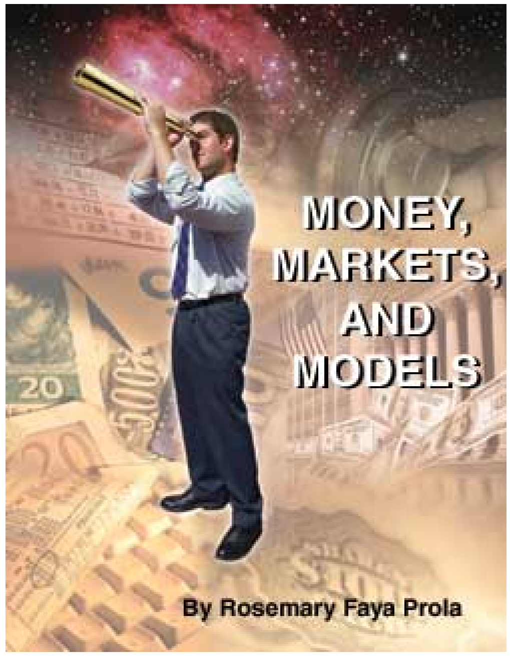
SPRING	2002	**VOLUME**	3	**NUMBER**	3



In the global digital economy, the business environment is fast-paced and highly competitive. As a result, the complexities of corporate finance are expanding, and "we" need to know more about it.

"We"are CEOs and CFOs seeking to balance risk and return. "We" are citizens keeping a close eye on the wheeling and dealings of large corporations. "We" are financial analysts creating new products for consumers. And "we" are investors trying to identify the stocks that will make us millionaires. (Who doesn't want to be one?)

There are scientists at work exploring the deeper recesses of the financial universe, seeking answers to many of our questions and to an equal number that we haven't even considered. They are finance scholars, and the Robert H. Smith School of Business at the University of Maryland has some of the best on its faculty.

The scope of the faculty's investigations into financial matters is galaxy sized. Its intent is to shed light on the way money, markets, and financial models work, and in some cases, to make them work better.

In the next few pages, you're invited to travel with some members of Smith's finance faculty studying important finance issues, including executive compensation, the impact of technology on financial services, financial information sharing, and corporate performance. You'll also have a glimpse of an exciting new mode of exploration.

What price executive stock options?

Executive compensation is an issue that frequently makes headlines. These handsome compensation packages usually include some form of stock options as a performance incentive. After a certain vesting period, the higher the company's stock price, the higher the potential reward for executives. Currently more than 97 percent of the Standard & Poor's S&P 500 utilizes executive stock options.

But what if a company's stock falls instead of rises, as has happened for numerous firms over the past 14 months? How do you retain management talent and encourage greater effort with a carrot that is now smaller than it was just over a year ago? Two Smith School finance professors, Nagpurnanand Prabhala and Mark Chen, are studying a popular but controversial

solution to this dilemma: stock option repricing. *(Pictured, l to r, Prabhala, Vojislav Maksimovic, Chen)*

“The practice of repricing stock options, that is, lowering the price at which the executive can exercise an option to purchase shares of stock, seems unfair to many people,” explains Prabhala, associate professor of finance. “Repricing options seems to undo the incentive for higher managerial performance and to reward poor results.”

A recent paper by Prabhala and N. Chidambaran of Tulane University, forthcoming in the *Journal of Financial Economics*, contradicts the widespread opinion that stock option repricing protects entrenched managers at the expense of investors.

“We did not find poorly governed companies among those that used repricing,” Prabhala states. “In addition, we found repricers two or three times more likely to fire their CEOs than other companies. This finding is inconsistent with the entrenchment hypothesis.”

“Repricing stock options is a useful, low-cost tool for companies to incentivize managers,” Prabhala concludes. In a follow-up study funded by a summer research grant from the University of Maryland Graduate School, the professor will attempt to quantify the costs of repricing to companies and the benefits to employees.

Assistant Professor of Finance Mark Chen has a continuing interest in executive compensation and its role in corporate governance. “Stock options are an important mechanism for aligning managerial incentives with the interests of shareholders,” he notes. “The question is, can they be designed to work better?”

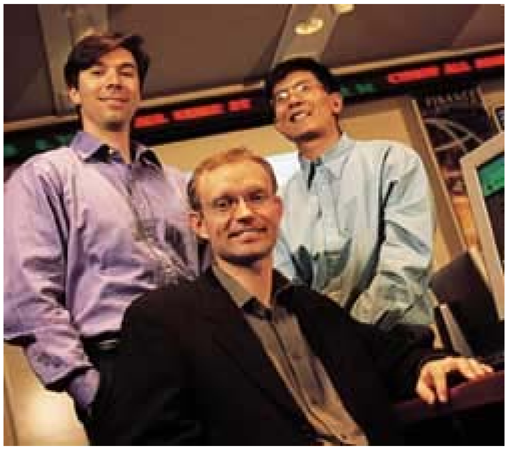
Chen recently completed an extensive study of the impact of different stock option repricing policies on executive incentives and retention. His investigation covered a broad cross-section of publicly traded firms over a six-year period and included more than 5,000 observations.

The evidence reveals that, “On average, CEOs of firms that grant repriceable options are more highly incentivized with option holdings and shareholdings than are CEOs of firms that pre-commit to a no-repricing policy,” Chen says. He also determined that “restrictive policies are associated with higher rates of executive turnover following stock price declines.” Chen concludes that repricing is an important tool for reducing voluntary executive turnover in highly competitive markets.

Banking on information

Your bank or credit union has a potential advantage over its competitors when it comes to selling you a new financial product - it has your personal data residing in its database. But is the company keeping the information in its “vault” or using the Internet and information technology (IT) to exploit it? In the intensely competitive financial services industry, is technology power?

Robert Marquez, assistant professor of finance, and Robert Hauswald, visiting assistant professor of finance, recently completed a study of the effects of IT on financial services competition. “We contrasted two dimensions of technological progress,” Marquez says, “access to information and ability to process information.” The researchers developed a theoretical model of competition among financial intermediaries to ascertain possible IT impacts. *(Pictured, l to r, Marquez, Soren Hvidkjaer, Nengjiu Ju)*



“We were able to show that, depending on which of these areas you believe is evolving more quickly, the financial services industry can be seen as becoming more or less competitive,” he states. “If the greater advance is primarily in the access to information, then the marketplace is very competitive. But if it is in the way the data is processed and what knowledge is extracted, the larger institutions who invest heavily in these technologies may have the advantage.”

Marquez notes that their results generalize to other financial markets where informational asymmetries drive profitability, such as insurance and securities. The authors have been invited by the Federal Reserve Bank of Philadelphia to present a paper on their work at a conference later this month.

This summer, Marquez will begin a study of the impact of IT on corporate governance systems. “There are both internal and external mechanisms at work in these systems,” he explains. “I want to see how IT interacts with them, changing the link between the effectiveness of the board (an internal governance mechanism) and the effectiveness of external markets.” Marquez has received a Smith summer research grant to fund his initial research.

Fair’s fair (and profitable)

For individual investors, a lack of information can make investment decisions difficult. But while some companies are reluctant to provide detailed financial data, it happens that, for them, (information) sharing is good.

Soeren Hvidkjaer, assistant professor of finance at Smith, and professors David Easley and Maureen O’Hara of Cornell University, have a forthcoming paper in the *Journal of Finance* that describes their study of how the level of information affects firms’ cost of capital. Cost of capital can be defined as how much a company needs to compensate its investors for the use of the capital needed to finance its operations.

“Traditional finance models suggest that a firm’s cost of capital is determined solely by how the firm’s stock price varies with the overall stock market,” Hvidkjaer relates. “However, one assumption in these models is that all investors have the same information about the value of a firm. Clearly, this is not the case in the real world. Some investors have better knowledge than others of how much a firm is worth."

The researchers' model incorporated New York Stock Exchange trade data going back 16 years, about 300 million trades. "We found that investors demanded higher returns in stocks with little public but more private information, whereas lower returns are required in stocks with low levels of private information. In other words, the more public information there is about a firm, the lower its cost of capital," he says.

"What our research suggests is that it's in the company's best interests to create a fair information environment," Hvidkjaer states. "To do this it should provide accounting numbers that reflect the true value of the firm."

Corporate moves

Do mergers and acquisitions benefit the economy? That's not purely an academic question, as potential corporate realignments are proposed on a regular basis in global industries ranging from airlines to computers to telecommunications.

For many years, the prevailing view in finance scholarship was that mergers and acquisitions did not lead to greater efficiency, and therefore, did not benefit shareholders or the economy. However, research by Smith's Vojislav (Max) Maksimovic, Bank of America Professor of Finance, and Gordon Phillips, associate professor of finance, upset the conventional wisdom.

Maksimovic and Phillips used a unique data set from the U.S. Bureau of Census that allowed them to benchmark each U.S. corporation's plants against industry standards. Then, when a plant was sold or the firm merged, they could compare each plant's efficiency before and after the transaction and discover if there was a gain or a loss. From their analysis, the professors developed a profit-maximizing model of optimal firm size and growth across different industries. With this model, they tested whether or not the pattern of sales and purchases across the U.S. manufacturing sector was consistent with profit maximization or whether there was evidence that firms waste resources by inefficient acquisition.

"Our analysis showed that mergers, acquisitions, and the growth of firms across multiple markets were efficient at reallocating resources within the U.S. economy," Phillips says. "We could document that mergers and acquisitions raised the productivity of the assets involved."

The Journal of Finance has published three papers by the professors over the past two years on their groundbreaking study. And, judging by the number of "fresh" Ph.D.s who have taken up this issue, their work is having a significant effect on subsequent finance scholarship.

Describing how companies finance operations is a major research focus of Nengjiu Ju, assistant professor of finance at Smith. In the October 2001 issue of the Journal of

Business, Ju and co-authors Robert Goldstein (Washington University) and Hayne Leland (University of California, Berkeley) published a paper on their innovative dynamic model of corporate finance.

"Most capital structure models assume that the decision of how much debt to issue is a static choice," Ju says. "In practice, firms adjust outstanding debt levels in response to changes in firm value. In our paper, we solve for optimal dynamic strategy of a firm and investigate the implications for optimal leverage ratio (equity to debt) and the magnitude of the tax benefits of debt.

"Our theoretical model is consistent with what one observes," he states. "It explains why the equity-debt mixture is lower than what other models predict."

In a new paper, Ju and co-authors have developed a model that incorporates the risk-aversion choices of managers to predict optimal capital structures for organizations. "While most other capital structure models maximize total firm value in the best interests of stockholders, financing decisions are made by managers not stockholders," he says. "CEOs care about risk and their optimal debt-equity mixture decisions can be different from the ones that maximize firm value. Our new model yields even more accurate predictions about the leverage ratios than our previous model," Ju states.

A New Perspective

Traditional models in finance have assumed that all investors and the institutions that may invest on their behalf behave rationally. There are a number of phenomena, however, that are difficult to explain using traditional finance models. For example, in recent years many unprofitable dot-coms were worth more in market value than their true or fundamental value.

A new research approach attempts to solve the dilemma. "Behavioral finance has quickly emerged as a credible alternative in explaining some observed financial phenomena that are hard to grasp in the context of rational models," states Lemma Senbet, holder of the William E. Mayer Chair in Finance and chair of the finance department at Smith. "The behavioral approach has filtered through significantly in the investments area, although it has yet to catch on in corporate finance," Senbet notes. Several members of the finance community at Smith are conducting research utilizing this novel approach.

A working paper by Ph.D. candidate Yue (Tracy) Wang and David Hirshleifer of Ohio State University explores the role of investor

psychology in explaining the "forward discount puzzle" in foreign (currency) exchange markets. According to traditional economic theory, forward exchange rates are unbiased predictors of future spot exchange rates. Empirical evidence, Wang says, shows the contrary: forward exchange rates negatively predict future spot exchange rates. She and Hirshleifer argue that, with irrational investors, this could happen.

A new study by Soeren Hvidkjaer looks at the link between cognitive processes and asset prices. “We traditionally use economic models to explain asset (stock) pricing,” he says. “However, there are return anomalies that we have not been able to explain rationally. I suggested that we look at the trading behavior of investors to explain some of these anomalies.”

One return anomaly, called “momentum,” is that stocks with low returns continue to decline and stocks with high returns continue to rise in price. “This momentum effect shouldn’t occur in an efficient market,” Hvidkjaer notes. He finds an explanation for this phenomenon in the behavior of small investors (those who buy/sell fewer than 1,000 shares per trade). “They appear to overreact to past news and could be causing this anomaly to occur. Large investors behave much more rationally,” he says.

Russ Wermers, assistant professor of finance, has taken a behavioral approach in some of his work measuring the performance and market influence of pension and mutual fund managers. An early paper by Wermers, on a study of mutual fund herding, won the New York Stock Exchange award for the best paper on equity trading in 1995. “Herding” is the tendency of mutual fund managers to buy or sell the same stocks at the same time.

Wermers found that there were higher levels of herding by mutual funds in trades of small stocks and in trading by growth-oriented mutual funds. In addition, stocks bought by herds outperform stocks that they sell by four percent in the six months following the trade.

“The future return differences appear to be permanent,” he notes. “This suggests that our empirical results are most consistent with theories where managers herd on new information about the future prospects of firms and help to speed the incorporation of this new information into prices.”

Wermers’ work has contributed to our understanding of the impact of institutional trading on securities markets and the impact of information on market prices.

Like explorers of our physical world, Smith’s finance scholars may follow more traditional routes or strike out on new paths in the quest for knowledge. Today’s financial universe presents endless possibilities for eager minds.

Finance Department Web Site: http://www.rhsmith.umd.edu/finance/

Smith Teams with Naval Postgraduate School to Offer Combined MBA

Beginning fall 2002, the Robert H. Smith School of Business will offer a defense-focused MBA degree program in partnership with the Naval Postgraduate School (NPS) in Monterey, Calif. The program is the first of its kind in the country, comprising courses taught by Smith School faculty and by professors from NPS.

Combined MBA draws on each institution's expertise

The combined MBA program, available to military officers and Department of Defense (DoD) civilians, will be delivered in Washington, D.C., at the Ronald Reagan Federal Building. It will provide students with core management and leadership skills in key business areas, including e-commerce, supply chain management, strategy, and marketing, as well as a unique understanding of business operations within the federal government and the Department of Defense.

Smith School faculty will teach the first "core" business courses comprising 27 credit hours, with the remaining "defense-focused" courses, comprising 27 credit hours, taught by NPS. While NPS faculty will travel to Washington, D.C., to teach many of the defense courses, other NPS-delivered classes will be taught via the Internet and through video conferencing.

Program fills a need in the defense community

"By combining the Smith School's renowned core business curriculum with the defense expertise of NPS, we can provide defense personnel with the unique skills they need to make the military the more efficient and business- oriented institution it strives to be," noted Howard Frank, dean of the Smith School.

"We've felt a great need to offer an MBA program in Washington, D.C., because of the area's large population of military officers and civilian DoD employees interested in seeking defense-focused graduate degrees," said Douglas Brook, dean of the Graduate School of Business & Public Policy at NPS. "The Smith School partnership is a big win for both the military and these personnel, who cannot leave their posts and relocate to California to pursue graduate education."

Weekend schedule enhances convenience

The typical student in the combined MBA program will be able to complete the program in 33 months. Classes will be held on alternate weekends on a schedule similar to Smith's current part-time MBA program in Washington, D.C. Prospective students must meet the admissions requirements of both the Smith School and NPS, and those who successfully complete the program will receive a combined MBA degree granted by both schools.

Enrollment in the first year is expected to be between 20 and 50 students. But with the Washington, D.C., military population estimated at 150,000, Frank believes that, in the future, hundreds of students may enter the program each fall. The program will be evaluated over the next four years and may serve as a model for future partnerships between NPS and business schools in other parts of the country.

For further information, contact the Naval Postgraduate School at 831.656.2755, or visit web.nps.navy.mil/~sm/

Adventures in Finance

By Lisa Gregory

As a college student, Bob Butman wanted to fly jets. Instead, he has soared to the top of the financial world. “Life has a way of working out,” says Butman, who today is president and CEO of TQA Investors, LLC, a highly successful hedge fund. TQA specializes in managing alternative investments, most notably convertible and statistical arbitrage strategies.

Growing up, Butman wanted to follow in the footsteps of his father, a test pilot and aeronautical engineer in the Air Force. However, he balked at his father’s suggestion that he attend his alma mater, MIT. “As a teenager, I couldn’t see myself as a ‘nerd’ sporting a pocket protector,” he chuckles. He decided on nearby Maryland instead. “It was relatively close to home, I was a fan of the sports programs, and I wanted all the options a large university could offer,” he says.

In high school, Butman had the opportunity to work on an IBM mainframe as part of a computer math class. So, when he decided to pursue his college education, he didn’t just sign up for the usual business courses, but also math, statistics and computer science courses, as well. “I got a solid education there,” he says of the university and the Smith School. “I think a lot of business students today don’t understand that you need to study more than finance to qualify for a good job on Wall Street. You need a broader exposure to the arts and sciences.”

After receiving his bachelor’s degree in management science and information systems management in 1977, he was still intent on joining the Navy as a pilot. Never one to take chances, though, he also went on several “practice” interviews prior to graduation.

Butman had received job offers from three companies, including IBM, when he received bad news from the Navy. “They found a slight heart murmur during my initial physical and that proved to be the beginning of the end,” he says. “It was peace time and the Navy just had too many pilots.” He joined IBM as a systems analyst.

After two years, the company offered to pay for him to further his education in an executive MBA program. However, Butman says, “I couldn’t stand going to school part time, and the job in which IBM placed me was dreadful.” He opted instead to go his own way. He enrolled in an accelerated program at the University of Pennsylvania’s Wharton School that enabled him to complete his MBA in finance in a year and a half, graduating in 1982. He then worked briefly in the Financial Markets Group at Data Resources, an economic consulting firm. His work required frequent visits to clients on Wall Street, and Butman soon realized that was where he wanted to be.

He got his chance in the mid-80s as the bull market took off and he was hired by one of the fastest growing firms on Wall Street, Drexel Burnham Lambert. There he rose to become director of quantitative equity research and took responsibility for running Drexel's decision analysis investment systems, the DAIS Group. "This team was responsible for both equity modeling services as well as developing proprietary long/short equity trading strategies for Drexel," he explains. "The institutional investment world was just beginning to recognize the powerful role personal computers could play in stock selection and portfolio management. It was an exciting time."

When Drexel suddenly went bankrupt in 1990, Butman and a partner purchased the DAIS Group's assets, and shortly thereafter, sold it to the Templeton Funds. Templeton Quantitative Advisors or TQA was formed to seed various hedge fund strategies, including convertible arbitrage, index arbitrage, and market neutral equity strategies. By late 1992, however, Sir John Templeton had retired and sold his firm to the large mutual fund company, Franklin Resources. "Back then, running hedge funds under a mutual fund umbrella was quite difficult," Butman states. In 1996, the five TQA principals formed an independent investment management group, TQA Investors.

Today, TQA specializes in managing global convertible arbitrage strategies for plan sponsors, fund of funds, endowments, foundations, and high net worth individuals. According to Butman, its particular expertise is enhanced cash management where the goal is to generate consistent positive performance for clients no matter what is transpiring in the broader markets.

So far, so good. After more than 11 years, the firm has posted annualized net returns to its investors in the low teens with no down years and only 12 losing months. In 2001, a tough year for the stock market, the TQA Arbitrage Fund was still up over 11 percent.

With assets of almost $600 million and new hedge funds sprouting up everywhere, every day the investment landscape becomes more competative, says Butman. "You can never let down your guard in this business. The markets can humble you faster than anything I know. We're just fortunate to have a very talented team of experienced portfolio managers who don't take anything for granted."

Clearly, Butman has found his place in the world of finance. "I love the challenge of what I do," he says. "I never have to be reminded that I'm rewarded for generating positive performance for our clients and very little else."

Being the principal owner of his firm also means he has the ability to control his own destiny. "I'm lucky that after the markets close, I can be home by five o'clock to make it to Tae Kwon Do or soccer practice," says Butman, who has two small children. "I can spend time with my family instead of traveling on a plane. Nothing is more important than that," he claims, adding, "Life is about small decisions."

And, in Butman's case, significant results.

Rely on People to Build Financial Integrity

by David C. Wajsgras '82, CFO, Lear Corporation

Business ethics and financial accountability are hot topics in today's business world. This is due, in no small part, to unfolding events involving large companies such as Enron and Global Crossing. Critics can also point to the recent technology boom, where we witnessed the sudden creation and even faster elimination of wealth from companies whose entire lifecycles could be measured in months. Now, many investors are questioning the integrity of our financial system, particularly the adequacy of U.S. financial accounting practices.

One of the great strengths of U.S. financial markets rests in what professionals call "transparency." Transparency refers to the ability of an investor to get timely and accurate information about a company's operations and financial performance to use in assessing the risks and opportunities presented by becoming a shareholder of the corporation.

The Enron situation has prompted many to question whether transparency in U.S. markets is as good as it ought to be, despite the fact that publicly traded companies are required to file quarterly and annual reports with the Securities and Exchange Commission.

However, while transparency is certainly a critical pillar in building trust in financial markets, I'm convinced that financial integrity cannot be achieved without the support of strong business ethics.

In our highly competitive economy, some business leaders have resorted to employing accounting practices that approach and sometimes cross ethical boundaries. While recent scandals are causing many to re-examine the rules that govern the processes and procedures by which we are able to obtain accurate and timely financial information about U.S. companies, it is imperative that we also continue to demand the highest level of ethics from those who create and report on financial results.

Financial accountability is paramount to success for the nation's publicly traded companies. Strong ethics in finance and accounting are the best way to prevent the conflict, suspicion, and broken faith that have recently emerged toward corporations and accounting firms.

By way of example, my company, Lear Corporation, is a large organization that supplies automotive interior systems to every major automaker in the world; our products can be found on more than 300 vehicle nameplates around the globe. We have been in this business for 85 years and have traded as a public company since 1994. Given the current high-profile issues surrounding financial reporting, even our company felt it was important to include in our 2001 annual report a supplemental letter to shareholders discussing the focus and priorities of our finance department.

At Lear, the responsibilities of our financial personnel are well understood. *At all levels*, our efforts are focused on hiring and training talented individuals who are dedicated to supporting the business with timely and accurate information and with the highest level of integrity. Our people clearly understand that data-driven information will result in fact-based decision-making, success in the marketplace, and value for our shareholders.

Corporate management must operate with the highest regard for its fiduciary obligation to act on behalf of the shareholders to help drive operating performance, provide accurate and informative financial reporting to illustrate how money moves into and out of the organization, and maintain unwavering confidence with the capital markets.

When it comes to investing in the U.S. economy, publicly available information is the cornerstone of decision-making. Just as important, however, is a company's reputation, specifically that of its management team. Investors will migrate toward companies that deliver what they promise and value organizations with leadership that has proven trustworthy over the years. A history of success in these areas can only be achieved by managing with fact-based information and the highest levels of financial integrity.

David C. Wajsgras, a 1982 accounting graduate of the Robert H. Smith School of Business, was named senior vice president and chief financial officer of Lear Corporation, a Fortune 150 company, in January 2002. Before joining Lear as vice president/controller in 1999, Wajsgras was corporate controller for Engelhard Corporation in Iselin, N.J., and held various financial management positions with Honeywell International, Inc. He earned an MBA in finance at American University. Wajsgras is a certified public accountant and a member of the Financial Executives Institute.

In Demand

A combination of business skills puts Smith's finance grads high on recruiters' lists

by Lisa Gregory

“Success is never final” is the mantra for Marriott International. But, according to Kevin Kimball ’72, it could also apply to the Robert H. Smith School of Business and its MBA graduates in finance.

“This is a good school that has gotten even better,” says Kimball, executive vice president and chief financial officer for the Marriott International Lodging Group. “These are students who are well prepared to take on the challenges of today’s businesses.”

As such, Smith School graduates in finance are much in demand. “We at Marriott have an excellent and growing relationship with the Smith School,” says Kimball. The financial group of Marriott hires an average of two to three MBAs a year, and “Consistently, those MBAs come from the Smith School,” he notes. “We have a total of 15 associates in our development finance group and more than half are MBA graduates of Smith.”

According to Kimball, most topnotch business schools produce graduates that are well-versed in the analytical aspects of finance. But, “What really distinguishes the Smith School is the ability of its students to partner with senior management in solving business problems,” he says.

Marriott is not alone in looking to the Smith School for potential employees. Just ask Ira Malis, MBA ’83, director of equity research for Legg Mason. “Recently, when I had an opening for an associate analyst in the REIT area, with a hotel background, my first call was to the Smith School,” he says. “That speaks to the success that our company has had.”

Legg Mason has hired six Smith MBA graduates over the past six years, one from the class of 2000 and five from the class of 2001. “In the majority of the cases, the graduate’s background meshed well with our needs,” Malis says. ”We have had so much success with John Woolford ’00 in our life sciences group, that we looked favorably on the school. Two of our hires from the class of 2001, Mark Hall and Chris King, were both part-time students, and both work in the telecommunications group. Mark was already on board, and he recommended Chris when a position opened.” The company’s other three Smith MBA 2001 hires, Tahmin Clarke, Paul Forward, and Eric Gommel, were recruited on campus. “They all have superior financial training,” Malis states, “and that is the most important skill for an associate analyst.

“It is hard to tell specifically what the Smith School is doing right,” he continues. “What I do know is that all six associates are on the road to being analysts. Their communication skills are great, their financial skills are outstanding, and their work ethic is strong.”

Smith alumni who majored in finance as undergraduates are also in demand. Graduates like Elisson Wright '01, now an analyst with JP Morgan Chase's Internal Consulting Services (ICS). ICS is an 18-to-24-month leadership training program in which analysts do four-to-six-month rotations in different businesses within the company.

Now Wright is involved in recruiting at his alma mater for the ICS program. He returned to campus last fall to participate in the analyst panel at JP Morgan Chase's informational seminar and to assist with interviewing. This past February, JP Morgan recruited at the campus Multiethnic Career Fair and invited several Smith students to a diversity open house to learn more about the company and the banking industry.

"Employers that have hired Smith graduates believe it is a good investment. And they continue to recruit on campus because of this," Wright states. This does not surprise him. "Having recently graduated, I know what an amazing program the Smith School offers," Wright says.

Competition Pays

By Alissa Arford-Leyl

Whether competing against peers at the University of Maryland or against teams from other top business schools in national contests, Smith School students have shown repeatedly that they have the business knowledge and charisma to give a winning presentation.

Smith MBA students compete annually in at least three national competitions, and with impressive results: the Venture Capital Investment Competition sponsored by the Kenan-Flager Business School, University of North Carolina (second place, 2001); Rutgers' Invitational MBA Case Competition (first place, 2000); and the E-strategy Contest sponsored by the Owen Graduate School of Management at Vanderbilt (finalist, 2002).

"To be successful in case competitions requires the application of the full tool kit we teach in the business school: functional knowledge, quantitative skills, communications skills, and teamwork," states MBA Faculty Director Rhonda Reger, associate professor of management and organization. "They're a tremendous opportunity for students because they provide a realistic environment to practice real-world management and consulting skills."

In case competition events, teams of students are presented with business cases - either real or fictional - and prepare reports recommending business strategies for the company. Teams usually are required to make final oral presentations and, frequently, business executives serve as competition judges.

Kevin Mason, a second-year MBA student, has participated in the Owen E-strategy Contest for the past two years. "It was a great experience to be applying all of your skills in a team dynamic outside the realm of the classroom," says Mason. "The reality factor is what I enjoyed most about the competition. Also, it reasserts that my education at Smith has been excellent."

The main in-house competition for Smith MBAs is the Accenture MBA Case Competition, the third of four required experiential learning modules (ELM). The competition is the first comprehensive test of strategic thinking and analysis skills that first-year MBAs encounter.

Now in its second year, the University of Maryland Business Plan Competition, sponsored by the university's Hinman Campus Entrepreneurship Opportunities (CEOs) program, is a campus-wide contest open to current undergraduate and graduate students and recent alumni. The Smith School and the A. James Clark School of Engineering jointly sponsor the Hinman CEOs program (www.hinmanceos.umd.edu).

This year this competition awarded a total of $50,000 in prizes. The winning teams for emerging company (Novoculi) and concept stage (PMConnect) included current Smith School MBA students: Jeffrey Porter, Novoculi's vice president for research and development, and Russell Lorber and Jonathan Wilson, co-founders of PMConnect.

"Winning the competition has given me a lot of confidence to go forward," says Porter. "I'm now going to concentrate on securing our first round of funding and developing partnerships."

University of Maryland freshmen studying business may participate in the Strategy Board Competition, a major component of the College Park Scholars Business, Society & the Economy (BSE) program. Roxanne Lefkoff-Hagius, associate director of the program and teaching professor of marketing, created the Strategy Board Competition in 1998 so that students could apply framework and theory from class in a hands-on experience. Lefkoff-Hagius received the school's Krowe Award for Classroom Innovation in 1999 for the course.

Teams of students start research on their assigned companies at the beginning of the semester, developing strategies for solving real problems and generating new ideas. As their final product, the students prepare three-panel display boards with their strategic recommendations. Judges from participating companies (15 in all in 2002, including Black & Decker, Hecht's, Marriott, Pepsi, and USA Today) award prizes to the best strategic plans.

Companies have expressed excitement about taking part in the Strategy Board Competition, saying that they get "very fresh ideas from freshmen," notes Lefkoff-Hagius.

Business Ethics is Focus of Student Trip

A group of Smith School of Business undergraduates traveled to Hong Kong in January to participate in a special seminar co-sponsored by the Smith School, the City University of Hong Kong, and the Hong Kong University of Science and Technology, "Business Ethics in a Global Context."

Patricia Cleveland, assistant dean for undergraduate studies at Smith, initiated the cross-cultural program. "The trip was a way to recognize the contribution of the BMGT Honors Council in promoting academic integrity at the business school and to complement its focus on business ethics," states Cleveland.

Over four days, the Hong Kong and American students discussed ethical issues in university admissions, test taking, and corporate behavior. Cleveland and Manisha Sharma, a senior majoring in finance and business who is a member of the University of Maryland Honor Council, made a presentation on the university's honor code. The group also visited the Hong Kong Stock Exchange, the Independent Council Against Corruption, and the Hong Kong Equal Rights Commission, and heard from government and corporate speakers.

The experience was thought-provoking for the Smith students. "It's very prestigious and also very hard for people to get into college in Hong Kong," comments Sharma. "This situation presents a dilemma for administrators and also makes it unfair to measure their standards against ours." Smith junior Emily Qiong Wu says, "What impressed me about Hong Kong was the balance between the western and eastern cultures. I'm now thinking about working in Hong Kong when I graduate."

Before returning to the U.S., Cleveland signed a student exchange agreement to begin in fall 2002 with officials at the Hong Kong University of Science and Technology.

Creating Stability in Global Markets
By Lemma Senbet

In recent years, my research has focused on bringing paradigms in corporate finance to issues in the public domain. Related to this topic, a paper of mine published in the Review of Financial Studies in 2000 advances an incentivized system of banking regulation. My co-authors and I argue that the existing capital regulation standards are ineffective in controlling the incentives of banks to engage in excessively high-risk asset portfolios. Without proper control, these risk incentives can lead to an unstable financial system and even wholesale failure of depository institutions. We develop a new approach to banking regulation to correct the problem.

Our approach builds on the incentive features of bank management compensation, such as salary, bonus, and equity participation, which influence bank asset risk choices controlled by bank management. More importantly, we show that when the regulator prices the deposit insurance premium to take full account of these compensation features, bank owners have an incentive to design a compensation structure that induces bank management to choose asset portfolios which are optimal from the social standpoint. Thus, an incentivized banking regulation emerges that fully controls undesirable bank risk-taking and leads to more efficient allocation of resources.

A current study extends this earlier research to the prevention of global financial crises, particularly in emerging economies. This study is motivated by dissatisfaction with the current literature, which is heavily influenced by macroeconomic determinants of a financial crisis and on ex post resolution of a crisis.

In January, my co-authors and I presented our work in this area at the annual meeting of the American Finance Association held in New Orleans. Our approach specifically looks at the role of incentives in mitigating the vulnerability of an economy to a potential crisis. We explicitly model the consequences of an implicit or an explicit bailout where the social planner (i.e., local government), local corporations, local and international banks, and external intermediaries are the key players in the system. Moreover, we recognize the twin features of recent financial crises in emerging economies, namely, banking and currency problems, and show how they arise in the context of our model.

We demonstrate that risk from exchange rate fluctuations exacerbates the propensity of borrowing companies and countries to undertake riskier - and less valuable - investments, since they do not bear the full potential downside of these investments. We show that a sudden change in the value of one currency magnifies into potential “contagion” risk in multiple countries linked through currencies that move together. However, this contagion effect hinges crucially on ill-functioning financial systems. For instance, countries with strong regulatory schemes and well-functioning financial systems, such as Hong Kong and Singapore, were spared from the Asian financial crisis despite their regional integration.

We then take a generalized approach in solving the banking and corporate sector incentive problems. We show that the risk-shifting incentives can be curbed through a specialized tax scheme that is validated by an external intermediary (e.g., the International Monetary Fund). The scheme prices a potential bailout on a revenue neutral basis ex ante (i.e., prior to the crisis), allowing the local companies/banks to pay for a potential bailout when they are able to pay, and providing a way for the external intermediary to credibly commit ex ante to a conditional ex post bailout.

While the incentive solutions we propose are rather unorthodox in the context of broad public policy issues related to prevention and management of financial crisis in emerging economies, we argue that they are relatively easy to implement and call on interested parties to "fix the roof while the sun shines."

Although East Asia and Latin America have been at the center of current debates relating to financial crisis, other regions, such as Africa, can draw lessons in designing and reforming financial systems that maximize the benefits of globalization while minimizing the attendant costs. Based on an analysis of the benefits and costs of globalization, I developed a menu of prescriptions for building capacity of capital markets, the banking sector, and institutions in emerging economies. My paper on the public policy implications of these measures was published in Journal of African Economies (Oxford University Press, 2001). This research has gained the attention of policymakers in Africa, and I currently serve as a resource person for the African Economic Resource Consortium, a macroeconomic think tank that facilitates rigorous research that informs policy.

Lemma Senbet is holder of the William E. Mayer Chair in Finance and chair of the finance department at the Robert H. Smith School of Business. A renowned scholar, Senbet has advised the World Bank, International Monetary Fund, Council of African Ministers of Finance, U.N., and other institutions on issues of financial sector reform and capital market development. He was recently named executive editor of Financial Management. To learn more about his research, e-mail lsenbet@rhsmith.umd.edu.

Nobody Loses in Stakeholder Management

Enron executives could have benefited from reading Smith School Professor Lee Preston's latest book, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Stanford University Press, 2002), co-authored by James E. Post, Boston University, and Sybille Sachs, University of Zurich.

As Preston, emeritus professor in the Department of Logistics, Business and Public Policy, explains, stakeholders are the constituencies that are affected - favorably or adversely - by the operation of the corporation. Investors and employees are the most obvious stakeholders, while third-party stakeholders may be unaware of their relationship to the company. This group includes communities and others who may experience economic benefits or environmental harms as a result of corporate operations.

"Managers are both stakeholders in themselves and fiduciaries for all other interests," Preston explains. "It is a manager's job to identify and balance stakeholder concerns. No one group of stakeholders has a greater moral authority than another."

Cowboy Capitalism

Preston describes the practices of Enron executives as far from stakeholder management. "Enron's leaders gave the impression to investors, employees, and the Houston community that they were very stakeholder-oriented," he says. "However, in the end they neglected the traditional responsibilities of managers by doing both illegal and inappropriate things to create tremendous windfalls for themselves.

"Enron is an example of 'cowboy capitalism'," Preston proclaims. "Get what you can and ride away."

The Stakeholder View

The central proposition of *Redefining the Corporation* is that organizational wealth can be created (or destroyed) through relationships with stakeholders of all kinds - resource providers, customers, suppliers, and social and political "actors." Therefore, Preston says, "effective stakeholder management - that is, managing relationships with stakeholders for mutual benefit - is a critical requirement for corporate success."

The book analyzes actual stakeholder management policies and practices in three firms - Shell (U.K.), Motorola, and Cummins Engine - over several decades. "Motorola is a medium-large multinational company famed throughout its history for its respect for the individual, while Shell - one of the largest companies in the world for the past century - is an example of an organization that broadened its commitment to all of its stakeholders during very turbulent times in the early 1990s," Preston states.

The notoriety of the Enron case notwithstanding, Preston believes that, since opportunities for this kind of abuse are so very numerous, "the fact that so little of it happens is rather reassuring. By and large, the system does work. Most people try to be truthful most of the time."

Redefining the Corporation is the culmination of a five-year, $600,000 project sponsored by the Alfred P. Sloan Foundation and co-directed by Preston, Thomas Donaldson, University of Pennsylvania, and Leonard J. Brooks, University of Toronto.

For more information on stakeholder management, contact Preston at lpreston@rhsmith.umd.edu.

Faculty Research Evolves into Successful Software Firm

At effective business schools, “doing” and “teaching” aren’t cast as opposites: they are complementary. “Smith School faculty are encouraged to interact with industry in order to bring realism into the classroom,” explains Michael Ball, Orkand Professor of Management Science and the school’s director of research.

Ball and three of his colleagues in the decision and information technologies (D&IT) department - all specialists in the area of applied mathematics known as operations research or management science - enliven their teaching with “real world” lessons they learned starting and running a small company. That firm, now RouteSmart Technologies, designs and markets route optimization software that helps package deliverers, newspaper publishers, utilities, and waste pickup companies save money by organizing their delivery routes more efficiently.

RouteSmart’s co-founders - professors Arjang Assad (D&IT department chair), Michael Ball, Lawrence Bodin, and Bruce Golden - first ventured into the business world as consultants, using models they devised as part of their academic research to solve routing and scheduling problems. They formed a small company in 1980; in 1989 that company joined with a New York group specializing in geographic information systems (GIS) to create RouteSmart, an 18-person firm located in Columbia, Md.

Among RouteSmart’s roster of clients: UPS, United States Postal Service, FedEx, *The New York Times*, *Wall Street Journal* (both newspapers use RouteSmart to create home delivery routes), and the giant New York utility, Consolidated Edison.

“RouteSmart clients have hundreds - sometimes thousands - of trucks, each making hundreds of stops a day. If you rework their delivery routes, streamlining them by even four or five percent, they can reduce the size of their fleets, lower their costs, and save a lot of money,” explains Bruce Golden, holder of the France-Merrick Chair in Management Science, one of RouteSmart’s founders.

“The company was synergistic with our academic careers,” adds Golden. “It fed real experience into our research and suggested interesting research problems.” The confluence of theory and practice helped the four founders and their faculty colleagues in operations research put the Smith School’s program on the map. “The Smith School is known nationally and internationally as a major player in operations research,” Golden says.

Smith School students benefited from the professors’ work, in the classroom and out. Undergraduate and graduate students had the chance to learn about RouteSmart while in school. Several went on to work at RouteSmart after graduation. One undergraduate, Larry Levy ’82, Ph.D. ’87, now runs the company, serving as its senior vice president.

“I started out as a math major,” Levy says, “but I soon wandered over to the business school, where I took a course in operations research with Lawrence Bodin. I couldn’t believe that I could get paid someday for doing something this much fun,” he recalls.

Levy developed close relationships with RouteSmart’s founders, which induced him to stay at Maryland despite other graduate school offers. He went to work for the company, writing his doctoral dissertation on letter-carrier walking routes. “I inherited this field from the faculty I worked with,” Levy states.

In 1998, RouteSmart’s founders sold the growing company, feeling that it required more time than they had to give. But that doesn’t mean they have lost the entrepreneurial urge. “I am waiting right now,” says Golden. “But there are some ideas I have in mind.”

Adds Michael Ball, “You never really lose the desire to make something happen.”

Quest for Knowledge, Tara Long, MBA '97

As a student at Marquette, Tara Long intended to study physical therapy. But, “I couldn’t stay awake during biology class,” she says with a chuckle. Instead, she majored in economics. “I’ve always been fascinated by economics and how markets worked,” states Long.

That fascination would lead her to a successful career on Wall Street and today, closer to home, in Washington, D.C., as director of research for the financial firm, MCG Capital Corpo-ration. “You’re always learning something new,” says the Bethesda native of her work. “And hopefully, you’re helping other people learn as well.”

At MCG, Long and her team are responsible for producing research reports focused on the areas of media, telecommunications, and technology. “We research different issues or trends,” says Long, who received her MBA with a concentration in finance from the Smith School in 1997. “We analyze current industry fundamentals, emerging economic and legislative trends, funding activity, and mergers and acquisitions to help shape our investment strategy and guide our existing portfolio.”

Long, who prior to MCG was managing director and senior research analyst for the research and investment banking firm of C.E. Unterberg Towbin and an equity research analyst for Nationsbanc Montgomery Securities, has spent nearly a decade researching public and private companies and industries for institutional investors. In fact, her published research, including eMarketing: Nothing but Net and Beyond the Banner: The Birth of Email Marketing, are both industry white papers.

“I enjoy understanding industries and companies, what makes them work, and what affects them,” Long says. That, “And being right,” she adds.

Entrepreneur Creates Structure Out of Chaos

For Roger Lingle, the most rewarding moment is explaining what his company can offer information-weary business people. “The light bulb goes off and their eyes get wide,” says Lingle, president and co-founder of Mirador Systems, Inc., located in Research Triangle Park outside Raleigh, N.C.

Mirador - the name means expansive view or outlook in Spanish - was created in 1999 and specializes in capturing concepts and intrinsic meaning from unstructured data. “It’s rewarding to know that you have created something that fundamentally will improve a person’s life - from store clerk to company president,” he states.

“The World Wide Web has increased the amount of information one must search through to find anything relevant,” says Lingle, who graduated in 1987 with a degree in finance from the Smith School. “My co-founder and I wanted to find a means to analyze textual information.”

Based on the Mirador Concept Suite, a unique concept extraction software framework, Mirador Systems provides applications that enhance corporate file shares, intranets, and portals. And the company’s flagship product, Mirador Concept Manager, Lingle states, is the first to offer a simple solution to complex and unstructured data management.

Throughout his career, the Smith School grad has been responsible for designing and launching financially successful and award-winning products. Prior to Mirador, Lingle, who also has an MBA from the University of South Florida, was vice president of marketing for Ganymede Software. He also held marketing and management positions at such companies as IBM, Wandel and Goltermann, and AT&T Paradyne.

Of his own company’s success, Lingle says, “We’re solving real business problems, and people are willing to open their wallets for that.”

Mentoring by Degrees

The MBA Mentor Program is changing to better serve the needs of Smith students. To achieve this goal, the alumni office benchmarked the mentor programs of other top business schools, according to Francena Phillips Jackson, director of alumni affairs. In addition, the office solicited feedback from past participants in Smith's mentor program and conducted a focus group with a number of first-year MBA students. "We now have a model that we believe will work well for Smith MBAs, and eventually, for our undergraduate students," says Jackson.

The mentoring program is in a pyramid format

At the top of each MBA pyramid is one successful, senior-level alumnus/a. This CEO/Partner/CFO-type will be helpful to the students in a very broad sense. Senior-level alumni have years of experience and can help Smith students identify long-term career goals. The next tier down will consist of several young alumni per pyramid. "We believe it is necessary to combine the efforts of all who are willing to work to help our students," Jackson notes.

Young alumni will coach current students

"We plan to keep the 2002 MBA graduates involved, as well as every class afterwards, by seeking their participation in the program once they become alumni," she says. These young alumni will be valuable to current MBA students by helping them prepare for their first jobs after graduation and in coaching them through the program.

The bottom tier of the model will be full-time MBA students. "We will have several students per pyramid, and they will receive their one-on-one mentoring from the young alumni," Jackson says. "Both MBA students and young alumni will receive career coaching and sounding board feedback from the senior-level mentor."

Part-time MBA students will be invited to sign up for the mentor program in fall 2003. That program's structure will be identical to the full-time MBA mentor program's.

MBA students will mentor undergraduates

The undergraduate mentor program, which will roll out in fall 2003, is a little different. This program will be geared toward direct-admit freshman and sophomore students. Undergraduates will be matched with first-year MBA students. The MBAs will be scholarship/fellowship students and mentoring will be part of their graduate assistantships.

"The MBA student will be helpful as an 'older' person who has worked in the business world and who can help their mentees start thinking about and preparing for life after graduation," Jackson says. For example, the MBAs will be able to answer questions about applying to graduate school, and about the realities of entering the working world.

“Our focus group results showed that MBA students would like to give back to the school by mentoring,” she notes.

If you share their sentiments, please contact Jackson at 301.209.3503 or fjackson@rhsmith.umd.edu. She would be happy to answer questions, hear suggestions, or provide you with more information about becoming a mentor to a Smith student.

Global Connections

The Smith School of Business network extends around the world. Members of the MBA class of 2001 visited with Sabrina White (second from left), director of MBA and MS admissions, at the MBA Forum for prospective students in Taipei, February 3. Pictured (l-r) are Sophie Wu, analyst, international department, Capital Securities Corp.; Sabrina White; Irene Chen, assistant manager, corporate banking group, Chinatrust; Dan Lader, manager, business consulting, Andersen; Katherine Yi-Yun Tsai, e-biz specialist, Ford Taiwan Services, Ltd.; Brian Lai, analyst, derivative/financial markets, Citibank.

Covington is 2002 Distinguished Alumnus

David A. Covington ’73 *(pictured right, with Burt Leete, MBA '65, associate dean)* was recently honored as the 2002 Distinguished Alumnus for the Robert H. Smith School of Business. About 400 alumni and friends were on hand when Covington received his award at the University of Maryland Alumni Association’s Third Annual Awards Gala. The event was held at the Inn and Conference Center in College Park, Saturday, April 6. The black-tie affair honored University of Maryland alumni who exemplify “the bold vision, bright future, and new directions” that make them a proud reflection of the leadership that is nurtured and grown at Maryland.

Covington has been with Deloitte & Touche LLP, since 1975, and is a partner with the firm. According to Dean Howard Frank, “Dave has not only given financially to the growth and expansion of the Smith School, but he has gone above and beyond by giving of his time and accounting and management expertise toward realization of the school’s mission and vision.” Covington has served as a member of the Dean’s Advisory Council, president and past president of the Smith School alumni chapter board, and chair of its finance committee. “We at the Smith School are pleased at this opportunity to publicly applaud your tireless volunteer efforts,” said Associate Dean Burt Leete, MBA ’65, at the gala.

Last year’s Distinguished Alumnus for the Robert H. Smith School of Business was Al Carey ’74. Carey is a senior vice president of sales, PepsiCo, Inc. B. Gary Dando ’64, a retired partner with Ernst & Young LLP, received the 2000 Distinguished Alumnus Award.

For a complete list of the 2002 University of Maryland alumni award recipients, visit http://www.umd.edu/alumni/.