E. W. Blanch Co., which has a unit dedicated to capital market products. "With the contraction of the traditional market, that would be a time for the capital markets to come in."

In the meantime, adds Cummins, "some insurers remain a little resistant to the concept, and I would agree that a certain amount of caution is warranted. But my view is that this new market, if not revolutionizing the industry now, will do so in 10 years. Somewhere along the way, insurers will come aboard.

"One of the things that convinces me of the market's viability is that almost all of the major reinsurance companies are now gearing up for cat bond issues.

"It would be a mistake to say that financial instruments will replace reinsurance, but I can see them absorbing bigger and bigger proportions of the traditional reinsurance market." R.W.S. ▼

BURNS *Continued from page 14*

and perhaps get more efficiencies that way. Then you don't have to tell the hospitals and doctors how to make do with less money."

Burns and several of his colleagues recently received a grant to study value-chain partnerships between the suppliers of health care products and the organized consumers of health care products, like the hospital systems. Specifically the group is looking at four different types of suppliers: the pharmaceutical industry, the hospital disposable supply industry, the equipment and device manufacturers, and the liability insurance companies.

This whole area, says Burns, "offers much more palatable approaches to getting savings out of the health care system than anything I have seen so far." *R.W.S.* ▼

DISTANCE LEARNING

Continued from page 3

Learning Systems, Inc. and MCI Communications Corp. The company has leveraged Sylvan's educational expertise and MCI's strength in telecommunications and computing to create a leading-edge distribution network for adult professional education and training services.

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BUSINESS PLANS *Continued from page 4*

that would have the properties of a bond," says Meyers.

As the contracts pay out, the revenues would go to various investors. Meanwhile, the money put up by the investors would go to the athletes. "It makes sense when you are talking about athletes who are younger than Jordan, or don't make as much money as he does but who might like a certain amount of cash early on to start their own company, relocate their families or whatever."

Meyers, who is working for Chase Securities in Manhattan, acknowledges that Star Bonds, Inc. would be a difficult idea to implement mainly because of the large amount of capital required. "It's not like starting up a coffee shop." ▼

TEACHING AWARDS

Continued from page 4

University-wide Lindback Awards for Distinguished Teaching.

GRADUATE DIVISION

In the Graduate Division, the Helen Kardon Moss Anvil Award, created in 1969 to recognize exceptional teaching effort and ability, went to Philip Berger, assistant professor of accounting.

The Excellence in Teaching Awards are given to the eight professors with the highest ratings from the MBA student course evaluation forms. The professor with the highest rating also receives the Class of 1984 Award. This year the recipient is Thomas Donaldson, Mark O. Winkelman Professor of Legal Studies.

The other Excellence in Teaching Award recipients include: Franklin Allen (Finance), George Day (Marketing), Stuart Diamond (Legal Studies), Jeremy Siegel (Finance), Karl Ulrich (Operations and Information Management), Michael Useem (Management) and Richard Waterman (Statistics).

The Miller-Sherrerd MBA Core Teaching Awards went to: Philip Berger (Accounting), David Croson (Operations and Information Management), Neil Doherty (Insurance and Risk Management), Thomas Donaldson (Legal Studies), David Reibstein (Marketing), Jeremy Siegel (Finance), Karl Ulrich (Operations and Information Management) and Michael Useem (Management). ▼

NAVY *Continued from page 6*

In 1992 Lanes moved to Washington, D.C. to take over responsibility for the \$1 billion development of the EA-6B aircraft. From 1995 up until earlier this year, he directed the \$500 million development program for the Tomahawk Cruise Missile, which included the need for close interaction with industry and government senior leadership in communicating both financial and operational requirements.

Lanes is now a member of the Secretary of the Navy's staff in charge of looking at force readiness and acquisition reform. In the near future, he will most likely be assigned to head up a major acquisition program in the Washington, D.C. vicinity.

Lanes has no second thoughts about the direction he has chosen. "You can't fly forever," he says. "I have found great opportunities in my new career." ▼

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