Today's Business Forecast:
Sunny With Increasing Clouds
On the cover of this issue of Perspectives, Professor Michael Shaw takes a light-hearted approach to the emergence of cloud computing—a technology that has broad applications for business. But as the Leonard C. and Mary Lou Hoeft Chair of Information Systems, Professor Shaw is serious about technology topics. In the classroom, he provides students with an understanding of e-business strategy and management. Outside the classroom, corporations seek out his advice and expertise as they weigh technology decisions for their enterprises.

Such excellence in teaching and in practice is the standard set by each of our faculty members. ILLINOIS professors of business administration, finance, and accountancy, many of whom you see featured in this issue, are consistently honored for their work with students and are highly regarded by the biggest and best companies in the world for their research-focused expertise.

These industry collaborations create important synergies: corporations receive valuable, objective advice; faculty scholars develop important ongoing relationships with industry that advance their research; and students receive the benefits of both—instructors who know the subject and can convey it with relevant, practical, personal examples.

With such a highly regarded group of academicians, it’s no surprise that ILLINOIS continues to be recognized as a vibrant and collegial research community. Our professors’ commitment to scholarly excellence sets the bar high for all of our students, whether they’re undergraduates, graduates, or Ph.D. candidates.

It’s what we expect, and what we do, at ILLINOIS.

Sincerely,

Larry DeBrock
Dean
INCREASING CLOUDS
by Cathy Lockman

Cloud computing is taking information technology, and business, by storm.

IT’S AN ART
by Tom Hanlon and Cathy Lockman

ILLINOIS leads the way in finding solutions for subsistence marketplaces and engaging students in the process.

DISAPPEARING ACT
by Cathy Lockman

What does the shortage of doctoral students in business mean for academia and for the business professions?

WHAT’S IN THE FED’S TOOLBOX?
by Doug McInnis

Quantitative easing is a new tool being used by the Federal Reserve to fix a stubborn recession.

WITHIN REACH
by Doug McInnis

How are earnings estimates determined and how is a company impacted by meeting, missing, or beating those estimates?
The Forecast Calls for Increasing Clouds

When meteorologists forecast increasing clouds, it’s time to pull out the umbrella. When information technology professionals predict the same thing, a whole different kind of storm is brewing.

Cloud computing is a booming business, one that you’ve likely engaged in, even if you’ve never heard of it. The Internet is the “cloud,” and the ability to store, share, and access information and services is the “computing.” If you’ve posted on Facebook, tweeted on Twitter, downloaded videos on YouTube, uploaded photos on Flickr, reviewed books on Amazon, or listened to music on Pandora, you’ve used the cloud. As the technology and the capabilities of cloud computing continue to gain widespread acceptance, it is raising lots of opportunities and lots of questions. And with the worldwide market for cloud services currently estimated at $160 billion per year, it’s raising lots of eyebrows, too.

Cloud Power

For consumers, the cloud represents easy and cheap access to information—and lots of it. For small- and medium-sized businesses, there can be similar benefits. Instead of buying all the computers to process and store their company’s data and then paying staff to maintain that technology, businesses can turn to large-scale data centers to do it for them remotely—that is, using the cloud. That means no big investments in information technology, no waiting for the equipment to be delivered, set up, and tested, and no salary expenses for monitoring or maintaining it. Instead, one business contracts with a second to provide the computing storage and services for them on a pay-as-you-go basis. Essentially, that second company has put the infrastructure in place to provide the power, and the first company taps into it to get, and pay for, just the amount they need.

Where people once had to build their own fires to heat their homes or go to the well to get their own water, they now turn up the furnace or turn on the faucet, tapping into the power grid that’s been established. The principle behind cloud computing is much the same.

“With the cloud, we’re moving to an era where computer power is more like using a utility,” says Michael Shaw, professor of business administration and the Leonard C. and Mary Lou Hoeft Chair of Information Systems. “You no longer have to put a complete information technology system in place to start a new business. You can connect to an existing system, get access to state-of-the-art technology, and the cost you incur is more proportional to your consumption. For entrepreneurs, that can be the difference between a successful venture and one that never gets off the ground.”

Ramanath Subramanyam, assistant professor of business administration, calls cloud computing “a great leveler, because it allows smaller enterprises to get up and running in a very short period of time at a factor that’s likely ten times less than if they set up their own system. You get cost effectiveness and time efficiencies and state-of-the-art computing power, which really levels the playing field.” For larger enterprises, cloud computing can provide the same benefits—and, in some cases, it can represent an even greater business

“[Cloud computing is] a great leveler, because it allows smaller enterprises to get up and running in a very short period of time at a factor that’s likely ten times less than if they set up their own system. You get cost effectiveness and time efficiencies and state-of-the-art computing power, which really levels the playing field.”

— Ramanath Subramanyam
opportunity, especially for those who have the vision and make the investment necessary to be the utility that smaller companies plug into. It’s an opportunity that many companies are betting on.

Consider Google. Collecting and processing all the information needed to create a reliable, efficient mega search engine is a monumental task that requires massive computing capacity and storage. However, once the infrastructure is in place, that capacity can be used for more than its original intent. In this case, the excess computing power can be offered to others as a service that’s paid for depending upon how much you need and use.

“One way of viewing it,” says Roy Campbell, professor of computer science at ILLINOIS, “is you can buy a warehouse and fill it up with electronic gear, provide a network, and with few people needed to run it, you can use the same massive parallel processing capabilities in place for your own business to provide a service for others. You can schedule it and provision it very economically, which allows you to run a business where people come to you for their infrastructure at a low cost. Cloud computing has allowed for the commoditization of providing services and economies of scale that can be passed on to users.”

It’s that aspect of the technology—that is, cloud computing as a service—that provides a company like Intelestream, founded by ILLINOIS alum Jason Green, with exceptional opportunities to grow. One aspect of the company’s business is Intelecrm, a Customer Relationship Management (CRM) tool. Intelestream’s cloud edition of this product allows “companies of all sizes to manage their business simply and from anywhere using the company’s proprietary cloud offering,” says Green, a 2002 business administration graduate. “Cloud computing eliminates complication, saves money, automates upgrades, and lets our customers concentrate on their core business. They have quick deployment, they don’t have to worry about an in-house IT department, and they pay only for what they use.”

**Taking Business by Storm**

With cloud computing offering convenience, cost savings, and efficiency, why isn’t everyone using it?

For many businesses, it’s a question of whether you are compromising the safety of your data for the convenience of the cloud. “When you rely on a third party to store and process your data, you have to be more concerned about security,” says Shaw. “Your control becomes indirect instead of direct, and some businesses aren’t comfortable with that.”

Green believes some of that is changing, especially in ventures like his that are run by young entrepreneurs. “Those who are under 40, and especially those under 30, are accustomed to having their information on email or Facebook. They’re used to it being stored somewhere else, like Google Docs. That proliferation and acceptance will continue. It’s just a natural evolution.”

But that evolution—as natural as it may be—doesn’t eliminate the need for caution. According to Subramanyam, the concerns about security, regulation, jurisdiction, and other legal issues are important decision drivers. “If you’re going to be in the cloud, you really must be prepared to thoroughly read, understand, and negotiate your service level agreement with the cloud provider. You have to be aware of the issues and craft an agreement that protects your interests.”

At the same time, Subramanyam believes that many providers are proactive in addressing these serious, thorny issues and that consumers are less intimidated by the technology. “The free tier is dominating so much of the consumer space in sites like Facebook, LinkedIn, and YouTube that the public is becoming more comfortable with the cloud. The problem is they don’t necessarily think about where the information is stored or how it’s delivered to them, they just know they have easy access to it. It’s important that consumers don’t let their comfort level with the technology lull them into assuming that everything is okay. They need to ask lots of questions and feel comfortable with the answers they receive.”

While small- and medium-sized businesses are jumping into the cloud, larger companies are just sticking their toes in. Only about 30 percent of companies with more than 1,000 employees have started using cloud computing. Some of the same control, security, and legal issues drive their decisions, as do concerns about maintaining the integrity of highly sensitive data or intellectual property, ensuring the predictability of service and a process for dealing with service failures, and verifying that the costs for the cloud truly would be lower than maintaining on-site IT.

**Hey, Hey, You, You, Get Off My Cloud**

The growing popularity of mobile devices also contributes to the widespread need for and acceptance of cloud computing technology. “People want ubiquitous access to information,” says Shaw. “They want to be able to connect from laptops, smartphones, even TV sets. The technology and the consumer continue to drive the trend toward the cloud and the opportunities to deliver service innovation by using it.”

An interesting example of mobile technology, cloud computing, and service innovation coming together is occurring in an unlikely environment. In India, where only 7 percent of the population...
At the end of the day, whether cloud computing creates new jobs or increased productivity depends on business execution. Business executives need to understand the underlying technological opportunities to execute well, but it’s not so much the technology that matters, it’s the service that the technology allows you to provide.  

– Michael Shaw

More Than Rainy Day Savings

While the private sector is often first in implementing innovation, cloud computing is also gaining traction in the public sector. With the federal government spending nearly $76 billion every year on information technology and the number of federal data centers growing from 493 to 1,200 in the last decade, and many of those centers utilizing only 7 percent of their servers, cloud computing has the potential to increase government efficiency and save U.S. taxpayers lots of money. Darrell West of the Brookings Institution recently estimated that the government could realize savings of between 25 and 50 percent on its IT costs by moving to the cloud, which could translate into millions of dollars.

While Vivek Kundra, the nation’s first federal chief information officer, isn’t predicting specific savings, he is advocating significant adoption of cloud services by the federal government in his recently released “Cloud First” plan, which sets a goal of devoting 25 percent of all IT funding to cloud computing initiatives and establishes an 18-month timeline to evaluate progress toward that goal.

He says the migration to cloud computing holds promise for substantial benefits even beyond the cost savings potential, including increased efficiencies, ease of interface for the public, and more responsible energy usage. At a Brookings policy forum last year, he said the goal is “to create an environment where we can engage with the American people and provide services that are lower cost, help us cut waste, and actually move the government to focus on serving the American people rather than building yet another data center.”

– Cathy Lockman

According to Shaw, it’s likely that both will coexist in a hybrid form, with consumers getting more of their information from mobile devices and companies like Microsoft finding ways to integrate their products into the cloud computing trend. “There is a place for both the PC and the cloud. Rather than the desktop dying out, it’s more likely that innovations will occur so that it can be used in new and improved ways together with remote technology of the cloud.”

In much the same way, there’s also a place for two kinds of clouds—private and public. When does it make sense for a business to get off the public cloud and establish a private one of their own? Campbell says it depends on how much you use it. “Businesses that currently use the cloud for 70 percent of their computing needs may be better off buying their own cloud rather than contracting with Amazon or another cloud provider,” he says.

Shaw says private clouds are also appropriate for enterprises that handle proprietary information or that have research and development data that need to remain secure. While it might seem that such information would be better kept on a PC rather than a cloud—even a private one—Shaw explains that the private cloud allows for globalization. “For instance, an R&D unit of a company with offices on one continent can exchange information with offices in another country. The private

have access to the Internet and personal computers are an expensive luxury for many, a collaboration between IBM and an organization within India’s Department of Labor is focused on helping millions of citizens access employment information. With mobile phones and services becoming increasingly reliable and affordable in India, the new cloud computing platform will allow job seekers and job providers to connect and share information about employment opportunities, searches, training, and trends, which opens the door for citizens to access vital government services from their phones. It’s the type of partnership and technology that holds promise and opportunities in emerging economies around the world.

Does the focus on and acceptance of cloud computing and the growing reliance on mobile technology sound a death knell for the personal computer? Pew Research Center’s fourth “Future of the Internet” survey of technology experts and stakeholders provides some answers, with 71 percent of respondents believing that by 2020 most people will be working from the cloud and in applications run from smartphones and 27 percent convinced that most innovative work will be run on and will develop from a PC operating system.
cloud can facilitate collaboration and therefore innovation.”

**What Else is in the Forecast?**

As legislators, regulators, and cloud providers find solutions that address the concerns of business, the market for cloud services will continue to grow. “The cloud has matured so much in the last five years,” says Subramanyam. “It is a robust technology that will only become increasingly viable for more and more businesses.”

What does that growth mean? In the United States, which has led the world in cloud computing innovation and adoption, it means opportunity—opportunity in terms of expanded markets, job and business creation, and new product and service innovation.

“Most of the leaders in the cloud computing field are U.S. companies,” says Shaw. “We are probably a year ahead of Europe and the rest of the world in development and deployment of the technology.”

The 2011 *Cloud Dividend Report*, released recently by Europe’s Centre for Economics and Business Research, reveals that the European economy sees significant upside as cloud computing establishes itself across the continent. The report predicts that in the next five years this innovative technology could be responsible for creating more than 2 million jobs across the European Union and adding 177 billion euros to the economy.

How valid are such predictions? According to Shaw, it all depends on how businesses use the technology. “At the end of the day, whether cloud computing creates new jobs or increased productivity depends on business execution. Business executives need to understand the underlying technological opportunities to execute well, but it’s not so much the technology that matters, it’s the service that the technology allows you to provide. Blockbuster, or other businesses, could have survived if they had provided the services that their customers prefer. Cloud computing is looming to be one of the ongoing technological developments that provide major opportunities for service innovation.”

—Cathy Lockman

**Why Are Our Heads in the Clouds?**

79% of American adults use the cloud. Here’s what they do online:

<table>
<thead>
<tr>
<th>Activity</th>
<th>% of internet users</th>
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<tbody>
<tr>
<td>Send or read e-mail</td>
<td>94%</td>
</tr>
<tr>
<td>Use a search engine to find information</td>
<td>87%</td>
</tr>
<tr>
<td>Check the weather</td>
<td>81%</td>
</tr>
<tr>
<td>Get news</td>
<td>75%</td>
</tr>
<tr>
<td>Buy a product</td>
<td>72%</td>
</tr>
<tr>
<td>Watch a video-sharing site like YouTube or Google Video</td>
<td>66%</td>
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<tr>
<td>Use an online social networking site like MySpace, Facebook, or LinkedIn</td>
<td>61%</td>
</tr>
<tr>
<td>Use online classified ads or sites like Craigslist</td>
<td>53%</td>
</tr>
<tr>
<td>Upload photos to a website so you can share them with others online</td>
<td>46%</td>
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<tr>
<td>Rate a product, service or person using an online rating system</td>
<td>32%</td>
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<tr>
<td>Download a podcast so you can listen to it or view it later</td>
<td>21%</td>
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<tr>
<td>Use Twitter or other status-update service</td>
<td>17%</td>
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<tr>
<td>Download or share files using peer-to-peer file-sharing networks like BitTorrent or LimeWire</td>
<td>15%</td>
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<tr>
<td>Use an online dating website</td>
<td>8%</td>
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Here’s why that 79% of Americans use the cloud:

- It’s easy and convenient                   51%
- Their data is accessible from any computer 41%
- It allows the flexibility to share information 39%

Here’s what worries them about cloud computing:

- Their data being sold, exchanged, or otherwise compromised 90%
- Their photos or data becoming part of a marketing campaign 80%
- Their data being analyzed and used by marketers to target them 68%

*Source: Pew Internet & American Life Project Tracking surveys (May 2008 – May 2010).*
"I think you can measure the impact of our work by this: Are we giving people who have not had a chance, a chance? To me, that includes the people in the subsistence marketplaces as well as our students. Are our students getting the chance to understand the global challenges that they will face in their lifetimes? I hope that in a very small way we are moving in the right direction toward a larger purpose."

— Madhu Viswanathan
India, which has a strong presence in Bangalore, the capital of the Indian state of Karnataka. Microsoft is focused on understanding subsistence marketplaces “although there is no bottom line insight,” Viswanathan says. “Microsoft has a lot of young people going out and doing experiments and learning about the culture. It's a way for them to engage, and they understand that this is the future.”

And, Viswanathan adds, the research and product design that takes place in and for subsistence marketplaces has the potential to find markets elsewhere. “These resource-constrained contexts can also lead to innovations for all markets. The potential for reverse innovation is real,” he says. “I believe we’re going to see more and more potential for solutions created in subsistence marketplaces to then come back to other marketplaces.”

He cites examples of telemedicine that can be used in communities in the United States and of rugged and inexpensive cell phones that can work in high temperatures, do not reflect the glare of sunlight, yield a good grip, and are functional. “Think of how the rest of the world could use innovations that arise from resource-constrained settings,” he says.

A Simulating Experience

Viswanathan has carved out a career of studying subsistence marketplaces. He has researched low-literate, low-income consumers in the United States for 14 years and has produced user-friendly nutrition education materials that are being used in Illinois. For the past decade, he has also focused on subsistence consumers and entrepreneurs mainly in India, developing a small team there. He created the Subsistence Marketplaces Initiative at the University of Illinois in 2005, which develops and disseminates knowledge for creating sustainable solutions in subsistence marketplaces.

Clarke, too, has been involved on the ground floor of ILLINOIS efforts to develop international initiatives. As director of the College’s Technology and Management program several years ago, one of his goals was to create new collaborations across disciplines. A yearlong graduate-level course and international immersion experience led by Viswanathan since 2006 has contributed to and benefitted from these collaborative efforts. During the past three spring semesters, Clarke has co-taught the course with Viswanathan.

In the class, students develop a deeper understanding of poverty and the behavior of subsistence consumers; they design and develop products for those consumers; and they prepare for an international immersion experience over part of the winter break. According to Clarke, this preparation is key. “Generally, in the U.S. we grow up without wanting much in life, so when we encounter people with very limited resources, in strained environments, operating in tough
When he was a sophomore in college, John Clarke visited Germany as part of an international experience for students. It had such a powerful impact on him, that when he came to ILLINOIS seven years ago he began developing programs so that business students could have their own short-term immersion experience.

Since then, he has taken hundreds of students to countries around the world to give them a firsthand look at the global marketplace. While some of the trips have been to subsistence marketplaces in India (see accompanying story), Clarke has taken students to China, Israel, South Korea, Brazil, and other countries as well.

“The College has a vision that every student should have an international experience,” says Clarke, an assistant dean and clinical professor of business administration. “Since not every student will be able to study abroad for a semester, we offer shorter trips from one to three weeks to ensure that more students have the opportunity.”

Why the focus on international trips? “It helps students to see what skills are required to work in a global environment and to start building those skills. Plus, it allows them to gain a new perspective on the world and on business and to just generally broaden your horizons, all of which are important to working in a global workforce,” explains Clarke.

While on the trips, Clarke requires students to take photos and videos and to keep written journals. “We structure these trips so that a student experiences as much as six months of life in a week to ten days. So it’s important that they have a process of capturing information, often personal reactions and observations, because processing that information over time is a very powerful tool.”

For instance, last year students on the India trip interviewed tsunami survivors in coastal villages as part of research for the development of a disaster shelter that could be deployed to other parts of the world in danger of potential large-scale flooding from hurricanes and earthquakes. “I’m sure that as those students watched the recent events in Japan unfold they have a different appreciation of what is really going on, are far better positioned to sift through the bombardment of disparate information, and are able to better understand the realities of the Japanese situation.”

While Clarke says there’s no way of knowing what environments ILLINOIS students will work in, what roles and jobs they will have in their careers, or even what industries will employ them, he is sure about one thing. “My experience taking almost 500 undergrads, grads, and executives abroad tells me that these kinds of educational immersion experiences are invaluable when it comes to developing and preparing future global operators.”

— Cathy Lockman
day-to-day conditions, we sometimes have a hard time processing the information and accepting the stark realities. To best prepare students for this kind of culture shock, it is important for them to understand as much as possible about the environment so that they are positioned for success and tooled to deal with the challenges they encounter."

Viswanathan believes that the virtual immersion section of the course, and particularly the poverty simulation, are extremely valuable components of this preparation. “What I ask students after the simulation is, ‘What did you do? How did you feel? What did you learn about poverty?’ This is a great way to get them started, to change their perspectives by being engaged,” he says. “They realize that ‘Wow, this is not a choice to be poor.’ They realize how you can go down in a negative spiral. And how you can’t take care of your family and how anxious you are, and as you are anxious you make bad decisions. I find that it’s a great way to get students engaged in thinking about poverty.”

Jenna Goebig, MBA ’12, agrees. “The pain, anxiety, fear, and frustration of living in poverty never goes away,” she says. Participating in a poverty simulation last fall before traveling to India in December, she found herself fighting against time to complete her tasks for the day—whether it was to renew an electronic benefits transfer card, pawn a television to buy groceries, or attempt to find a job as a senior citizen. “We were so busy trying to find means to provide for the physiological needs of the family that we exhausted ourselves,” recalls Goebig. “It was an eye-opening experience about the real obstacles facing families in poverty, and it was instrumental in preparing me for the harsh reality of physical immersion into the subsistence context.”

**An Indelible Impression**

Greater understanding comes from the actual immersion into the subsistence marketplaces themselves. The trips to India leave an indelible impression on students. “The experience was incredibly eye-opening,” says Brian Schertz, MS ’09. Schertz went to India with the graduate class last winter. “We talked in detail during the fall about subsistence market characteristics, especially with respect to India, but it didn’t compare to being there.”

Schertz said many things impressed him about India: the sheer number of people, the unevenness of development, the friendliness and resiliency of the people, and the opportunities in the markets—“not only in what they need to improve their quality of life, but in what we can learn from them as they have managed to survive in these conditions.”

Schertz notes that he came home feeling blessed and realizing that businesses have the responsibility to give back and help people who are in need. John Hedeman, assistant dean of students, has been on two such immersion trips with students and says that’s exactly the kind of impression an opportunity like this can provide. “The hope is that this experience will allow students to build the skills of understanding, of empathy, and of their obligation to use their leadership and skills to make the world a better place. We don’t know what directions our students’ lives will take. Some will be business professionals, design leaders, or engineers, and as they grow their careers, the difference they can make is going to grow as well. I hope that in 15 to 20 years, we’re going to hear about these students making a difference in society.”
Stig Lanesskog, associate dean for MBA programs, agrees. He accompanied Viswanathan and Clarke’s class on their immersion trip last winter and brought along four of his MBA students who were working on a project for a retailer in Mumbai. “This trip absolutely helped to shape the students’ perspectives of India and the global marketplace,” he says. “They have a better realization that products and services for individuals in this market need to be considered very differently, as the MBA’s norms do not often apply. I think this will serve them well as they transition to industry and consider how to best tailor offerings for different geographies across the world. Also, they were struck by the warmth of the people. Even those who lived in challenging situations were so welcoming and gracious. I think that is a good lesson for all of us.”

Those are just the kinds of experiences Clarke hopes students take away from these opportunities. “A successful short-term study abroad trip to subsistence marketplaces in India is a life-changing experience for our students, even for our international students from developing nations. In just a few short days on the ground, they get to explore complex situations firsthand, wrestle in person with things that we see only as a video clip or sound bite, and process information in ways that enrich their understanding of their own environments, environments in developing nations, and perhaps the world as a whole.”

After the winter immersion trips, students return to campus where Clarke and Viswanathan work with them to refine their product ideas for the subsistence marketplace. “First, they study the needs of consumers in the subsistence marketplace, then they collaborate on product or service ideas, then they take their ideas to India with them to see if they will work,” says Clarke. “Sometimes, the ideas they think will work before they go get completely turned on their heads. Then the students have to reexamine what will work in an environment where people have to make very different buying decisions because they live in a resource-scarce area, buy in small quantities, and have nowhere to store items. They use this post-trip knowledge to take the business concepts they’ve learned and create prototypes of business plans and product and service developments that can work for these consumers.”

**From the Top Down**

The class and the trips also cultivate a view that’s much different from the macroeconomic, or top-down approach, that students may learn in textbooks. Viswanathan describes the approach as a bottom-up one. “My starting point is with the micro-level behaviors and life circumstances of consumers and entrepreneurs living in poverty,” he says. “We start with understanding at this level and develop insights for product development and business models using this basis.”

Viswanathan’s view of these consumers and entrepreneurs is one of respect and humility. “I don’t like saying these are valuable markets that we can sell to,” he says. “I like saying these are preexisting marketplaces that we can learn from and that we can design solutions for. In turn, these solutions can help all of us. That is why I refer to them as subsistence marketplaces.”

Those solutions, Viswanathan says, can be designed by a range of organizations “from an enlightened social enterprise that is basically trying to find solutions, but at the same time has a social mission, to a business that is enlightened to say, ‘I think I can do well as a business, and to do so requires...”
understanding individual and community needs and doing good as well.”

One solution that is working is VisionSpring, a social enterprise in India that provides low-cost vision solutions. To assist the vision entrepreneur, ILLINOIS students created a bag for VisionSpring that stores inventory and a deployable kiosk for vision testing.

**Other Creative Initiatives**

Graduate students aren’t the only ones who have the opportunity to creatively study subsistence marketplaces. Viswanathan has also developed a module on Sustainable Businesses for Subsistence Marketplaces for Business 101, a required course for freshmen business students. According to Clarke, “The Business 101 module ensures that all students have an early introduction to this very important business topic. In fact, that first exposure can be where they begin to develop their concepts for the future products and services they design for the graduate course.”

For Viswanathan, it’s a way to begin to develop global citizens and to fulfill what he considers his “larger purpose with teaching at ILLINOIS by creating early and later integrative experiences at both graduate and undergraduate levels on the topic of sustainability.” To do so, he also offers courses on environmental sustainability at both the undergraduate and graduate levels.

Marketplace literacy education is another creative initiative that Viswanathan has spearheaded for many years. He founded Marketplace Literacy Project, a non-profit organization, in 2003. He also developed a consumer and entrepreneurial literacy program for low-literate, low-income people that begins with “know-why” rather than “know-how”—that is, it centers on enabling understanding of the marketplaces among low-literate buyers and sellers. The program calls for a variety of educational methods, including picture sorting, simulated shopping, and role playing, all aimed at tapping into the learners’ experiences—in hopes of placing these people on paths to lifelong learning.

For example, Viswanathan says, consider a poor woman who wants to start a food shop. “She needs know-how—that is, know where to locate, how to design the menu, and so on,” he says. “Our feeling is, even if you’re low-literate and poor, if you can think of the know-why in addition to the know-how, if you can think a little more broadly about your situation, then you’re on a more promising track. For example, Why don’t I start a food shop? Why don’t I sell foods to middle-class households? Why don’t I sell the ingredients to hotels?” and so on. Or ‘Why should I even be in this business? Maybe it’s the wrong business.’ So if you can get people to understand the why of the marketplace, then they can understand why they should choose this and not that path. They can understand how to make wise choices and influence the marketplace around them.”

Viswanathan says that his marketplace literacy education program is working on a small scale, and he is intent on widening the reach. In trying to expand the impact, his team is creating mobile phone animations that deliver lessons on marketplace literacy. The hope is that these animations would be in use worldwide.

In addition, Viswanathan mentions other efforts to expand the literacy education of people in subsistence marketplaces. One educational effort is based on a movie, *Shakti Rising*, made by Madura Microfinance Ltd., one of the largest microfinancing companies in the world. Madura worked with Viswanathan’s team in India to embed marketplace literacy issues into the movie, which depicts a young mother of two in rural India who wants to start a business. She overcomes numerous challenges in doing so, both at personal and marketplace levels. The partnership between Madura and the Marketplace Literacy Project aims to use the movie as a platform to create self-administered, video-based educational modules that require no teacher, but can be used by groups of individuals who want to learn how to better themselves in subsistence marketplaces.

“My goal in scaling is to move from three zeroes to at least five zeroes in the number of people we reach,” Viswanathan says.

But progress won’t be determined by numbers alone. “I think you can measure the impact of our work by this: Are we giving people who have not had a chance, a chance? To me, that includes the people in the subsistence marketplaces as well as our students. Are our students getting the chance to understand the global challenges that they will face in their lifetimes? I hope that in a very small way we are moving in the right direction toward a larger purpose.”

— Tom Hanlon

— Cathy Lockman

The April 2011 issue of Inc. magazine featured Viswanathan’s course as one of the country’s “Top 10 Best Entrepreneurship Courses for 2011.” For more information on subsistence marketplace initiatives, visit: www.business.illinois.edu/subsistence and www.marketplacenliteracy.org.
For the last decade, there has been a growing concern that the business professorate is shrinking. While not everyone agrees that the shortage affects all business disciplines equally, the rallying cry in accountancy has been loud enough to be heard in boardrooms, classrooms, and break rooms across the country—and the data has been strong enough to make the academic community, the profession, and the public sit up and take notice.

For E.B. Altiero, it was an email from her employer that got her attention. As a financial auditor for Ernst & Young for five years, she had been contemplating a career move and was looking for just the right opportunity. Ernst & Young, recognizing the doctoral deficit in accountancy and its potential impact on the profession, was getting the word out to their best and brightest about the Accounting Doctoral Scholars (ADS) Program, a response initiated by the accounting profession to address the looming shortage of accountancy professors.

Altiero read the email and “knew instantaneously” that it was meant for her. The daughter of a university professor, she was familiar with the academic lifestyle and was at a point in her career where she was ready to embrace the challenges and opportunities that it provides.

One of those challenges—the financial one—was made easier when Altiero was selected for the inaugural ADS class in 2009. The program provides a $30,000 annual stipend for four years for 30 outstanding men and women who commit to the professorate. In total, the ADS program has committed to recruiting, selecting, and funding four classes, or 120 new Ph.D. students, from 2009 through 2016, making it a $17 million investment.

Why did the accounting profession feel it was important to take this step? Drastic situations require drastic measures. According to Doyle Williams, the executive director of the ADS program, the shortage is

“When there is financial stress on institutions, the funding for doctoral programs is one of the first things to dry up. While this isn’t true at ILLINOIS, where we can fund our Ph.D. students, it has been true for other institutions.”

— Mark Pecher
reaching a crisis stage, with a report by the American Accounting Association indicating that there are may be as many as 500 accounting professors becoming eligible for retirement each year in the next ten years and less than 200 graduating from Ph.D. programs every year. Add to that the fact that up to 40 percent of those graduates come from other countries where they might return to teach, and the shortage looms even larger.

**Doctoral Deficit**

As the idea of the ADS program took shape, the AICPA needed to find funding partners for the more than $17 million required to implement this ambitious program. That’s where the boardroom came in.

The accountancy profession, led by the Big 4 as well as 65 other firms and 48 state CPA societies, stepped up to the plate to fund the ADS program. “The profession was very concerned that a shortage of faculty would mean there wouldn’t be the teaching talent to adequately prepare students, which in turn would impact the pool of talent entering the firms,” says Williams. “Academia is the lifeblood of accounting, with more than 60,000 new graduates entering the job market every year, so the profession has a vested interest in seeing that these young people receive the best training from qualified professors.”

That vested interest translated into the sponsoring organizations making a generous $17 million commitment to the ADS program. With the third of four classes getting ready to enter Ph.D. programs at 42 different universities across the nation in the Fall of 2011, nearly 90 scholars will be reaping the benefits of the profession’s investment immediately. Down the road, students taught by those scholars and later employed by many of the sponsoring firms will be reaping the benefits of the ADS program as well.
In addition to Altiero, ILLINOIS has three more ADS students, including Tony Bucaro, Keith Czerney, and Stephen Rowe. In the Fall of 2011, three additional scholars will join them.

“Because of the existing shortage of faculty, many schools can only take one accounting doctoral scholar,” says Williams. “They just don’t have the number of professors to supervise additional Ph.D. students. At universities like ILLINOIS, which is an accounting powerhouse, there is still a strong emphasis on tax and auditing, where much of our shortage exists, so they have the research focus, the faculty, and the reputation that appeals to the scholars.”

For Bucaro, who was a partner at Deloitte & Touche when he decided to apply for the ADS program, that’s just what he was looking for. “I had researched the top accounting schools and Ph.D. programs and chose ILLINOIS because I knew that the training I would get from such a prestigious program would open doors to me in the future.”

Which brings us to another part of the equation—the commitment of the universities in taking on the task of training the professorate.

“We try to maintain a one-to-one faculty-to-doctoral-student ratio,” says Mark Pecher, professor of accountancy. “It’s an intense mentoring activity and a substantial commitment on the part of the faculty.”

It can be an expensive proposition as well. However, with one of the largest and most successful programs in the country at the undergraduate and master’s levels, Ira Solomon, professor of accountancy and department head, explains that making that investment is necessary to ensure that the ILLINOIS program, and the profession, will have the faculty needed to keep up with the increasing demand for accountancy education.

“It’s important both to business and to the academy,” Solomon says, “because the profession needs graduates who have had the mentorship, teaching, and academic rigor that comes from strong, dynamic faculty members.”

Cost Concerns

Of course, it wouldn’t be a true business dilemma if there weren’t some economic issues involved, one of which is the opportunity cost students incur, which goes right to the heart of why there is a Ph.D. shortage in the first place.

“Accounting students have great career options and earning potential,” says Jerry Trapnell, executive vice president and chief accreditation officer for the Association to Advance Collegiate Schools of Business (AACSB). “It’s extremely difficult to make a decision that means taking four, five, or even six years away from that earning potential and on top of that possibly incurring costs for your education and living expenses. The ADS program has helped address this problem, but we need to continue to have dialogue on how we can minimize opportunity costs for students.”

The willingness, or unwillingness, of universities to shoulder the significant costs of providing financial and faculty support to all incoming doctoral students also has an impact on the shortage.

“When there is financial stress on institutions, the funding for doctoral programs is one of the first things to dry up,” says Pecher. “While this isn’t true at ILLINOIS, where we can fund our Ph.D. students, it has been true for other institutions.”

Additional pressure comes from the fact that Ph.D. programs aren’t revenue generators, and that most universities don’t hire the Ph.D. students they’ve trained in order to ensure an infusion of new ideas and perspectives, so making the investment is a challenging proposition.

Add to that the fact that there are state budget crises across the country, impacting both funding for programs and salaries for faculty, and you see the dilemma many business deans are facing.

“By the nature of the intensive learning process involved, Ph.D. programs represent a very high cost form of education,” says Larry DeBrock, professor of business administration and dean of the College of Business. “However, the fact that you see business schools maintaining these programs during this period of budget stress is evidence of the great benefits Ph.D. programs provide to the faculty and to the research mission of the units.”

“ACCOUNTING STUDENTS HAVE GREAT CAREER OPTIONS AND EARNING POTENTIAL. IT’S EXTREMELY DIFFICULT TO MAKE A DECISION THAT MEANS TAKING FOUR, FIVE, OR EVEN SIX YEARS AWAY FROM THAT EARNING POTENTIAL AND ON TOP OF THAT POSSIBLY INCURRING COSTS FOR YOUR EDUCATION AND LIVING EXPENSES.”

– JERRY TRAPPNELL
Jaimi Goodfriend had more than 10 years of experience in finance and an MS and MBA from Northwestern when she approached David Ikenberry, who was then chair of the ILLINOIS finance department, with a proposition. With an interest in preparing students for the working world, she had written a syllabus outlining a plan for teaching a course on investment analysis. Ikenberry liked what he saw and offered Goodfriend the opportunity to teach an eight-week module on a trial basis to see if it was a match for the department and for her.

That was four years ago, and now Goodfriend, an adjunct lecturer, commutes two days a week to Urbana-Champaign from Chicago, where she has a consulting practice and works for a firm that offers predictive trading systems. She brings her experience in active trading, security analysis, and portfolio analytics to the classroom, teaching courses on options, futures, and financial derivatives.

Goodfriend is part of a growing number of experienced professionals who are following their passion for teaching while at the same time helping to stem the tide of the looming Ph.D. shortage in business. In 2009, she completed the professionally qualified (PQ) bridge program through the Association to Advance Collegiate Schools of Business (AACSB), an intensive week-long program that focuses on course and classroom organization and structure, teaching platform skills, testing strategies, classroom management, and, what Goodfriend describes as “methods that create the best learning environment for the students.”

Like other ILLINOIS faculty members, Goodfriend is exceptionally talented, but she is a rarity in the College of Business, where Ph.D. credentials are the faculty standard and very few adjunct positions are available.

Heitor Almeida, professor of finance and director of the department’s Ph.D. program, says while ILLINOIS is not seeing the shortage of Ph.D. candidates or faculty that is reported elsewhere, he recognizes the value that faculty members with real-life experience and current professional affiliations bring to the classroom.

“Most of our students are looking for jobs in the industry, so having someone who works in the finance profession gives students a perspective on the real work world and contacts in that world that can be very helpful as they explore their career paths,” he says. Plus, PQ faculty can fill a void in curriculum offerings by bringing their expertise in areas of finance that are on the cutting edge of practice.

“While a candidate with experience and a Ph.D. is ideal, there are experienced, talented people with a passion for teaching who don’t have the doctorate but are important assets to rounding out a program.”

Says Goodfriend, “I absolutely love teaching and I also love working in the markets. As an adjunct lecturer, I have the best of both worlds.”

– Cathy Lockman

“I ABSOLUTELY LOVE TEACHING AND I ALSO LOVE WORKING IN THE MARKETS. AS AN ADJUNCT LECTURER, I HAVE THE BEST OF BOTH WORLDS.”
– JAIMI GOODFRIEND

“WHILE A CANDIDATE WITH EXPERIENCE AND A PH.D. IS IDEAL, THERE ARE EXPERIENCED, TALENTED PEOPLE WITH A PASSION FOR TEACHING WHO DON’T HAVE THE DOCTORATE BUT ARE IMPORTANT ASSETS TO ROUNding OUT A PROGRAM.”
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– Cathy Lockman
Building Bridges

With so many challenges, what are some ways to stem the tide of the doctoral deficit? Some steps rely on the generosity of the profession, not only through their funding efforts of the ADS and other programs, but through their initiatives to encourage some of their most talented staff to consider the professorate.

Rowe, who was an audit manager at KPMG before entering the Ph.D. program at ILLINOIS, says supervisors and partners at his firm provided strong encouragement and support throughout the ADS application and selection process. “The firm is a financial supporter of the ADS program and was very excited to learn that I had been accepted.”

The firms’ willingness to supply the academy with research data is also an important way to encourage the work of doctoral students.

“The ADS program is a great step, but also just a first step, by the profession,” Peecher says. “Growing the pool of qualified doctoral students will do little to address the shortage unless these new students subsequently have access to relevant empirical data for conducting research. Without data, it’s a bit like hatching chicks but not feeding them,” he says.

Bucaro agrees. “My firm was very supportive of my choice, as I think is true of all the firms who have made the financial investment in the ADS program,” he says. “However, the more the firms support not just the training of the Ph.D. but the ongoing research of academicians as well, the more successful we’ll be in increasing the numbers of Ph.D. students.”

Another initiative that addresses the shortage of doctoral students is the Ph.D. Project, an effort that has focused on increasing the numbers of minority business school professors through information, support, and preparation. Since the establishment of the Ph.D. Project in 1994, the ranks of African-American, Native American, and Hispanic-American business professors has tripled—from 294 to more than 1,000.

AACSB Bridge Programs provide a two-tiered initiative that offers alternative avenues for professorial preparation. The first is the academically qualified (AQ) portion, which provides business training for those with a Ph.D. in another discipline and awards an AACSB-endorsed certificate that enables them to teach in one of the association’s 607 accredited business schools.

Trapnell explains that while the AQ program is controversial because it’s not the traditional model of doctoral education, “It is a creative response to addressing the shortage. It may not be an ideal solution, but it does have its place. For instance, an industrial psychology Ph.D. might translate well to organizational behavior or human resource management,” he explains.

The second tier of the bridge program is the professionally qualified (PQ) portion, which trains experienced business professionals for work in the classroom. “The PQ bridge takes those who are judged to be professionally qualified, that is, those who have a master’s degree and significant experience in terms of breadth of work and duration, and gives them an intense orientation to the academic community,” says Trapnell.

Again, while the PQ bridge isn’t a solution to the shortage, it can provide a shot in the arm, especially for those schools “that, unlike ILLINOIS, do not offer doctoral programs, but focus on providing high-quality professional degrees in accounting at the undergraduate and masters’ level,” says Trapnell. “Those schools still provide a strong education, but often they must choose from a much smaller pool of faculty applicants to begin with,” he explains.

So while the PQ program creatively fills a need in closing the gap in faculty shortages and in bringing a practical perspective to the classroom, everyone agrees that it isn’t a substitute for, but rather an important complement to, Ph.D.-qualified professors.

“It’s important that the education of undergraduates and master’s degree candidates be facilitated by instructors with Ph.D.s who are relatively independent of the practice side of
It’s All Academic

When you’ve been in the accounting profession for several years, what is it that you need to know to make the leap to an academic career?

The ADS focuses some of its efforts on just that question. According to Williams, “Our orientation conference is a very valuable aspect of the program because it provides an opportunity for potential scholars to engage in an honest conversation with current Ph.D. students and professors about what the academic life is like, both the challenges and the rewards.”

For Czerney, an external audit manager for KPMG before he came to ILLINOIS to pursue his Ph.D., the ADS conference was “very informative and helped me better understand the demands of a Ph.D. and those placed on a researcher. Plus, it provided me with my first real opportunity to network with accounting professors from various universities.”

That’s the goal, says Williams. “We want to provide a way to help young professionals make informed decisions in a structured way before they invest the time and effort in making that change and before others make the investment in them.”

Czerney came away convinced the career change was right for him. “After considering my options, I felt as though academia would provide me with new professional and intellectual challenges that I would not be able to find in another position in the industry. As an academic, there will always be new research questions and new students to challenge me.”

Rowe also says the challenge was appealing as was the opportunity to carve out his own niche. “During my time in the profession, I especially enjoyed teaching regional and national training through KPMG. I also enjoyed the technical side of accounting and auditing along with constant learning. I view entering a career in academia as allowing me to focus even more of my effort on the aspects of my professional experience that I enjoyed most,” he explains.

Perks of the Professorate

It’s a career that seasoned professors agree is a very satisfying one. For Williams, serving as executive director of the ADS program is his latest role in a long and distinguished career in accounting. He founded the School of Accounting at the University of Southern California, served as a dean of the business schools at both USC and the University of Arkansas, and served terms as chair of the AACS B and board member of the AICPA. While he could retire, he continues to lead the ADS program, “because it’s critical to the future of the profession and higher education in accounting that we have the talent to teach tomorrow’s leaders.”

What can that faculty talent expect from the academic life? “Being a professor allows you to leave a legacy in terms of impact on students and contributions through research that over time influence the profession in ways you might not even be aware of, and you can do that without giving up financial success,” says Williams.

Solomon, also a professor with a long history of service to the academy and the profession, adds that: “The academic life is a calling. It’s an opportunity to interact with bright young people, to push the knowledge frontier, and to be part of a dynamic intellectual community that promises challenge and fulfillment.”

“After considering my options, I felt as though academia would provide me with new professional and intellectual challenges that I would not be able to find in another position in the industry. As an academic, there will always be new research questions and new students to challenge me.”

— Keith Czerney
How the Government is Using Quantitative Easing to Fight the Recession

Fixing a flat tire usually requires a jack, a wrench, and some elbow grease. But if the lug nuts are rusted, you might need more tools, or even a mechanic, to help you get back on the road.

A stubborn recession has posed the same situation for economic policymakers. The usual tools haven’t been enough to heal the ailing economy, so the Federal Reserve has had to reach a little deeper into its toolbox to find a fix.

Quantitative easing is a specialized “jack” that the Fed hopes will help lift the U.S. economy. Essentially, an effort to pump vast new sums of money into the economy, quantitative easing is not a step the Fed took lightly, nor without consideration of the many potential risks as well as the benefits. By purchasing about $2 trillion in long-term Treasuries and mortgage-backed securities from 2009 through early 2011, the goal was to get money into the hands of banks for them to lend and to drive down long-term interest rates so that businesses and consumers would want to borrow and spend. The purchases were done in two rounds, known as QE1 and QE2.
The cash infusion did drive down interest rates, but it also spurred ripple effects that penetrated every corner of the U.S. economy and much of the rest of the world. For instance, quantitative easing caused the dollar to lose value. “Declines in the dollar are a double-edged sword,” says Anne Villamil, professor of economics. “A weaker dollar boosts U.S. exports and lowers the trade deficit, but it also raises the cost of oil and other imports, adding to inflation.” Meanwhile, other nations complain that the weaker dollar makes their exports to the United States more expensive and costs them business and jobs.

Hammering Out a Strategy

Congress has given the Federal Reserve the mandate to promote a high level of employment and low, stable inflation. Lowering short-term interest rates is one tool the Fed uses to meet those goals. But with short-term interest rates already about as low as they could go, and employment still high, the Fed determined that additional easing of monetary policy was needed to support the economy.

“At that point, you can’t push those short-term rates any lower,” observes Charles Kahn, professor of finance and department head. “So what do you do? You go to longer-term instruments, which are still paying something.” He believes quantitative easing is “no more damaging than the old method of buying short-term instruments.”

But because it’s a less common practice, it has some economists worried. Federal Reserve Chairman Ben Bernanke addressed those concerns after the announcement of QE2 in an op-ed piece in The Wall Street Journal: “Purchases of longer-term securities are a less familiar monetary policy tool than cutting short-term interest rates. That is one reason [we’ve] been cautious, balancing the costs and benefits before acting. We will review the purchase program regularly to ensure it is working as intended and to assess whether adjustments are needed as economic conditions change.”

Trying to quantify how much quantitative easing helps or hurts the U.S. economy may not be possible. “Oil prices have been driven up by (both) turmoil in the Middle East and QE2,” says Villamil. And she notes that quantitative easing by the Fed was accompanied by other measures to boost the economy, including tax cuts and increased government spending.

What quantitative easing did do, says Kahn, is show Americans that the Fed hadn’t run out of mechanisms to fight the downturn. “If the Fed had had nothing left in its toolbox, consumer and business confidence would have suffered. Confidence is important.”

But the potential for long-term harm has some U.S. and foreign economists concerned. They argue that low interest rates may help spur the creation of asset bubbles or that inflation might soar if the Fed doesn’t withdraw the huge sums of money it has pumped into the economy in time.

In fact, just the fear of high inflation could cause problems. “There is a risk that some investors might say there’s no way to reverse this in time to avoid high inflation, so I’m selling my Treasuries right away,” says William Emmons, assistant vice president and economist at the Federal Reserve Bank of St. Louis and an ILLINOIS business administration graduate. “So it’s a fragile balance. With these new tools, there is higher level of risk that people might lose faith. It could happen that something of a panic could set in and foreign investors could start dumping Treasuries because they don’t believe the U.S. could keep inflation under control. If that happens, then the policy fails.”

And Emmons cautions that no one should expect a quick fix from quantitative easing. “Because the Fed’s anti-recession
measures were so extraordinary, getting back to normal monetary policy could take a long time, maybe three, four, or five years just to normalize things. And there’s the risk of something going really wrong in the meantime. It’s as if you hiked up a really high mountain—it’s a long way home.”

**Time to Retool**

The number of economic sectors impacted by quantitative easing is large. Debtors benefit from lower interest rates—and the United States is mired in debt, both nationally and individually. At the same time, savers suffer as returns on their fixed-income investments wane. “When you lower the cost of credit to people getting mortgages, you’re reducing the return that long-term investors get, which hurts certain groups, like retirees,” says Finance Professor George Pennacchi. “In turn, some people may be taking on too much credit risk (by investing in junk bonds) because that’s the only way they are able to get higher rates of return.”

And while the weaker dollar helps U.S. exporters, it “could have a depressing effect on at least some U.S. industries that depend on imported commodities, such as oil,” Pennacchi says. Quantitative easing may also be triggering a series of secondary impacts that haven’t received a lot of attention. “When oil prices go up, more farmers shift their production from food to ethanol,” says Pennacchi. “The result is higher food prices.”

Pennacchi adds, “It’s unlikely that quantitative easing will make everyone better off. There will be winners and losers. And it may not be such a good deal if the Fed can’t reduce quantitative easing at some future point to avoid higher inflation.”

Bernanke, in his op-ed piece, says concerns about significant increases in inflation are overstated. “Our earlier use of this policy approach had little effect on the amount of currency in circulation or on other broad measures of the money supply, such as bank deposits. Nor did it result in higher inflation. We have made all necessary preparations, and we are confident that we have the tools to unwind these policies at the appropriate time.”

In recent testimony before the Senate Banking Committee, Bernanke also maintained that the rise in both oil and other commodity prices would not result in widespread inflation. In fact, he rejected the notion that quantitative easing is primarily to blame for rising commodity prices. The culprit, he said, lies with “rising global demand for raw materials and constraints on global supply.”

**It’s Debatable**

Meanwhile, quantitative easing has caused some foreign governments—China, Brazil, and Germany among them—to complain the policy wouldn’t work or was downright harmful to their interests. The head of Brazil’s central bank said quantitative easing would distort world markets and make it more difficult to halt the rise of Brazil’s currency. German Finance Minister Wolfgang Schäuble said, “The U.S. has already pumped endless amounts of money into its economy. The results have been hopeless. And now, to say let’s pump more (money) into the market is not going to solve their problem. With all due respect, U.S. policy is clueless.”

In the period leading up to the crash of 2008, the Fed repeatedly fine-tuned its actions to keep the economy out of...
The Q&A on QE2

What’s the Upside of QE2?

• Banks have more money to lend.
• The stock market rises.
• Interest rates fall.
• The overall economy gets a boost.
• Federal Reserve shows it still has tools to fight recession.
• Consumer confidence gets a boost.
• Consumers and business pay less to borrow.
• Home refinancing at lower interest rates gives consumers more cash to spend.
• Exports rise, easing the trade deficit.
• Export growth shores up manufacturing.
• Interest on the national debt falls.

What’s the Downside of QE2?

• Oil prices rise.
• Consumers have less to spend as gas prices rise.
• Imported raw materials prices rise.
• The overall cost of imports rises, pinching consumers and worsening the trade deficit.
• Food prices rise as some U.S. farmers switch from food to ethanol crops.
• Retirees and other fixed income investors suffer from low interest rates.
• Investors shift to riskier investments to get higher yields.

What are Additional Risks of QE2?

• Inflation could rise sharply.
• Investors could dump Treasuries.
• Asset bubbles could form and eventually burst.

recession. As a result, some people thought the economy had been freed from the downside of the business cycle. But this proved an illusion—the downside had merely been postponed. During the good years, bubbles had formed in housing and stock prices, and both eventually burst.

Today, some people think the economy would have been better off if the Fed had allowed it to take some knocks during the extended period that preceded the crash, says Emmons, the St. Louis Fed economist. Still others, including some members of Congress, want the Fed abolished.

Bernanke defends the Fed’s actions, saying: “The Federal Reserve cannot solve all the economy’s problems on its own. That will take time and the combined efforts of many parties, including the central bank, Congress, the administration, regulators, and the private sector. But the Federal Reserve has a particular obligation to help promote increased employment and sustain price stability.” He says the steps taken to ease monetary policy help fulfill that obligation.

In the meantime, economists continue to hash over the pros and cons of quantitative easing. “This is something economists will debate for years to come,” says Emmons. “And it’s something they may never agree on.”

– Doug McInnis

“If the Fed had had nothing left in its toolbox, consumer and business confidence would have suffered. Confidence is important.”

– Charles Kahn
Within Reach

The Incentive to Meet Earnings Estimates

“IF INVESTORS AREN’T FIXATED ON QUARTERLY EARNINGS, THEN MANAGEMENT’S MYOPIC BEHAVIOR MAY BE CURTAILED. MANAGERS CAN STILL PROVIDE THE NECESSARY INFORMATION TO CAPITAL MARKETS BUT, AT THE SAME TIME, CAN REDUCE THE FOCUS ON EARNINGS AS THE PRIMARY INDICATOR OF FIRM PERFORMANCE.”

– W. BROOKE ELLIOTT

Woe to the company that fails to meet its earnings estimate. The price of its stock will almost certainly fall, stockholders will grumble, and managers could be on their way out.

The comparison of analysts’ earnings estimates to actual earnings is one of the most closely watched rituals in the financial world. To miss an estimate by as little as a penny a share invites trouble.

Many corporate managers deal with this quarterly ritual with a ritual of their own. They try to steer analysts toward a number the corporation can meet or beat. Sometimes they do this by providing management’s own earnings estimates; sometimes they do it by providing a few key tidbits of useful financial information.

Once the analysts have reached a consensus estimate, management can then make minor but legal accounting adjustments to ensure they meet or beat that number. For instance, they can boost profits by changing their estimates of how long equipment will last. This would reduce the allowance for depreciation.

As a result, a missed earnings estimate is often construed as a sign of trouble. “If they miss, then they didn’t even have the margin to manage earnings,” says Kevin Jackson, assistant professor of accountancy. “The impact of that can be pretty dramatic, and it would be reflected in stock prices.”

Focusing on Strategy

The quarterly task of meeting or beating analysts’ estimates is time consuming, and it can detract from a company’s ability to manage for both the short and long term. “Managers have been surveyed as to whether they had decided not to make a capital investment because the expenditure would make them miss an earnings forecast,” says Jackson. “A majority said they had done so at some point.”

W. Brooke Elliott, associate professor of accountancy, says management’s fixation on earnings estimates leads to short-term thinking. “Numerous studies have documented that managers often behave myopically—focusing on managing quarterly earnings to meet expectations in lieu of focusing on the long-term strategy.”
Although analysts provide a wealth of information, the investing public tends to fixate on the earnings estimate and the comparison of that estimate to reported results. This fixation ends up causing problems. But a recent study by Elliott, Jackson, and Jessen Hobson, assistant professor of accountancy, suggests management could diffuse the problem by putting earnings into perspective. “Our idea was to reduce the fixation on net income as the one important number,” Hobson says.

Management could do this when it issues earnings guidance, by breaking the company’s financial results into components such as gross revenues, cost of sales, depreciation, and research and development. “This would remind investors that earnings are just one piece of the puzzle, not the whole puzzle,” says Jackson.

For example, a company could boost its earnings and meet the earnings forecasts by slashing R&D expenses. In that case, investors who fixate on earnings might assume that a company had performed well because their earnings results met their guidance, when in fact it had mortgaged its future. With disaggregated earnings guidance, investors could more readily identify the change in R&D expenses and more accurately determine whether the final number is good or bad news, Jackson says.

In the long run, breaking out the numbers would benefit the company as well. Says Elliott, “If investors aren’t fixated on quarterly earnings, then management’s myopic behavior may be curtailed. Managers can still provide the necessary information to capital markets but, at the same time, can reduce the focus on earnings as the primary indicator of firm performance.”

Getting it Right

The earnings estimates the public sees are the tip of a much larger analytical machine. Buyout firms, for example, employ in-house analysts to determine the finances of potential buyout targets. An example would be Warren Buffet’s Berkshire Hathaway. Berkshire may spend billions of dollars on an acquisition, and it wants to make sure the outlay is justified and that it isn’t paying too much. So it supplements information from other sources with information it collects itself. “Companies like
It’s Got a Good Beat

The first chart shows the percentage of companies in each of the last 42 quarters that have beaten their earnings estimates. The second chart identifies S&P 1500 companies that have beaten their earnings estimates much more often than that. To make the list, the company must have at least 20 quarterly reports on file.

Historical Quarterly Earnings Beat Rate

S&P 1500 Historical Stocks with Highest Beat Rate

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<thead>
<tr>
<th>Stock</th>
<th>Company</th>
<th>EPS Beat Rate</th>
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<tr>
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<td>Deckers Outdoor Corp</td>
<td>96.4%</td>
</tr>
<tr>
<td>TTC</td>
<td>Toro Co./The</td>
<td>96.2%</td>
</tr>
<tr>
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<td>96.0%</td>
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<tr>
<td>IVAC</td>
<td>Intevac Inc.</td>
<td>95.5%</td>
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<td>Mettler-Toledo</td>
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<tr>
<td>OIS</td>
<td>Oil States International</td>
<td>95.5%</td>
</tr>
<tr>
<td>NOV</td>
<td>National Oilwell Varco</td>
<td>95.2%</td>
</tr>
<tr>
<td>SNX</td>
<td>SYNEX Corp.</td>
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<tr>
<td>AFG</td>
<td>American Financial Group</td>
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<tr>
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<td>Greif Inc.</td>
<td>95.0%</td>
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<tr>
<td>GILD</td>
<td>Gilead Sciences Inc.</td>
<td>94.6%</td>
</tr>
<tr>
<td>LMT</td>
<td>Lockheed Martin Corp.</td>
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<tr>
<td>SYMC</td>
<td>Symantec Corp.</td>
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<tr>
<td>UTC</td>
<td>United Technologies Corp.</td>
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<tr>
<td>VAR</td>
<td>Varian Medical Systems Inc.</td>
<td>94.6%</td>
</tr>
<tr>
<td>CTSN</td>
<td>Cognizant Technology Solutions</td>
<td>94.1%</td>
</tr>
<tr>
<td>EXBD</td>
<td>Corporate Executive Board</td>
<td>92.3%</td>
</tr>
<tr>
<td>ISRG</td>
<td>Intuitive Surgical Inc.</td>
<td>92.3%</td>
</tr>
<tr>
<td>DWA</td>
<td>DreamWorks Animation</td>
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“IF IT LOOKS LIKE THEY’RE GOING TO BE A PENNY SHORT, THEY MAY MAKE SMALL BUT SUBTLE CHANGES. BUT IF THE GAP IS LARGE, THEY PROBABLY WON’T TRY TO BOOST EARNINGS BECAUSE IT COULD TRIGGER SHAREHOLDER LITIGATION ACCUSING THEM OF COOKING THEIR BOOKS.”

– GANS NARAYANAMOORTHY

Berkshire Hathaway do most of their analysis in house,” says Johnson. “They have their own people out there sniffing around.”

Earnings estimates are also used for firms that aren’t publicly traded, says Gans Narayanamoorthy, assistant professor of accounting. These can be used to determine a buyout offer. “Let’s say you want to know what to pay for an ice cream shop that’s not publicly traded. In that case, you might hire a consultant or an auditor to go over the books and say, ‘This is what the revenues and earnings are.’ Then you could use those numbers to figure out what the shop is worth.”

For the most part, the earnings-estimate process is on the up and up. “It’s possible for a company to make small changes to conform with analysts’ estimates,” says Narayanamoorthy. “If it looks like they’re going to be a penny short, they may make small but subtle changes. But if the gap is large, they probably won’t try to boost earnings because it could trigger shareholder litigation accusing them of cooking their books.” Narayanamoorthy’s research found that management would instead be likely to issue earnings guidance to get analysts to revise their estimates lower, so shareholders wouldn’t be blindsided by bad news.

And at least for the moment, Congress has given executives an added incentive to play it straight. “The Sarbanes-Oxley Act requires executives to certify that their accounting is accurate,” says Narayanamoorthy. “Of course, there will always be the Enrons of this world, where they make changes in their accounting to show that they are much better than they actually are. But that is a rare occurrence.”

– Doug McInnis
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