Preface

THESE PROCEEDINGS are based upon a Conference conducted at Oregon State University on May 13 and 14, 1970.

The conference was sponsored jointly by the Schools of Forestry and Business and Technology. Co-chairmen of the Conference were Professor Ray A. Yoder of the School of Forestry and Professor Lester B. Strickler of the School of Business and Technology. Both co-chairmen wish to acknowledge the help of various individuals from forest products industries and financial institutions who aided in formulation of the program.

Conducted informally, the Conference was designed to provide a forum for an interchange of views as to the problems, policies, issues and opportunities that forest products firms and the financial institutions will face in funding this rapidly changing industry in the coming decade. The topics covered a broad spectrum that should interest bankers, investors, finance officers, accountants, foresters, planners, developers, and others concerned about current and coming developments in the forest products industries.

These Proceedings were based upon tape recordings of the various speeches and papers presented during the Conference, and upon the ensuing discussions. The Editor has attempted, in the process of abstracting and re-writing, to preserve as much of the authors' original phrasing as was possible. If, however, he has erred in doing so, the Editor assumes complete responsibility.

Ray A. Yoder
Editor

School of Forestry
Oregon State University
Corvallis, Oregon
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WE ARE PLEASED to welcome you to Oregon State University. For those of you I haven’t had the pleasure of meeting, my name is Ray Yoder, and I am a member of the teaching faculty of the School of Forestry. It is my pleasure to serve as your host for this opening session. This afternoon, the codirector, Dr. Lester Strickler, Professor of Finance, will preside. He will not be with us this morning, by the way.

I am told by Will Post, who is standing at the rear of the room, and who is director of conferences of this kind on behalf of the School of Business, that we are about equally divided as to our backgrounds. We are about half from Forest Industry and the other half from financial institutions. And, of course, we have Bill Padgham, who is a maverick. He is a graduate of the School of Forestry, but is with one of the banking institutions.

There can be no doubt that the topic we confront today is both important and timely. The forest industries are widely recognized as having very high capital requirements per employee and at the upper levels of management are among the most capital intensive of investment enterprises. This is especially true of those firms that own or control extensive timber properties to supply a significant part of their raw material requirements. It would be redundant to recite to you the principal developments that have taken place in our industry during the decade just past. Those of you from the forest industries have a lively awareness of these trends from
firsthand experience on the firing line. Those of you from the various financial institutions have also kept close watch on developments in our industry. However, our concern is with the years immediately ahead, in which our industry must plan to meet the needs of the future, which we know will be a predictable one at least in some respects. You know far better than I the importance of financial planning in ensuring the success of any business venture.

During the next 2 days, as you listen to the various speakers assembled here, and as you exchange points of view with them, you should gain some new insights into the more important problems, policies, and issues that affect financial decision-making in the industry.

You will note that the Conference is a joint venture in which the Schools of Forestry and Business share equally. This is as it should be, because the forest-based industries provide the bulk of the industrial employment and business activities in this region. Accordingly, only an interdisciplinary approach would seem to be appropriate. The same reasoning was followed in selecting the speakers and the audience. They come to us from different geographic areas, and, as indicated before, both the industry and financial houses are represented.

I would like also to acknowledge the presence here (he said he was not going to address you) of Dr. Earl Goddard, the Dean of our School of Business. Now I'd like to present to you Dr. Carl Stoltenberg, Dean of the School of Forestry, who has some words to say on behalf of the two Schools and of the University.
Welcoming Remarks

Carl H. Stoltenberg
Dean, School of Forestry
Oregon State University
Corvallis, Oregon

THANKS, RAY. Dean Goddard and I had an agreement that one of us would say a word of welcome on behalf of President Young and the Deans of the two Schools. My suggestion to Earl was that if there were any student demonstrations going on outside, I would gladly take that opportunity to let Earl speak on behalf of the University and to welcome you to the conference. Since things are quiet this morning, it is my turn. And it is a pleasure to welcome you to a rather quiet and studious campus. This is a campus that does give really thoughtful consideration to the problems of the world and the country, as well as to the institutional problems of education. Here, we seem to be resolving or considering these problems in a very peaceful way.

We have not had strikes this year or excessive turmoil. We did declare a moratorium on classes (President Young did last Friday) and during the morning of that day we had some meaningful dialogue sessions in the individual schools. Faculty and students together talked over problems of concern, both with regard to academic matters and with regard to the world situation.

In the afternoon, faculty and students from different schools met together, and again, we gained an added appreciation about how different elements in the university community think about different subjects. I think that none of you would have students be unconcerned with the very serious problems of the world that we now have. I think that most of you would share with us the concern over the way their interests and their feelings are expressed.
You may have noticed the student who just came in. He is one of our students in forestry from France. The same is true throughout the campus. We have students from all over the world who are exchanging ideas and making friends with our other students, and it is from these kinds of concerns and associations that world peace is a matter of very drastic concern to all of the students on campus. I don’t think you will have any demonstrations or strikes, or anything violent happen in the next couple of days on this campus. It is rather fortunate that we exist a little bit farther away from the sources of great assistance and help from outside the university circle that so often breed the kind of violence that we had at Portland State and some other places recently.

I really do welcome you to this conference on behalf of the two schools. The Schools of Business and Forestry cooperate very closely on this campus. Many of the forestry students take what amounts to a minor in business in their undergraduate work, and then many shift to an M.B.A. program after they receive their Bachelor’s degree in forestry. On the other hand, we have a very active minor program in forestry for those students who are majoring in business, both at the Bachelor’s and Master’s level. The same is true for our effort to open up the resources of the university and to provide conference situations like this one where people from the forest industries and related business institutions can come together and discuss problems of mutual concern. Both Dean Goddard and I have other commitments, so we will not be here all of the time. I have two National Forestry Research Advisory Committees meeting on campus this week; so I will be in and out. But we’re glad to have you with us, and I’m sure the conference will be productive.
Planning For The 1970's:
Is It Possible In The Real World?

Dr. Leonard Guss
President
Leonard Guss Associates

INTRODUCTION
by Professor Ray A. Yoder

MUCH OF THE SUBJECT MATTER of the conference, as you can tell by the program, will deal with financial planning. There should be no disagreement with two corollary thoughts. First, financial planning, though extremely important itself, is but a part of overall planning. Second, planning helps lend stability to any enterprise. I am certain that you will agree with me that our industry does not have the best of reputations in the matter of stability.

Our leadoff speaker is eminently qualified to talk on this topic of planning. He holds degrees from several universities. You have a list of these in your program. He has been employed as an industrial economist, as a manager of marketing research, and later as a director of marketing and economic research for Weyerhaeuser Company. He is a national director of the American Marketing Association and, recently, has struck out upon his own and has formed his own consulting firm, which deals primarily with marketing consulting. It is a pleasure to introduce Dr. Leonard Guss, who will discuss “Planning for the 1970’s – Is It Possible in the Real World?”

ADDRESS

GOOD MORNING. I am delighted, and still somewhat surprised, to be here. Being in a mixed audience of financial
people and industry people places me somewhat in the position of Robert Benchley, of my generation, and I guess that is true of some of you. When he was going to school on a campus very much like this one, he took a course in U.S.-Canadian Relationships. Being Robert Benchley, he didn’t bother to attend any classes. When he showed up at the final examination, he was faced with one question. “Please discuss the U.S.-Canadian Fishing Rights Treaty of 1857 — first in the viewpoint of the Canadians, and then from the viewpoint of the United States.” He thought a bit and then he started to write. He said, “I will not discuss the U.S.-Canadian Fishing Rights Treaty of 1857 from the viewpoint of the Canadians, nor can I discuss this treaty from the viewpoint of the United States. However, I will discuss it from the viewpoint of the fish.”

I would like to discuss planning from the viewpoint of the fish. Titles like the one that I have chosen, “Is Planning Possible in the Real World?” usually turn me off. I don’t know about you. Because I’m sure that the question is totally rhetorical; that naturally planning is not only possible, but is widely practiced; that the trick is not in whether to plan, but in how. And also, I usually hear with an inner ear that the speaker just happens to have a pretty system, which he will impart to me. And that this will convert my futile planning to successful planning. Further, his system is likely to be so esoteric that otherwise I would not stand a chance of developing it, lacking the forms of the mathematical simulations of the relationships required to exercise this technique.

Now, obviously, I am not really concerned with whether planning is possible. I am concerned only with whether it means anything. With whether it has meaning not only to the planner but to the plannee. With whether it bears any correspondence to the world that was, the world that is, and the world that will be. It may seem a trifle late in the game to question the usefulness of planning. It is part of the conventional wisdom that planning is better than not planning, that forethought is better than afterthought, and that a peek is worth two finesses. We have many people whose jobs involve planning, whose job titles include the word “planning,” and who produce plans with
appalling regularity. There are even people who teach planning and I'm shamefaced to admit at times to having been one. Naturally, there are even more people who study planning, a circumstance that pleases the teachers of planning. There are articles, books, treatises, and “how-to’s” galore. Frequently, there are meetings where people who have planned exchange confidences on what they did, who they did it to, more rarely on how it came out. Every company goes through the exercise of developing detailed plans, usually to a high degree of sophistication. They incorporate such concepts as modelling, planning cycles, time horizons. In the face of so much practice, in the face of so much expertise, certainly, admittedly, in the face of so much need, why is planning so rarely a realistic guide to action? Why indeed, for many people and many companies is planning a total exercise in futility? There's the rub.

I will say right now that I do not propose a general and all-out attack on planners and planning. I do not claim that planning is useless and noncontributory to the welfare of the business, or for that matter, a social enterprise or a government agency. I wish merely to point out that the world is littered with failed plans. That old plans are rarely looked at in the light of current events, and that when they are, faces often burn and cars turn red and that, in fact, it is the merest chance when a long-range plan turns out to have more than a passing acquaintance with reality. This is part of the folk wisdom which says that the best laid plans of mice and men gang aft a-gley. As a mouse who has often planned and lost, I would like to explore with you some of the reasons why; the hazards incurred in planning; possibly share some insights with you into what I believe planning is and what it is not; what it can do; what it cannot do; and how you might avoid being clawed by this angry beast of reality.

Without redefining planning, let's accept the concept that planning is an ordered attempt to manipulate or accommodate to the anticipated environment, present or future. Theoretically then, planning should be in high conformance with the real world, rather than with the fantasy world. And, although no one expects planning to be perfect in every detail, it should not
disappoint either the planner or the one whom it is planned for, in the sense that the plans diverge widely and wildly from what later turns out to be the event. Now, what are the elements of planning as seen by the devil’s advocate or Cassandra approach? Let’s take them one by one. Without referring to anybody’s definition but my own, a plan usually contains, explicitly or implicitly, implicit in the other segments, the following components:

1. A situation analysis. It often recapitulates the history of the business of the firm.
2. A statement of the present state of the company, its resources, its facilities.
3. A statement of company goals and objectives that usually take off from, and are related to, the description of the immediate present. For example, a 15 percent profit growth a year, a 50 percent market share.
4. A forecast of the anticipated future, defined broadly as in GNP or narrowly, as in a company sales forecast.
5. A statement of expected actions that either the company will take or some other body will take that will, in ordered sequence and on certain dates, accomplish the goals to fit the future.

Now if it’s a good plan, by today’s standards of goodness, it will also have some of the following:

An assignment of responsibility, voluntarily or forced, to make the events happen.
A spelling out of the assumptions, often known to the select as exogenous events, on which the future and thus the plan depend.
A measuring or a tracking system that will notice deviations when they occur, and finally, a program of alternative action to take to correct the deviations, or to consider if the deviation is so wide that it is obvious to everybody that the plan is screwed up, although some diehards will insist that the world is screwed up.

Now this seems like a good list, or at least as good a list as any. Why doesn’t it always work? More to the point, why does it work so rarely?
Planning for the 1970’s

Let’s examine these component parts, one at a time, a situation analysis being the first.

Now, most situation analyses that I have seen failed to analyze the situation. This may be due to a lack of comprehension about what makes the industry and the company tick. The planner may have only a superficial knowledge of how his industry grew, what is essential, what is peripheral to his industry, what happened in a logical, traceable way, what was serendipitous. Often, the situation is described romantically. Now you have to be careful here, because my definition of a romantic probably differs from yours. A romantic, to me, is one who believes that hard numerical information really defines the world. Situation analysts often develop strings of numbers, but numbers are results, not causes, and impose an order upon relationships that exists not in the real world, but in the mind of the observer, and thus armed, the planner moves on to stage two.

Stage two is the state of the company, and this is an area that is fraught with peril. The question here is not so much inaccuracy, but irrelevancy. What resources and what facilities are truly important in planning? Many companies – perhaps most – have each a myth as to what they are all about. With some, it’s their land base, or raw materials, with others it’s plant. Still others value their technical know-how, and others are frank to say it’s their money. Often enough, these resources may not play a role in the future as they have in the past. Their importance is a reflection of the men who historically emphasize them, rather than truly being a base on which to build. I have yet to see a plan that even treats of the state of the company’s mind, its guts, if you will. Many plans imply the possession of cold courage, icy nerves, total flexibility, and rapid-fire reaction. But where in the plan is a past demonstration of these qualities? Where will they come from in the future? Of course some companies, especially the larger ones, may not know what they have, and often they do not know what they know. Knowledge and experience are widely scattered, and they are rarely brought to bear in one planning effort. Moreover, when it is, this is often done by a planner who is actually a filter, who sees and hears through his own biases so
that what gets put down is his version of reality. We are all faced with this. Companies often have reams of data, but these were collected for specific purposes: taxation usually, sometimes sales control, sometimes manufacturing control. Rarely is the data base available to utilize some of the newer planning techniques. Of course, this doesn’t necessarily stop anyone from using them.

The next point that I mentioned is a statement of company goals and objectives. Now these may be at times – and I’m sure that all of us here have seen many such statements both inside of our companies and outside of our companies – so blithering, sometimes so fatuous, that it is embarrassing for an outsider to read them. Sometimes the goals express the rate of profit increase or share of market, without any statement for the services to be rendered to gain these “goodies.” I’ve heard described that wrath and greed without thought usually mark such statements, or the goals are so generalized, so motherhoodlike, so all embracing that any plan or no plan would serve equally well. As Lowell Say said, and I put this in because he said it before Ted Levitt, “If you don’t know where you’re going, any road will take you there.”

It’s not surprising that so many companies find it difficult to express their objectives. After all, a goodly number of companies haven’t yet decided what business they are in. Company after company is engaged in searing soul searching, trying to define what it is they’ve been doing for all these years, convinced that a proper definition of their business will save them from the necessity of doing it well. Convinced also that all those factories and trucks, offices and warehouses are either accidents of nature or reflections of too narrow a look at life. If you don’t know what you’re doing now, how will you know what you want to become? Or — if you’ll like it when you get there?

I mentioned the forecast of the future. Everyone lives in anticipation of the future. Expressed or implied, we all have a mental set, so that present action is in conformance with anticipated reality. No part of a plan is more key than the forecast that frames and guides all action. Even companies that
Expect to perform against the trend still have to know that trend. Forecasts are often tied to action. A forecast of the economic, political, and social environment may be totally exogenous (now since that’s the second time I’ve used that word, I want to come back to it) for all except the General Motors of this world. But a forecast of company results demands company action, either to fulfill it, or if it’s disastrous, to avoid it. Most plans fail because the information base is terrible. The information base is terrible because the data are lacking, or collected carelessly, or irrelevant, inadequate, or inaccurate. The planner may have a romantic vision of just what is relevant. We live in a total world (now that sounds so trite). But when did you last see a plan that projected anything more than numbers? We plan around the economic environment as though we were not social animals at all. As though politics, technology, and psychological self-conceptions did not exist. As a result, these plans are whispers on the wind. What happens to projections made? As I’ve described — there is no lack of failed projections. This is why they are rarely read after first issuing — it’s too embarrassing.

I have a sample of economic statements and noneconomic statements. The ones I have picked have no magic in them; they are neither the best or the worst. I’m sure you all have your own samples. As far as I’m concerned, they are simply physical.

“The changeover from war to peace will bring depression.” Many of us might recall the state of mind that this country was in in 1945. This was not only a fair reflection of the state of mind of the country at that time, but a basis for action and conversion from World War II to the times thereafter. In 1945, economists predicted 8 million unemployed. In 1947, actual unemployed totaled 2½ million. That hurts. “The general average of price rises for the next 25 years will not be more than 1 to 2 percent a year.” A reasonably noted source arrived at this conclusion by whatever decent techniques were available to us all at the time. Are any of us planning on that basis? “The ever more plentiful supplies of food and goods, higher standard of living and education should make the containment of violence easier during the coming 25 years.” I don’t know about
you, but I was relieved that my safety was assured on campus this morning.

Well, we have to come to numbers sooner or later. This is as good a set as any. It is from the annual report of a large company (a fine company) projected for 1970 (really in 1969, since at the time I wrote this, I didn’t have figures for 1970) and considering the kind of talk I’m giving, I just won’t give you my own. Off by a mile—20 percent—except in the case of the FRB index, which is considerably more.

Here is a forecast for men in the armed services (this isn’t too bad—it’s only about 50 percent), projected for 1970, really in 1969-1970, and again, useful planning techniques were widely used. I am not citing these because of the sources, but simply because they are as typical as anything. We might as well have one for our own industry: projected plywood demand by 1975—it’s supposed to have reached the august heights of 7½ billion feet. At least we can be thankful for small favors—errors do go in both directions. Here’s one, and to me the question at the bottom is the key one. When you were planning in 1965—and I’m sure that many of us were planning in 1965 as we are planning in 1970—how many of these issues, which are the key issues of life today, did we take into account? How meaningful were our plans and could our plans have been those that set these considerations of war, of ecology (ecology was a word so esoteric in 1965, I don’t think I ever came across it outside of Biology Departments of Universities), the quality of life, consumerism, recession, decay of the schools, minority conflict, student riots, and so on ad nauseum—we could just expand the list. The real question of course is how many of these kinds of concepts and the ones yet to be heard from in the next 5 years are you taking into account in your financial planning of today?

Planning is based on the assumption that it is possible to develop information, to set goals, and to manipulate people and the environment sufficiently to achieve these goals. Now all of these are presumptions and sometimes they are presumptuous. Many company plans are made against the grain, or with the forced acquiescence of the people who have to carry them out.
Oh, I know the President talks about teamwork and anyone who wants to stay on the team nods and smiles. But most plans are done to others and when it comes to carrying them out, few people are around. Now why is this? Well, frankly, I don’t know. I speculate that it may be because many good men intuitively recognize the lack of reality in much planning, and won’t play this game except under the direct eye of the boss. Plans are regarded by this type as a written form of blue-sky dreaming, to be produced at annual meetings and promptly set aside at the first crisis. Crises of course occur with astounding regularity, say every weekday. I conclude that people usually don’t do what the planner says they will do, in or out of the company. This lack of proper behavior on the part of employees, managers, customers, and regulatory agencies can be most distressing.

I mentioned the idea of assignment of responsibility. This is often abandoned at the earliest opportunity. If the manager is lucky enough to have a PERT chart or a CPM chart, he can show that event 1 didn’t happen right, and they can junk the rest.

I mentioned the spelling out of assumptions. I said earlier that I would get back to exogenous, and here I am. Exogenous is a favorite word. This spelling out of assumptions is usually a statement of the exogenous, the noncontrollable, the outside-the-context-of-what-we’re-talking-about events. Now I really don’t want to discuss technique here, but you will recall that predictive models usually combine internally generated forecasts correlated to predictions of exogenous events. When the model doesn’t work, the model simply says that the exogenous forecast was wrong. Yet, this is a program for failure, because the world is made up of exogenous factors. This is why modeling often does not do what it is supposed to do. It’s not useless, but it does not do what it is supposed to do.

Measuring and tracking. This problem has become more critical since the introduction of computers. And the concept of exception reporting, which has fooled people into thinking that they have a tracking system. The key and critical idea here is to be able to recognize a warning sign when you see it. Signals are
thrown up all the time and from every direction that a plan is going wrong. But they are not heeded because they are not recognized as signals, but rather as isolated information. This may go back to not understanding the business. How many of us now are just beginning to take the data on consumerism as information that should signal some meaning to us? How many are still ignoring these data? You can’t track what you don’t recognize. This has been commented on before, that “they have eyes and see not.”

Alternative actions. Now this is the last element of the good plan and no more often present than one would suspect in what I said before. First, it is hard work enough to write one course of action that will get by the boss. Second, alternatives are usually viewed with bias because if they were preferred, they would have been mentioned first. As it is, most alternative actions are used simply to justify by their obvious inadequacy the suggested course of action. More important, rarely indeed, are alternative actions geared to alternative events. One has to assume that things don’t turn out the way the plan says. Either everything collapses while the boys regroup, or things go on as they always have, which says something about the importance of the plan.

Now, to sum up, planning is (to put it mildly) frustrating. It is usually done as a graft on the skin of the business, with no real impact either way. If it succeeds — in other words, if it is a guide to reality — it may be by accident, as often it is. If it fails, small loss, except to discourage the next attempt. Planning is, I believe, dependent on broader perceptions of what is real and what is controllable. Substituting mathematical formulae for thinking and feeling won’t work. The ordered worlds of the simulation or other model are fine as an aid to thinking, dreadful as a guide to action, without a conscious flushing out of all those exogenous factors that together make up the real world.

Can any plan detailing action last in time? No. Can any plan specifying a future last in time? No. One of the advantages to being a speaker, as I’m sure you have noticed before, is that you can ask and answer your own questions. I believe that our
ability to predict the future in meaningful ways is close to zero. However, our ability to speculate about a series of alternative futures and devise a reasonable course of action for the most likely events or scenarios is high, very high. And therein lies the key to planning, one I have named as Guss’ law. For a plan to correspond exactly to reality, all factors must be controllable. Guss’ corollary: the more a plan depends on exogenous factors, the less likely it will be realized. Guss’ principle: if all business plans depend on noncontrollable events, none will be realized.

Why bother to plan? Is it worth it? Well, yes. Oh, very much so. The plan itself, I believe, is of almost no value. There is a good argument for burning all plans as soon as they have been written, as some sort of a ceremony, because they have lost their value, except as an historical document. The value, of course, lies in the planning, not in the plan. The value lies in the understanding of how and why what happened, did. What are the interrelationships – the building blocks that make up the industry, the company, the department? The value lies in speculating about the future, but focusing on the company. In other words, the postulated future is, I believe, less important than the posture of the company, so that it is free to respond agilely to any one of a series of likely, but unpredictable, futures. The ability to respond is vastly increased by planning. What is planning, then? Is it wisdom? No. It is an aid to understanding. We have already been reminded that with all of our gaining of wisdom we should get understanding also.

Now I have one more slide I wanted to show you which, due to superb planning, I have lost somewhere along the way. So I would like you to use your imagination and visualize this last slide with no reference and no source. Flashing on the screen, all it says is “Prosperity is Just Around the Corner.” Thank you.

QUESTIONS

Professor Yoder. Thank you very much, Dr. Guss. We have allowed ample time in all these talks for an exchange between you people and the speaker. He is, in other words, on the spot. I
would like to lead off this particular part of our program by asking a question of my own. I happen to teach Forest Management Planning. I believe that you have addressed yourself to this question as though planning were a single person's efforts. I teach that planning should be through a team approach, not only for the sake of bringing several disciplines into the act for the sake of their backgrounds, but also so you can make other people accessories before the fact. Would you care to comment upon this?

Dr. Guss. Delighted. This is not a nonstrategic ploy. Like all of our actions, planning has its share of "shoulds." I think the point that I was trying to make is the wide divergence between the "shoulds" and what happens. Planning should be a team effort. More importantly, I'm a firm believer, a member of the school, that the only kind of planning that has any meaning is that planning which is really done by the people who have to carry it out (one way or another).

I couldn't be in closer agreement with you. Rarely have I come across examples where planning is really carried out this way. Where operating people, operating in the full sense of the word, actually create and evaluate the assumptions, flush out their plans, and treat it the way that we are talking about - as a team effort, as an integral effort, as something in which they are totally involved. More often than not, planning is relegated to planners. Planners who may be divorced from the functions and the realities of the company.

I agree with you as to what it should be. I'd like to get some feedback from the group. One of the things that I noticed when I got this brochure was the vast amount of open space available for discussion. Now I wonder if we can get something going in this group as well, such as answering questions, in which I'd be delighted to go as far as I can.

I might open the door. How many of us here do planning in the way that they feel totally involves the people who have to carry out the plans? You know the way I'm saying it because, you see, if you don't put up your hand, it means that you are agreeing with some of the things I said this morning.

Well, I'm not going to force you. I'm not going to look a gift industry in the mouth. This will imply to me that the
frustrations that I'm trying to point out here are common — common enough so that all of us here have experienced them. And in one of these rough frustrations where the planning is often something done by people to other people, I think that's wrong, but I think that it's reality in the way it is today. Is that a fair answer to you?

I was interested in your slide on your key issues of today as related to planning of 1965. It might be interesting to ask yourself "If you had planned in 1965 for these issues, what would you have done differently?" I mean, if you were sitting down in 1965 and planning for these issues, what would you have done differently than you did?

A beautiful question, and a nasty one. Let me make two points, one of which will dodge around, and one of which will try to answer the question. The dodging around one is that my key point is not so much what we would have done in 1965 with some perceptions of things, or what we will do in 1970 with an equal but different list of the kinds of qualitative things that will affect our lives within the next 5 years, but the unknowability. You see, what I'm trying to say is not "You fellows who didn't think of these things in 1965 weren't smart," but simply that only in terms of the merest accident could you possibly have developed that total list as well as a few others, as being concurrent in anybody's planning. Because we do not have this kind of foresight, you could have speculated on the possibility of economic recession, you could have speculated on the possibility of war, the likelihood of war. Whether or not you could have speculated on the consumerism, minority conflict, and student riots, I do not know.

So one of my points is the unknowable nature of some things and therefore the necessity to build a plan that focuses more on a company than on the environment, because the environment is too close, and unknown.

The second one is that there are a good many things that you could have done in response to some of these anticipations. One of them, depending on what business you are in, is business opportunity. It is true that one man's problems are another man's opportunity. Ecology, air pollution, water pollution, littering, the components of what we talked about of ecology,
are problems for some companies and form business opportunities for others. Companies and divisions of larger companies some years ago decided that this was a business, whether it was in smoke-screening equipment, or a certain kind of disposable packaging, or whatever it might be.

You could look on these things as a clue to a business, a product and product concept. Consumerism is, I think, a very important one. You didn't have to go back as far as 1965, for as recently as several years ago the beginning impact, the increasing obligation, willy-nilly, laid upon the manufacturer and services to the general market, can be visualized. I think that what we have seen (now this is a personal opinion that I'm interjecting) today in consumerism is the beginning, not the crest of the traffic.

Therefore, as business planners, it would be perfectly proper for us to visualize what will be our responsibility in the future. Our business responsibilities in terms of product specifications, in terms of warranty, in terms of service: service, for example, of an appliance manufacturer. I'm sure many of us are familiar with what Whirlpool Corporation has done to turn the disadvantage of service into a business asset. It could have led those of us who were involved in construction and building (many of us in the Forest Products Industry do get inevitably involved with construction and building) into the concept that if we are to respond to consumerism, we cannot lose control of our product at as early a stage as we have been losing control of it before. How do you maintain control of a product? By maintaining control of the market into which it goes, which has led some companies into total installation to control their product, which is the only way that they provide the guarantees of service and quality that are being increasingly laid upon companies.

Now, these are some of the kinds of benefits. Some of them I think you simply have to face as information, which you tend to accept, you tend to believe or act around, and you tend to do very little specifically about.

Decay of the schools could offer an opportunity for action. If you live in a community as Equitable lives in Newark,
you might take some specific action to try to improve the school system of the community in which your major headquarters or major plants are.

More than that, I really don't know what to do about it. So I think that your ability to respond to some of these things would vary. To some — consumerism, ecology, and so forth — quite positive responses are possible. And many companies have made them. To others, I think you shrug your shoulders and say "Well, if that's the way it's going to be, we'll dodge the ones that we have to dodge and respond to the ones that we have to respond to." I don't know how much of an answer that is.

Dr. Guss, you mentioned that one of our problems in planning is an inadequate data base. I think you implied that not only is it inadequate with respect to the exogenous factors, where it is mostly inaccurate, but also the internal factors of the company are often either incorrect or not the right ones under consideration. Of the internal factors, I think you talked about some nonquantifiable factors — perhaps the personality of the company. Do you think these things can ever be explicitly recognized and dealt with, and secondly, do you think the quantifiable factors that are generally incorporated in the plan are the right ones? The traditional measures — accounting measures — are these really the determinants of the outcomes, or are they the results?

Yes and no. "Yes" to your first question and "no" to your second. Let me go back to the "yes." To me, the social climate, or the culture of the company, is just as real an aspect of what that company is all about as the number of plants it has, the number of manufacturing employees, financial resources and data processing, and anything else that can be related with the facts. I find it so rarely recognized as fact. Many people deal romantically with themselves and their businesses. Not only do they not accept what they are, which is kind of up to them to determine, but they do not make the attempt to determine what kind of a company they are and what they would really like to do. This leads them into many strange highways and byways. Let me draw an example from quite a few years ago when I was doing a diversification study. At that time I was
employed by the Battelle Institute, and diversification studies were the popular game of the day. Companies would come (they still do) to companies like Battelle and to other consultants, and I have to be very careful about what I say about consultants.

At that time this company, which was a very large manufacturer of crankshafts, wanted to diversify. The initial guideline laid down to the consulting organization was “We will consider anything that is profitable.” I distinctly remember the president of that company saying how we would go into candy bars if that would be a profitable venture. Although we were all rather foolish in those days, we weren’t quite that foolish, so we didn’t bring up any candy bar possibilities.

We spent a fair amount of that company’s money looking at many exciting possibilities, all of which were thrown out, one by one, for one reason or another. Eventually we got down to the key issue that what they really wanted to make was crankshafts and if we could find another application for crankshafts, other than the ones they knew about, that’s what they wanted to do in diversifying.

This is the kind of expensive game that you can get into when you don’t understand the culture of a company. I’m not trying to imply that there is anything wrong with having a particular mental set, with having a particular internal culture. It is as much a fact of life as that most of us have two arms, two legs, a certain number of eyes, fingers, noses, and whatever. This is part of what we are. The not recognizing what we are can cause us a great deal of grief, not only in such absurd examples as this very true one I gave you about diversification, but in looking at how we deploy our own resources.

I mentioned, perhaps too briefly, this state of the company’s mind, or its carriage. I have and perhaps many of you have seen, time and time again, companies seriously consider business ventures in fields that are so foreign to their nature.

Let’s take the very active consumer goods fields – I’ve seen industrial companies used to highly engineered, high value, infrequent purchase considerations thinking about getting into
something like the toothpaste market. Let's pick an example of the highly competitive consumer field, the cosmetic market, where to those few who are foolish enough to carry their fantasies into reality, they get slaughtered — not because they are bad businessmen, but because their total mental set, the way their company is organized, their response to time, the way that they do things, is just not geared to this type of venture.

I've seen the reverse happen too. This lack of recognition of what we are, I consider a prime reason for the failure of many kinds of plans. The lack of even willingness to pay attention to the idea that there is a company culture, a way of doing things, a certain set of things that we feel comfortable with, a certain set of things that we feel uncomfortable with. I think it's very expensive. And to make again the point that I made in my talk, sometimes (it really isn't funny, but it could be amusing) when companies imply in their planning, criteria that they have never been able to deliver in real life, new product ventures that are always supposed to return 30 percent after taxes on the ROI basis, when they have never in their lives returned 30 percent on anything, companies that imply a reaction time like lightning, (the steely nerves, the iron jaw) the total reaction to the market place, when the usual response time is measurable by seasons. This kind of thing is a very expensive hobby. If planning would deal with these kinds of circumstances, it would be very realistic planning. It doesn't have to be right, remember. To my mind it's the process, more than the plan. The very willingness to deal with it is the basis of reality.

The second point you mentioned, based on the inadequacy of internal information — I think we've all been faced with this, mostly because the kinds of information that we historically collect are not designed for planning purposes. In our industry, we collect an awful lot of information for taxation purposes. In other industries, we may collect it for sales purposes, or broader purposes such as marketing, or for manufacturing control. Then we have to take this information, developed for some entirely different need, twist it, distort it, extrapolate from it, and somehow fit it into the planning context. But because planning
deals by necessity in the future, and all of this information is historical, what we are faced with is the necessity of extrapolation, and this is a true method of walking backwards into the future.

In engineering, which is close to the heart of a lot of us in the companies that own substantial timber lands, in order to enter into markets that maybe they've never been in before involving recreation, home, and other developments of real estate aspects, do you see any problem of the character or social state of the mind of these various companies in possibly being lured into markets that they're not familiar with?

Well, because we all know that there are some of us here who are precisely in this position, I'm going to have to phrase my answer in this way. For the average (whatever in the hell average is) timber owner, to get into recreational land development with the same concept, the same people, the same business methods as he was in cutting and selling timber, I think it's suicidal. Unless he has by some freak a piece of land that will sell itself. Every once in awhile, people do luck out.

There is nothing to prevent any company from gearing itself to do many things. The question is “What will that gearing cost be, and how much of a distortion to the whole company will that gearing be?” There are companies that have added adjuncts, which have tried to gear themselves to certain kinds of business, but the people whom they've added, the people with whom they've traded, the function they've set up, is so distorted, so strange, so foreign to the general environment that it flounders and dies. Now this is an extreme case. I think it is perfectly possible for a timber-owning company to get into this area. As long as they recognize this entirely different business — and when you are selling leisure homes and vacation homes, recreational developments, you are selling something that is a world away from selling timber. It sounds obvious, but I don't think that it's often carried out in the plan.

Ideally, I suppose it would be desirable to have a plan turn out to be accurate and realistic. In planning yourself or in guiding others you assist in planning, do you tend to work toward an optimistic plan, a pessimistic, conservative plan, or which approach do you shoot for?
You are thinking in terms of one component in planning, are you not? In other words, the objectives or goals are standard? The plan to me would encompass very many other things, and I think that you would probably agree on that from what you said. I have to split my answer again. When it comes to weaseling, I think I'm at least as good as anybody in this room. I believe in a very conservative, pessimistic evaluation of the internal realities and the capabilities of a given company. I believe in an optimistic target setting or goal for the same reason that many other people do. If it isn't just a little bit beyond high reach, we just don't grasp that far for it. Now, this is my definition of realism. An optimistic target – more pessimistic assumptions. Instead of making the bland assumption that an optimistic target can be realized, if our plans insist on detailing just how it is we plan to reach this magical goal, as no goal is possible without a plan to reach it. Even the statement that we will do this year what we did last year implies a set of actions. If nothing else, it implies that we will do the same thing as we did last year, with the same people, the same resources, the same merchandising structure, whatever it might be.

So often we ignore the fact that when we make no changes, that doesn't mean that we haven't defined a certain set of circumstances, a certain set of attributes. We have. They simply happen to be the same ones that we've always used. That's as positive a statement as any other kind of statement. So my general answer to you is more optimistic targets, colder looks at who is going to do what, and our ability to change. Not that our ability to change is nil, but I believe that our ability to change is far smaller than our ability to postulate change for the sake of planning.

There must be someone here who has disagreed with something that I've said. I know this is a hard way to start a morning, with so many negative comments. I do want to put them into perspective.

You are talking about the situation that we are going to look at today, and we talk about our goals and objectives. But what about the restrictions that we have when evaluating goals and objectives that pertain to the forest products industry? We
are considering the next 10 years, when substitute materials are coming in. We were talking about total involvement in planning. What will pulp mill superintendents and those involved in plywood complexes and in managing, etc., do to get involved in planning? They are taking care of their production jobs every day, and somewhere they have to get this information. They pick up the annual report and see that the President or the Chairman of the Board says we are going to double profits. Then he is the one who is probably going to do that. He is looking for a 1-year plan. He wants to know what he is going to make, what he is going to ship. He probably pretty well knows the quality of logs that he is going to have. We get into the question of goals, but then how do we look into these restrictions? If you could explain this part — I didn’t quite understand.

All right. I would rather not deal with technique, as I said before. The concept you bring out that we have to enumerate and spell out and understand the restrictions in so far as we are able, to me is just as real as our understanding of the option. And one of the points that I would like to make is that without being so negative that we paralyze action, it is possible to lay so many criteria, so many restrictions, so many constraints upon what we do that we are terrified to put one foot in front of the other. And this is not the purpose of planning or any other action. Ignoring these restrictions, what will happen to make these profits double? What will absorb these markets of confusion? This is to my mind absolutely naive, and I think that many of us do it all for fun. We ignore the kind of realistic assessment of restrictions that we can make with available information, with available technique, with available speculation. In some cases within a cultural climate of a company, it is considered less proper to look at restrictions than it is to look at opportunities. Where that exists I think it may be described as being rather costly. The kinds of restrictions you have mentioned — the physical limits of the forest, the impact of competitive materials, the changing demands of markets — can all be looked at more or less, but you have to do the best you can and make the best assessment you can.
That's why all of us are in different kinds of business. The very act of looking at the restrictions can be a very rewarding thing. One overall kind of restriction that I could mention in the forest products industry, or at least to all those people concerned with forest products, is that there is one broad philosophical question that many of us are trying to deal with. All of us are trying to deal with it in one way or another, which can underlie very much of the planning that we do. This is the question of supply versus a postulative demand. And people seem to fall not evenly into one of two groups. There is a group of people who believe that demand is rising at a greater rate than supply and inevitably demand must press upon supply. There is another group of people who believe that this is not so, that supply can be made economically available in such a way as to meet or exceed demand. A fair dichotomy, but I'm not going to load the question one way or another.

The lack of examination of that point, the lack of the implications of those restrictions, whichever they might be, I think can make all planning futile, unless you have spelled out and really tried to look at these things. In much planning we start with philosophical premises. We take one of the two factors that I have just mentioned, and we decide which one it is going to be. We build our plans from there, without having examined it. Where that is the case, all I can suggest is that we probably have a 50-50 chance of being right, which may be better than some of the other circumstances. But I fairly agree with you that restrictions have to be identified — have to be looked at — in the same light as any other contributing factor to the plan.

*How do you view technological forecasting?*

*With terror!*

*I seem to be in some sort of conflict here, because at one stage we were saying that the operator should be meeting his operational responsibilities, and at the same time should be looking for exogenous forces such as technological change and social issues. There seems to be some conflict as to whether at the operating level you sometimes don't get the "why" across as to what is essential; so we say if all things are essential, how do*
we resolve the conflict? How do we keep from doing so in a plant with a 5-year depreciation period, when the technology would be out the window in 5 years?

I don't quite see the conflict that you have expressed, and if you see one in what I said, then I said it badly. Let me go over that again. First, technological forecasting is an increasingly sophisticated bundle of techniques in which we have simply said to ourselves that within limits, we can predict certain kinds of logically indicated technical change one way or another. We can do this one of two ways. We can either take technical parameters that exist today (which may be the speed of a paper machine, which may be productivity factors, which may be the speed of aircraft) and we can extrapolate these or push them into the future. The other way is what we might call normative forecasting, in which we look out ahead and say, "By 1980 we have got to have something that does something like this: Working backwards from 1980, what do we have to have in 1978? What do we have to do in 1976? Eventually what do we have to do this summer in the laboratories in order to get to where we want to get in 1980?" Within limits, these techniques are valid. They are less precise than economic forecasting techniques and we all know the troubles and the validity of economic forecasting. This isn't quite that good.

I did not mean to imply that an operating person (a person who has the primary responsibility for planning) is necessarily the same guy as the one who has the responsibility of collecting information. I think it perfectly proper and absolutely necessary for anyone charged with the responsibility of planning to seek his information where he can. He can devolve this responsibility upon capable staff, of course, provided he understands what is being done and takes the responsibility for assessing and integrating it. It is perfectly proper, if you are an oil company, to have your technical people evaluate for you the technical and economic feasibility of oil from shale, or if you are in a chemical company, it would be perfectly proper to evaluate the petrochemicals as a source, or wood chemicals, or any other technological change which isn't here yet, but which may come about. You can send that responsibility off, but what
you cannot send off is the responsibility for accepting what it might mean to you and to your plan. Then you are asking an awful lot of the staff support, not only to make a technical forecast, but to tell you how it will affect your actions. You can separate the information gathering from the integration into a plan. I think all of us do.

_I think you are into a two-way deal here. Your plans have come upward from the operating people. They are relatively short range and deal with real life and things that are predictable. Then there are the plans that perhaps come down from above, from the people who are dealing with the total resource of the company and projecting what it might do with those resources over a period of time. You are in two ball games, really._

Yes. And if they meet in the middle or somewhere near the end, that’s great. The kind of planning that I was talking about, and I think it’s not unfamiliar to all of us, is the kind of planning where all we really live by is the year-to-year operating plan. The longer range plan continually recedes into the future. The two never do come together. Instead of coming together, the long-range plan is always out in the future, and the short-range is always chasing it. The two never really meet. That is the reason I made the statement that in many companies, what happens to the long-range plan is totally immaterial. Things go on as they have before. Where they do meet, you have the kind of situation I consider ideal for planning. That does not mean that the budget of first year’s planning is necessarily an expression of the first year of a five-year long-range plan. That’s asking an awful lot of a long-range plan. But if the two never come together, then what you have is a graft upon the skin of a company, and it’s really an exercise, a scenerial picture of the world that probably won’t come about, and if it does, it’s not going to change anybody’s actions anyhow.

_I recall hearing Governor Robertson, of the Federal Reserve Board, state privately one day that they would have been better off (in the Federal Reserve Board) in 1968, to have traded him off for three or four economists._
Well, you have asked two separate questions. I think that I can say in all fairness that I consider what you are talking about to be the most vital thing that you can do in planning. I’m a little distressed at this casual willingness to trade in us economists quite so cheaply; I mean on the basis of 3 to 1. I at least like even odds. This is precisely what I am suggesting. That when we live in a world of numbers, that we are being romantic, to the extreme. I mentioned the term romanticism before, and I said that I have a different view of romanticism than many people whom I have seen.

I have heard certain of the social disciplines described as romantic: sociology, anthropology, psychology. Of course economics is a social discipline in that sense too, as opposed to the hard disciplines, science, chemistry, physics; in business it might be the accountancy and so forth. But in my mind, there is nothing more romantic than this kind of hard information. I believe in a role reversal. I believe that in true romanticism, a person believes that numbers describe causes. I don’t think they do; I think they simply measure a fact. If we are ever to understand causes, we have got to have these very kinds of inputs that you are talking about. Without them, we have no sense of reality, but simply the comfort of numbers. Now, numbers are very comforting. Don’t get me wrong. You can add them and multiply them, subtract them and draw charts with them. They are delightful, whereas this other kind of information is very difficult to deal with. But that’s the world we live in. You see, I think that’s what does describe the world.

Now, there are various ways of bringing imperfectly seen and imperfect information into our planning and into the way that we act. We do it all the time intuitively anyhow. We don’t really operate on the base of numbers. We operate on all of these subjective and qualitative inputs. We can handle them more explicitly, and many companies are doing so in their long-range planning. They are starting to flush out these kinds of things.

I was thinking about this as I was driving down the other night. I wasn’t really anticipating your question, but I was thinking more of venturing it myself. The thought occurred to
me that many people have dealt with this question. What kind of person tends to head up companies over a period of time?

I think I was driving through Portland when I started and at Portland I was recalling that most companies that have management separate from ownerships, 50 or 60 years ago, 70 years ago, perhaps, were production-oriented people. People who were concerned and whose standards were, "How do we produce the most and the best with the resources available to us?" They were followed 20 years later by salespeople, not marketing people, but salespeople. "How do we sell with our available products the most and the best?"

In recent years who succeeded the salespeople as presidents of companies? Was it lawyers, or was it the financial people? Knowing that I was coming to talk to groups of at least half financial people, I thought that the question might arise, "Who is going to be next?" One of the things an historical view tells you (if nothing else) is that it's going to be somebody else in this sequence of events. If it were the manufacturing people 70 years ago, and salespeople 50 years ago, and maybe legally trained people, financially trained people today, who is it going to be 10 years from now? I venture to say, it's going to be psychologists. Treat the company psychologist with respect, if you've got one; he may be your boss in 10 years.

*Professor Yoder.* I would like to offer one comment here about our discussion, besides the fact that I thought it was outstanding. I spent a year in Rome as head of Forest Industry Development Planning at the U.N. Commenting about your statement on optimism *versus* pessimism in planning, we had what we thought was a very optimistic plan for one of the continents, which consisted largely of developing countries. We got the whole thing put together by assembling its various parts, then decided as a group that what we had was a blueprint for failure. So in this case, we started with optimism, which ended up with some pessimism. This is one of the traps that planners fall into. Dr. Guss, we thank you very much for an excellent presentation.
The Outlook for Credit and Its Implications for the Industry

Mr. Roger M. Keefe
Senior Vice President
Chase Manhattan Bank

INTRODUCTION
by Professor Ray A. Yoder

OUR NEXT SPEAKER, Mr. Roger Keefe, is no stranger to the Forest Products Industry. I first had the pleasure of meeting him back at Yale at one of Zeb White’s Industrial Forestry seminars, where he spoke on essentially the same topic he has today. I took some notes at the seminar, and in referring to them a few days ago was reminded that he spoke of his bank arranging over a billion dollars of funding to the pulp and paper industry in one year’s time, for expansion alone. I was also reminded of the words of one of the members of the Ways and Means Committee not long ago when he said “You know, a billion here and a billion there, and it starts to add up.” Mr. Keefe is a graduate of Yale and has served on the Executive Council of the Class of 1941 for 9 years, and as treasurer since 1966. His position is that of Senior Vice President of Chase Manhattan Bank. He is also Chairman and Trustee of Saint Thomas More Corporation, and a member of the National Republican Finance Commission. He is treasurer also of the Advisory Finance Commission. He will speak on the outlook for credit and its implications for the forest products industry. We are delighted to have you, Roger.

ADDRESS

THANKS A LOT. Well, gentlemen, it’s a great pleasure to be with you this morning, to be back here in beautiful Oregon, which unfortunately, I am able to visit only too infrequently
these days, and to be once again with my friends of the Forest Products Industry with whom I have spent some happy and exciting years.

I think that by all odds, it is the most fascinating industry in the world. Its sheer size would command interest, whether we ruminate about its great forest that covers 25 percent of the vast continental areas of the United States, or the literal billions spent on its capital projects, or its position as probably the third largest employer in the country. But I'm also impressed when I think what other industry is at once a creator of beauty, a devout developer of natural resources, a commodity business, a consumer business, and a natural partner of other great businesses, such as plastics and metals. Its perimeters and parameters must be broader and more inclusive than any other congeneric industry in the world, I would think.

Is it any wonder, then, that its exciting opportunities have called forth in our day the breed of energetic, imaginative, and educated young executives whom we see managing our great Forest Products Companies? Thus, it is always a challenging and a great pleasure to be with you. This morning I've been asked to share with you some thoughts on "The Outlook for Credit and Its Implications for the Forest Products Industry."

I guess this might break down into four logical questions. Will credit be available in general over the next decade? At what prices will it be available? Will it be available to the Forest Products industry? Under what conditions will it be available to the Forest Products Industry?

As for the general availability of credit, I believe that we must be careful not to confuse current uncertainties with conditions as they are likely to exist during most of the coming decade. At the moment, we appear to have the worst of two worlds – an inflation marked by rising prices and wages, and an economic downturn marked by continued tight money, increasing unemployment, and a lack of consumer confidence evidenced by slower sales and an increase in the rate of personal savings.

A year ago, before the Financial Executives Institute, I commented that monetary policy would have to bite quickly if
it were to be effective without causing a recession. Six months ago, before a group in Washington, I stated again that one gets the feeling that the longer monetary policy must be used alone to fight inflation, the more probable it becomes that a downward spiral will be difficult to control.

Today, I would simply say that the present situation cannot be expected to exist for long. All segments of the economy — capital, labor, the public, government — now recognize intellectually that inflation must be licked. The problem is that none of them yet really believes that it is going to be licked, at least to the extent of restraining their appetites for price and wage increases, capital expenditures, and public expenditures. The federal government may be somewhat of an exception to this, although Vietnam, the celestial space race, and public pressures for social and urban problems place even this sector in doubt. If all, I must repeat, all the major sectors of the economy do not become convinced that inflation will be licked, the Federal Reserve will have no option but to continue a very restrictive monetary posture with its appendant dangers of a downward spiral, which we may not have the machinery to control. Of course the federal administration is well aware of this. And that’s what our chief economist, Bill Butler, likes to call “the game plan.” He defines this as a plan to cool down inflation by holding actual production, in real terms, below the economy’s potential for a period long enough to get the increase in prices and wages under control.

Bill remarked recently, before the American Management Association, that the scenario runs in much the following fashion: First, tight budget and monetary policies, level out the rate of growth in real GNP to the point where real production is below the potential. This has already been accomplished. There was a very small decline in real GNP in the fourth quarter of last year, and further minor declines appear in prospect for the first and second quarters of this year. But this does not add up to a genuine recession.

Second, the reins of restraint are relaxed just enough to permit some increase in real GNP, while maintaining a gap between actual and potential real output. Such actions have
been taken in the form of a smaller budget surplus or perhaps a minor deficit and a moderate move in monetary policy away from the extreme tightness of the past year.

Third, these policies apply downward pressure on prices and costs, so that the rate of inflation will gradually decline to a tolerable 2 percent or less some time in 1971.

Fourth in the process, the policy of restraint can be eased further to get the economy back on the track of balanced growth with reasonable price stability.

Now, whether this game plan works is problematical in view of the many long-term wage contracts that have been signed recently and are due to be negotiated in the next several months, as well as the unfortunate experience of many financial executives in the postwar years of counting on inflation to bail their companies out of otherwise marginal capital expenditures, and the increasing pressures on all levels of government for socially oriented programs. However, the game plan is either going to work, or we are going to go through the wringer of a recession, which to be sure will probably be relatively mild and of short duration. Perhaps we could share some informal thoughts on these probabilities during the discussion period if you would care to do so.

These short-term prospects are, however, less important than the outlook for credit conditions over the really long run, over the entire decade of the 1970's. Obviously, the degree of confidence with which one can predict this far into the future is limited. But, based on certain economic assumptions and projected relationships between economic and financial worlds contained in our bank's recent book of the long-term environment, the following picture emerges.

Based on an anticipated annual growth rate of 6½ percent through 1980, GNP by that year would reach approximately 1.8 trillion dollars. Based in turn on an analysis of the various sectors of this projected future economy, and of the relationship of their income expenditures and resulting financing needs, a projection can be made that the total financing by all sectors of the economy by 1980 will amount to approximately 210 billion dollars, or about 11.7 percent of
The Outlook for Credit and its Implications

GNP at that time. This compares with an approximate figure of 97 billion, or 11.3 percent of GNP, for 1968. Figures for 1969 are not yet available. Concentrating for the purposes of this discussion on the corporate sector, the outlook at first glance appears to be quite favorable. United States corporations are projected as having total financial requirements of about 215 billion dollars in 1980, as compared to an estimated 107 billion in 1968. But this represents the rate of increase as a shade below that of the GNP itself. Moreover, internal cash flow of corporations (retained earnings plus depreciation and depletion allowances) is projected as increasing more rapidly than GNP. As a result, external financing for corporations is expected to rise from about 43 billion in 1968 to only 75 billion in 1980, an annual increase of less than 5 percent a year and appreciably less than the expected annual increase of funds available from private and institutional sources.

Thus, if corporations were the only factor in the financial market, we would expect them to be able to meet their financing needs readily, and at rates significantly below those that have prevailed in recent months. But other demand and supply factors indicate that this optimistic prediction must be significantly modified. The major projective pressure will come from a mortgage market, with the addition to mortgages at an annual rate projected to rise to about 80 billion dollars by 1980 (well over 3 times the rate of increase in 1968). This reflects the following:

- A sharp increase in the number of family formations,
- Construction costs increasing much more rapidly than prices generally,
- And an assumed fairly extensive program for subsidized housing for low income groups.

This steep increase in the demand for both commercial and residential mortgages will permeate the whole interest rate structure of the 1970's, which will prevent any significant decline in the yield on other financial instruments. From the supply side, the major traditional suppliers of mortgage funds, mutual savings banks and savings and loan associations, will be
unable to supply anything like this amount of mortgage credit. The reasons for this are: First, generally high levels of interest rates during the 1970's should make rates paid by thrift institutions not especially attractive, and the need for occasional periods of tight money to restrain a generally buoyant economy raises the probability of occasional periods of disintermediation. Second, the number of young families will expand very rapidly during the 1970's, but young people tend to save a significantly smaller proportion of their income. As a result, the volume of consumer savings should remain a smaller than normal percentage of consumer income during the decade, cutting the flow of funds through savings institutions. In this situation, extensive governmental programs may be inevitable to facilitate the flow of funds into mortgages including government guarantee programs to increase the systems of thrift institutions, subsidies, and direct lending.

Yet, a major portion of mortgage financing will still have to be picked up by commercial banks, by institutions such as insurance and pension funds, and possibly even by individuals, if a government program of some sort should convert an ordinary mortgage into a marketable instrument. Thus, the need to finance the expected huge surge in mortgage debt will provide direct competition to corporate borrowers with respect to their traditional sources of funds. And this at a time when insurance companies and pension funds are expected to continue to reduce a portion of their funds going into fixed yield securities, in favor of increased equity investments.

The second point of pressure is the financing need of the state and local government. While the Federal Government, in the absence of further Vietnam-type wars, will run significant surpluses in the 1970's of a magnitude to finance both its projected own programs and to continue a major program of assistance to local governments, the gap between state and local revenues and expenditures will continue to widen. Important, but less overwhelming pressures will come from the area of consumer credit, because of the large proportion of younger families in the economy of the 1970's. Federal needs, on the other hand, are estimated to be minimal because of rising tax
receipts and represent projected sales of agency debts to finance special projects.

Given the expected relatively low levels of savings noted above and combined with the expectation that monetary policy should remain reasonably restrictive in a period of rapid growth, the projected total demand for credit in 1980 for mortgages, tax exempts, and consumer credit, when added to projected business external financing, appear relatively high. Of course in any given year, demand and supply of funds are of necessity equal. Or in other words, any given level of output automatically generates a sufficient level of savings to finance it. In this sense, the concept of a nationwide credit shortage is meaningless. The question, however, is not that demand for and supply of funds are equalized, but at what level of interest rate this takes place. This gets us to the question, “At what price will credit be available?”

In general, the picture we are projecting is one of equilibrium at fairly high rate levels. An average of 6 percent on AA industrial bonds, for example, with the occasional possibility of really tight short periods. In addition, one factor that has eased the strain of higher rates in recent years will be reduced in effectiveness. Corporations have in the last 2 years increased their direct financing by way of the issuance of corporate commercial paper at a fantastic rate and at costs below those of alternative sources. This expansion, however, has been into a vacuum. As the market matures, given the steady but relatively slow growth of demand for short-term liquidity instruments, rates for this type of financing will be brought more and more into line with those of traditional sources of credit. Let’s say, then, that our corporations are going to be operating in an atmosphere of interest costs that are high, for a period ahead, which makes a discount factor insignificant. Let’s say that one of our definitions of “high” is that the interest cost will bear a more significant relationship to the success of a new project than normally has been the case.

Now to the question of whether credit will be available to the forest products industry. My basic assumption is that adequate credit will be available. However, the industry must
continue to realize that in a period of high interest costs, selective credit may be practiced most freely by short- and long-term lenders. It is now recognized that the integrated forest products companies have a tremendous capacity to retire debt, even in periods of generally unfavorable business conditions. The cash flows resulting from depreciation and depletion are substantial, and although tax treatment is never as good as we would like to have it, nevertheless it is generally favorable to the industry. And as an aside, it will be interesting to see what comes out of the conference on timber taxation that is now going on in Washington. Furthermore, while it may be undesirable as a long-term practice, many companies have the ability to substantially reduce their cost of sale section by rescheduling cuts of their own timber.

This peculiar resource, timber, which hovers someplace between inventory and plant, has long given comfort to knowledgeable lenders. But it would be wise for the industry also to eliminate as much of the cyclical characteristics of its business as is possible. This is done by integration, long-term contractual relationships, intelligent analysis of markets, sales opportunities, and possibly even some congenerate expansion, which will generate countercyclical earnings if conditions such as those that are occurring now in the housing market continue.

One point not so frequently related to credit extension as it might be, I think, is the view that the investment community has of the forest products industry. I’m sure other speakers at this meeting will talk about this, but obviously the industry’s rate of return on shareholder’s investments for the past 15 years has been generally less satisfactory than that in a good many industries with which the forest products industry has had to compete for this investment dollar.

If a satisfactory picture cannot be developed for the equity invested, the forest products industry will be forced to rely more heavily on credit, both in absolute terms and in relation possibly to its capital base. All of this says that there is a real obligation on the part of the industry for innovation, efficiency, and cost savings. However, there is also a need to tell as good a story to the investment community as may be done properly.
If you have not seen it, I commend to you an address by Robert Jones, a partner of Arthur Andersen and Company, who spoke at the Fourth Annual President's Forum, sponsored by the American Paper Institute last October. Mr. Jones points out in his address that the forests products companies have an important asset (he is referring of course to timber), which in almost all cases is increasing in value each year. But neither the aggregate value nor the annual increment value are available from the financial statements for purposes of determining return on investment and earning per share. He goes on to make some comments about why this is so and some useful suggestions as to what the industry may do about it.

The conditions under which credit will be available to individual companies within the forest products industry are, of course, the traditional ones to which we have referred here: an adequate capital base, an ability to liquidate debt through cash flow, and the maintenance of a stream of quality earnings, which will make the company attractive to all segments of the financial and investment community. In addition, companies will be most attracted to banks when they maintain good deposit relationships through the ups and downs of their borrowing requirements, and to long-term lenders when they represent repeat business along fairly well-established lines. However, I believe that lenders will give increasing attention to the quality of major projects that are to be financed. In a period of high interest costs, where inflation is to be attacked and licked, the corporation can no longer count on being bailed out by inflation when a new project is financed. In deference to stockholders as well as lenders, this implies unusual care in selecting projects that will produce the best results. Our assumption is that quantitative techniques are essential in long-range financial planning.

Although corporate existence may not be threatened by a limited number of poor selections, vis-a-vis new projects, the entire financial community, lenders as well as investors, like to be associated with a company that does not assume so much debt that it is unable to keep its place with competitors in such things as facilities and research. Or indeed a company that may
be inhibited from certain courses of action in the future by debt that is imprudently high or whose terms are too restrictive.

Thus, it seems to me that the most imaginative company will have produced a debt capacity study, probably prepared by the corporate staff and often with the assistance of knowledgeable bankers, which will be kept up to date and will enable the company to determine a proper level of debt that can be serviced under any assumed condition. It will also consider new projects and will light up what we like to call a “corporate profile.” This profile defines the perimeter and parameters of a company’s interest. This usually means identifying corporate goals, putting the finger on strengths and weaknesses, and the examination of these characteristics both on an absolute and a comparative basis. Certainly the corporate profile should rank priorities. It should always be in existence and should be reviewed deliberately on a regular basis.

Perhaps the most notable characteristic of companies that have easy access to credit during the next decade will be their approach to planning and management in this sophisticated way. And I am happy to say that there is evidence that a high proportion of the best companies in the forest products industry seem to be acting in this manner. In closing the formal part of these remarks, I would like to pay tribute today to those industrial pioneers who have hammered out your great companies in the vast forest and the hot marketplaces of this huge country. No analytical model for quantifying long-range planning goals, no computer-based analysis of the costs of financing, however useful and important these may be, can substitute for their hearts and brains and gutsy intuition. Fortunately, the forest products industry is still people, with this kind of leaders. Success rides a fast horse, and even bankers like to be aboard a winner. It was a great pleasure to be with you. Thank you.

**QUESTIONS**

*You mentioned statistics that you were referring to in terms of corporate debts or demands for external financing at*
least for the next 10 years; they assume a 61/2 percent growth rate in the economy to 1980? Am I correct? Did I hear that right?

That's right. Of course this is in terms of dollars as they exist from time to time. In other words, they would include the inflation factor also.

They do include the inflation factor. Could you tell me how much that is estimated to be?

That's a fair question, and following Dr. Guss' remarks of this morning, we have numerous sets of assumptions on which to act, depending upon how this goes. But our own internal sensitivity analyses go from 2 percent to 4 percent on inflation in a period.

Briefly, for a definition, you mentioned quality of earnings. Does that somehow mean depletion as opposed to operating income?

I think there is great reason for many companies to have shown cash flow in telling us as good a story as is possible in their statements over the years. But I think eventually you pay dividends out of earnings. You don't pay dividends out of depletion. I think that, actually, the net profit figure, a continually rising net profit figure, after all charges, is very important for the industry and for the individual companies within the industry. This involves the elimination, if you will, of the cyclical feeling that plagued the industry for many years.

In reference to this talk by Robert Jones, of Arthur Andersen's — you didn't say what you thought of his remarks.

I thought they were very good. I thought that I had recommended them to you. I'm sorry if I didn't.

Do you think that this is something that should be shown in company statement?

Yes. Of course Robert Jones is a distinguished accountant and a member of a distinguished firm, and he's made his own suggestions as to how this might be accomplished, whether by footnotes or other explanatory remarks. And I (although obviously we deal in financial statements all the time), wouldn't have the temerity to speak to the accounting industry as to how this might be accomplished, whether by footnotes or other explanatory remarks. But it seems to me that the forest
products industry is unique in having this resource, timber, which hovers someplace between inventory and plant as it exists, and which is always renewing itself. To throw this into the framework of normal accounting does not seem to me to be reasonable.

*You mentioned that unless factors other than credit restraint are applied to this inflationary spiral, we are apt to have a recession or continue one. What other factors were you referring to — I suppose labor restraint? And a second question — do you think there's any hope for those other factors coming into play in the near future to control inflation?*

Well, that’s the game plan. There are certain wage settlements that are obviously giving us great problems. On the other hand, I think we all ought to remember that only one-third of the industrial workers in the country are unionized. So that the pressures that begin to get applied are going to be applied first to the nonunionized workers and gradually back this up towards the unions, it is hoped. Now, there is no perfect way of saying it. If you want my personal views, I am somewhat pessimistic at this point. I think it is going to be a very difficult thing to control.

Another thing is that you have all seen the new McGraw-Hill survey for this year on capital expenditures, and I think if I recollect the figure correctly, it was 13 percent that industry was planning. Well, this would be a very hard thing to cope with, if you took it on face value. On the other hand, let’s assume for a minute that probably 40 percent of all capital expenditures in the United States are made by utilities of one kind or another. And those utilities have built into them certain profits that take care of that kind of investment in an economic sense, a little bit differently than an ordinary industrial development. So that there is a possibility that both wages and capital expenditures could be dampened substantially by what’s going on at the moment.

It might be interesting, if you gentlemen care to do so (you represent a great many companies and financial institutions and otherwise), to show how many of you have a
program, since your last budget, of cutting back on some capital expenditures? Give me a show of hands on that. How many of you are going ahead with no plans to cut back capital expenditures? Now that’s interesting. Quite a few didn’t say anything, which is all right, but there are at least a significant number who are cutting back.

I believe you happened to mention a closer relationship with profitability. Were you talking more about bank credit, or credit in general for the company?

I think I made that remark in reference to a new project that you might be starting. In other words, that you are going to have costly credit over the next few years, and that you've got to take this more into account in designing your new project and seeing what your rate of return is going to be.

Mr. Keefe, thinking of game plans, let's assume for the moment that labor will be unrestrained, and assume that this is the correct function. What would you then predict that we might look forward to?

Well, I don't think there is any question as to that; you look forward to a very substantial bust. Because the country simply can't live with inflation of the kind we've had, in the area of 5½ to 6 percent.

Then you're eventually leading into government action of some kind?

I think you unquestionably would be if there isn't some slowing down in the next year. As you know, the calls for this are coming in many directions now. And not just from labor, they are coming from many industrial sources — they are coming from government sources. It's quite interesting.

Do you really think that union leadership will exercise restraint?

Well, I think this is a very hard thing to answer. I think that you've got to get down to the blocks on your city where you will have one or two men out of work and the wife just doesn't want her husband to get involved in anything like a strike, of losing his job over an increased wage. I think this is the kind of pressure that practically is going to get applied.
In other words, we’ve got to get into a recession?
Yes. You’re making no mistake about it. You’re in a partial recession right now as you all are very well aware.

About two-thirds of the employees are not members of the union. Is that what you said?
Yes. Two-thirds of industrial employees. There’s lots of room outside, and this is something that people do tend to forget.

It seems that the national goals for housing are to build 26 million housing units over the next 10 years. This, of course, assumes that we have the ability to supply or deliver the raw materials to do it, and it assumes that we can build them, but you talked about the needs for funds flowing into the mortgage market. Can we, from a financial point of view, fill this goal?

I think it’s a question that we are going to have to address a lot of attention to. If we looked at the machinery as it exists at the moment, I think that we would fall short, for the reasons that I mentioned. In other words, the pinch is going to be on the traditional supply of credit and there doesn’t appear to be anything like it in prospect. If this is running about 27 billion dollars now, it will be up to 80 billion dollars by 1980. There just doesn’t appear to be anything like that amount of funds that’s going to be available. I think that what a great many thoughtful people in the country are thinking about is better ways of bringing together funds of all kinds in the country.

You heard a lot of political cracks taken, for instance, at the bank holding companies. Well, one of the real reasons for speaking so about the bank holding companies is that the bank ought to be performing a better function of bringing together various kinds of funds with various kinds of people who ought to be using them. An interesting example is the sale of real estate investment trust certificates, which we announced a few weeks ago, and which have been followed by a number of other banks. Now this is a means of focusing on the real estate industry, focusing on the construction industry, saying to ourselves, “All right, we’re not going to be able to get the money from the traditional sources; let’s go out into the free market place and see what is around.” And it will be interesting of
course; we have delayed, as others have delayed, in putting out these issues because of the condition of the market. But they will get out soon. I’m sure of that. It will be interesting to see what the reaction will be. We expect it to be very good, but there should be a lot more done like this.

*What rate of construction do your projections project?*

Well, we hear the same figure that you’re talking about, that we will have to have over 2 million housing starts for a good many years to be able to catch up, and the pressures are growing every year.

*Looking at the availability of credit to the forest products industry, how do you view their ability to raise funds in respect to the basic operating phases of it as compared to some of the quoted integration into the housing and recreational areas?*

Well, if I understand your point correctly (and I think other speakers are going to deal with this), I foresee that the forest products industry is going to have trouble raising money for its normal operations. I don’t see this happening for the development of forests, for cuts, for decking logs, for all this sort of stuff that might have to be done.

Now when they get into the other areas, I think they’re going to get into a variety of kinds of financing. You take a company like Boise-Cascade. There is land development, where an entirely different kind of financing is required for land development, even when it’s under the wing of a big corporation. Or move into another one of their divisions, for instance on the mobile home building, where it’s going to require a consumer credit type of operation to support that kind of thing. So the big company that gets congeneric and goes out this way is going to be faced with assembling a financing package and some of it is going to be expensive.

I think it’s very interesting to see that these Boise-Cascade debentures were sold the other day at 10 percent. They were all off the shelf, but you could buy bonds at issue price from the syndicate members, so that it appears that the syndicate members probably swallowed about 20 percent of the issues themselves. I think you will find that companies like that (I’m not criticizing them for doing this, for they’re bright people,
and I'm sure they figured this thing out), but I think that when they're going to have to have money for a specialized kind of financing, it's going to have to be with a dramatic interest rate -- certainly well above anything else that we've seen on the market.

*What comment do you have about the average heavy need for housing now? Will we have a continued attitude by the new families that need this housing that constitutes a psychological block against having a 3-bedroom house like we all wanted to have when we were married? Will they be willing to live in a one-bedroom home? What is your feeling?*

Well, you are getting into psychology, in which I'm not practiced. All I can say is that I think the trend everywhere in the world, and not just in the United States, is to get families out of their pattern of concentrated living. In the worst places -- for example, in the ghettos -- this causes all sorts of incest and disease and lots of other things. In our society, it causes problems with the use of the bathroom, and kids growing up too soon and a lot of other things that come into it.

I notice that even the planners in Central America have done some very interesting things, such as designing concrete homes in modules of four. This provides basic shelter, but then there is provision to build 3 more units on that. I think this is a natural desire. Maybe some of you are more expert in psychology than I. I think people are going to want more housing, and not less. I think they are going to be willing to pay for it, but there is a limit to what they can pay.

*I think this is the key, but I'm a little concerned. I think the comments have been pretty much from the practical dollar aspect. Toning this a little bit with what the doctor said earlier, and to start with, a rough example. There are a million people who are born, live, and die in India without ever having a roof over their heads. The desire is not there. Why? But let's go over to our country. I see a trend in our college kids today, who don't put much credence in a 2 or 3-bedroom home. They are really not interested. And I see another thing cropping up that maybe would tone down your figures a little bit. We are talking about one hell of a birth control program in this country. And I*
wonder what this is going to do to that 2,000,000 housing a year. And I wonder if your remarks are toned with this type of thinking, or are they just merely practical remarks of the business?

Well, again I wouldn't know. Certainly the pill has had a definite effect. I think one of the slides that Dr. Guss showed on this thing showed that the population is off from where it was expected to be. And possibly somebody who is expert in psychology could answer this question. I just believe myself that we are going to demand better housing in this country. It may be a different kind of housing than we had before. I think there is going to be a willingness by a lot of people to live in high-rise dwellings who weren't willing previously. But then you consider the deteriorated state of much of our urban housing and how much more of this will be deteriorated 10 years from now. Everything I have heard from industry sources indicates a tremendous need for housing.

The quantitative projections of housing are a matter of mathematics. You may accept the 1968 Housing Act, which calls for 26 million new units, but which is very careful not to say what kind of units, whether they are apartments or mobile homes or single family dwellings. Now, the kind of questions you raise seems to deal with the question of people’s involvement with housing. That people will need a roof of some kind or another, I’m willing to accept. What kind of a roof, and how much of themselves people want to put in a house, versus alternative ways of spending their time and money, which could be for vacation homes, world travel, and what else, I think is very much the kind of question Mr. Keefe would deal with in his uncertainty analysis approach. This is a way of trying to quantify these qualitative judgements. To me, the important thing is that we recognize this is just as real a consideration (the psychological involvement with housing) as is the number of family starts, the number of marriages, birth control, and what else. It has to be dealt with in order to come out with the true picture. It all ties together. I have to believe that people are getting less involved with housing, just as people are getting less involved with automobiles. Now, that’s a personal opinion
versus the kind of thing that would have to be dealt with in this analysis.

Mr. Keefe. That point of view I think is very good and apropos. A lot of this is the way you are standing. I suspect some of us who are pretty comfortably off might not mind getting less involved with housing because maybe we have just cut the lawn of our own home, and don’t need the extra bedroom, and the kids have grown and gone, or something like that. I think there are a lot of people around this country who want to get very much more involved with housing. At least this is the assessment that we make.

Do you have any suggestion or comments on how a company should proceed in land development? Should they, as a generalization, proceed down the road of their own internal land development? Should they wholesale off their lands that have recreation development potential? Dr. Guss talked this morning about company management perhaps not being capable of managing a function completely unrelated to what they have been managing before. Do you have any comments or observations on how a company should exploit that potential?

Well, I think it depends a lot on where that company is located, what kinds of lands are involved, and obviously a good many other things. I agree entirely with Dr. Guss’s remark this morning that you can’t shift readily from one business to another the kind of company culture that you have. So maybe you go out and acquire a mortgage banker to do some of this work, as Weyerhaeuser has done recently. Or you may go to a multiple land-use development as our friend down in Georgia has done, with quite interesting results. On the other hand, when he went to North Carolina he found very different problems, and he tried to translate some of the things he had done very successfully in Georgia to big tracts in North Carolina. Finally, his solution has been to bring big food-growing companies and others into that action; let them go ahead and develop this land. I think you really have to see what kind of land you have, where you have it, and tailor-make a situation to do it. But normally, I agree entirely with Dr. Guss that you should not attempt to develop land or do anything else
that constitutes a major shift from your ordinary business, using the same people who have been doing your forestry.

I think Dr. Guss said a lot of the forest products companies have a fair amount of understated values on their books of the timber resources you mentioned here. I wonder if you might just tell us how Chase Bank looks at these resources, and how you go about evaluating. What tools do you use to quantify this belief — the understated value on a company's balance sheet?

There are two ways. One is the balance sheet way, in which I think you could say that well blocked-up timber that is available, is served by roads, and is reasonably well located geographically, is saleable as a commodity to a lot of people. You've all known the great big discounts that have accompanied these sales of big timber tracts. When I was actively engaged in lending on such properties, I would see companies come in with what I would say was a 40 to 60 percent valuation on a timber tract. In other words, what I'm saying is you could turn around and sell to somebody else. The other thing is, how well does the tract fit in with their operations? And I think that a company should never get with a bank or lending institution or anybody else who doesn't understand their business, hasn't been out to see their main properties, and fails to understand very definitely how much the cut from that particular tract of timber will contribute to that particular company's operations, or could go into it if the situation arose, where you needed to liquidate debts.

So I think you have to look at this sort of thing from both a balance sheet and from a cash flow point of view.

You mentioned that in the next decade you thought that financing would be available to the industry through banks, but that as far as public equity offering, it would not be attractive because of the price to equity ratio. Was I right in that, because of the cash flow?

Yes. I think that is quite right. I think that the capital base in the industry as a whole, now, is adequate to support even a higher level of debt than it has at present. So I'm not worried. But there is some point at which this shouldn't happen, and the
industry, and individual companies within the industry, will be paying the penalty for it. I certainly believe that the industry has got to show an ability to attract the investment dollar, the equity dollar. And, as you know, your return as an industry has not been competitive in that respect since say 1955, or thereabouts.

I wonder if that isn't the very advantage of the cash flow, and where it is reflected. For instance, you can take maybe larger depletion and depreciation, which will not show up in the price to earnings ratio. So it is a real thick story — merely a fictional bookkeeping.

Okay, so this is where we get into the good story. And I think it is very important that that story be told, as it was told by Robert Jones. If any of you would like to look that up, it was at the President's forum of the American Paper Institute last October.

You mentioned that financial institutions would be less willing in the future to finance projects that depend on inflationary benefits for their justification. I think you termed it as a free ride on inflation. Well, in my opinion, this industry has hardly got a free ride from inflation, in terms of its end-product prices, in 10 or 15 years, though I admit that timber holders have benefited to some extent through higher prices or higher values of their timber, in depletion income. It does seem to me that in one area inflation has, and will continue to have, a very great impact on our financing needs, and this is the extent that we have opportunity to replace labor with capital equipment. I know in my own company, which is Simpson Timber Company, increasingly we find that marginal investment of a few years ago tends to take on more economic justification because of escalating wage benefits in our plants. And for this purpose we are going to be looking for financial support.

Well, I think you should be. I'm not for a minute suggesting that you ought not to be going after increased efficiency. I think you very definitely should be. Of course any investment that eliminates labor today has to rank pretty high. I'm definitely saying that the idea of investing in something
today, because if you wait for tomorrow you are going to pay 20 percent more, is not necessarily what I think ought to be done today. This is the point I was trying to make in respect to inflation, that it is going to get less one way or another.

Inflation is either going to get licked by something like the administration's game plan, or it's going to get licked by our being put through a wringer. It's going to get licked; the country can't live with it. The laborer can't live with it, and he's coming to realize that. His first reaction is to turn around and say, "Give me higher wages." But he has had less take-home pay since 1955, so you know what this does to his purchasing power. This takes time to think through, but I think this inflation is going to get licked. We just hope it isn't going to be through the wringer process. But I entirely agree with you that you should proceed as you indicated and should borrow for that kind of labor saving. I think you can show very attractive returns on that.

Would you comment on the variable mortgage proposal that I believe was brought out in U.S. News and World Report several months ago, where the interest rate would vary on the monthly housing payment? Would you give us some background on that?

I think that there is, generally speaking, a pretty good acceptance of this idea. I think the difficulty that people are finding with it is what to tie it to. In other words, what is the point of variation? Now, there are already classes of credit, which are being quite widely used, that do have this sliding scale attached to them. Most notable among them is the Euro-dollar financing that is going on, in which many American corporations, possibly even some of the people in this room, are involved. There the general point of departure is the inter-bank rate for time deposits. There is a spread, and the loans are running up to 10 or 12 years, based on that spread. But I don't believe that anyone has as yet established a very satisfactory departure point. Maybe some of you fellows have some ideas about it, and certainly we would love to hear about them. Then, of course (mathematically) you have the problem of the level of payments, and how do you handle that?
GOOD AFTERNOON. I want to introduce myself. I am Les Strickler, Professor of Finance from the School of Business and Technology here at Oregon State University.

I want to apologize for not being able to be here for the morning session. From what I have heard, the presentations were outstanding. I will be your chairman for this afternoon and tomorrow morning, and then you will revisit with Ray Yoder on the last part of the program.

I would like to invite your attention to an effort in the School of B & T which we have found most worthwhile. For the last 3 years we have had individual business executives come to our campus to teach our business classes for a day. We don’t hold regular classes, so the students come to whatever meeting they want when they sign up.

We have had tremendous turnouts for these programs. The last time we did this, the program featured Weyerhaeuser Company, from which firm our next speaker comes. Prior to that we had Pacific Northwest Bell and before that, U.S. Steel. Maybe one of these years we are going to get an Oregon company.

The topic our speaker has chosen, or perhaps I should say the topic I hope he will address himself to, is one that has impressed me in the aforementioned series of visitations with his firm.

I noted when he came down to handle the finance session with the students that he held his ground exceptionally well, so
I think we have something great to look forward to. Gentlemen, I present to you Mr. Cal Knudsen of Weyerhaeuser.

ADDRESS

THANK YOU. I am not going to deliver a prepared address to you this afternoon. Perhaps I should, but I think that in dealing with this particular topic I can handle it better on an informal discussion basis. This may mean that I may end my talk with a whimper instead of a bang, because I don’t have a prepared peroration to work up to, but you will bear with me in that respect. I think we can get down to business.

The topic that was assigned to me has a preliminary phrase called “a newer view.” And I do want to beg off from a newer view because I am not going to break any newer ground today. I am not really going to present anything that will come as a surprise to anyone. I am going to discuss some of the logic that is the newer image of what Len and Roger were talking about this morning. That is some of the logic by which the company internally makes its decisions with respect to financing and investment opportunities.

And I want to share this logic with you. It is currently in use and has been in use in Weyerhaeuser Company for some period of time. We have made very substantial commitments to the financial community and to our stockholders and to ourselves, based in part on this logic at least, and I would like to share it with you and invite your constructive criticism and your views upon it.

Basically, I think we are talking about a larger problem, at least as far as my particular job is concerned, and that is how do you make a company grow? How do you set and achieve a rate of growth? We are interested in this because, like most companies, both publicly and privately held, we have as one of our basic financial objectives, and I think probably the dominant financial objective, that we continually increase the shareholder’s values. And that means we continually (and hopefully consistently) work toward an increase in the stock price.
We believe that from a financial standpoint, because I am not addressing myself today to the many other considerations that go into a growth program, such as whether or not you can get into the housing business using foresters, for instance. I realize that is an entirely separate problem, and a very real one. It has financial implications but it is not a numerical analysis; instead it is a judgement analysis.

We believe that the best method to achieve continuing increase in shareholder values is to achieve a consistent growth in earnings per share. This is a very simple basic premise. There is nothing very complicated about it, and I think it would meet with general agreement. You get growth in your stock price from your earnings per share, but you also get synergistic growth from consistent growth in earnings per share. The reason is that the market, which is the sum total of all investors in the United States and abroad — the market places a special value in the way of a higher multiple on the stocks of companies that have demonstrated an ability to achieve consistent growth in earnings per share. They place a lesser value on companies that show (over time) an increasing trend of earnings per share, but in a very sharp cyclical manner.

I think that our industry has several very fine examples of that. There are companies that have had a more consistent record in the past than Weyerhaeuser Company and they enjoy a better multiple today and that is the reason, consistency. The forest products industry is of course fairly capital intensive. And therefore this problem of achieving growth in earnings per share relates, to a very high degree, to the making of a series of investment decisions. In doing so, we in Weyerhaeuser rely very heavily on analyses based on the discounted cash flow rate of return on total money employed, as an analytical tool. We do this because we think, obviously, the advantages of using that approach outweigh the disadvantages, and there certainly are both.

First, however, it does reflect the DCFROI Method and I’m sure you are all familiar with those initials, but I will just refer to it as the ROI method. It reflects the time value of money. Those projects that achieve a higher earlier return of
cash show up better on this type of analysis than those that achieve a later return of your money. This means that, generally speaking, with some qualifications, those higher ranked projects return money available for reinvestment earlier. So you get better growth, and also your money is at risk for a shorter period.

One of the difficulties with this particular analysis is that the ultimate number that you wind up with doesn’t indicate whether you get your money back early or whether you get your money back late. If you get it back late it implies that you are getting a lot more back later, because you discount that cash flow to the present to rank it. Nevertheless, you are at risk a longer time, and you don’t have the money available for reinvestment in that constant turnover, which yields growth. The method of arriving at an ROI, where you project the cash flows in and the cash flows out for the entire life of the project, does indicate at what point the money comes back, so implicit in the process is a look at that point, which is a very important feature.

The second important advantage is that it forces an estimate and it forces the people who are doing the projecting to do this, year by year, for the life of the project, which means they have to have a view, and express a view on some very important factors in any investment decision. One is what they expect is going to happen in the way of costs over the life of the project, what the impact of this expected cash flow and earning stream, which includes after-tax earnings, will have on the earnings per share, and what times. Also, an examination of the project life versus the product life cycle for the product involved, if there is some particular feature that is relevant in that respect. All of these give us a better look at the risk factor as it relates to the return.

Now I think I mentioned the principal disadvantages as I’ve gone along. First, the number itself doesn’t reflect the timing of the earning per share contribution. Secondly, neither the method nor the number that results, or the ranking that results from the method really intelligently deal with the problem of risk in any given investment.
There is a general assumption that the higher the return the higher the risk, but that is not necessarily true. What we are searching for always is the investment that has a relatively high return with a relatively low risk, and the key to successful growth is to be able to separate those from the reverse. The other difficulty in using the ROI method is one that is really more in perception than in fact. It has been my experience that business men have great difficulty in relating discounted cash flow return on investment to a growth objective and in the economic context with which they are dealing, the immediate cost of money, dividend policy, and so forth. I think that this is a perceived difficulty and we feel that we are doing something with respect to risk analysis, and that it is taking not all the hazard out of it but it is giving us a better view.

Roger gave you an example of how they approach risk analysis. We have similar ways of quantifying at least some factors of the risk. What are the odds that it will be below a given figure or above a given figure?

I think that you can tend to quantify your risk and at least have a view on what kind of risk you are accepting in exchange for a better return.

The other problem is the one that I really want to address myself to today. It is how this DCFROI approach might be used to provide at least a set of logic for us to look at some of the larger and more specific questions that are implicit in our business. Questions like: “Should I increase the dividend?” “Can I afford to borrow money today?” “Should I diversify?” “What rate of earnings growth should I expect from my company?” “What will happen to export chip prices in the next 5 or 10 years?” “How much debt should I incur?” “Is the anticipated return from any given project good enough to achieve my goals?” “What do I think about a variable rate loan?”

These are all questions of the real world, and questions on which we can have a view. I’m not saying that we can provide a mathematical answer, but there is provided in the state of the art, today at least, a logical method to examine some of these questions from a rational basis rather than an intuitive basis,
which too often is the case. I am getting back to Roger's comment this morning that many chief executives are willing to pay the cost of making an intuitive decision. This is because they don't know what the cost is, but often that cost is really too high and all of us are looking for the methods to reduce that cost.

There is a relationship between the cost of money, the growth rate you are trying to achieve, your dividend policy and your borrowing policy, your level of debt and so forth, insofar as it relates to your making investment decisions that are presented to you from time to time. It has some defects. First, I am going to display to you how that is expressed mathematically. Then I will talk for a minute about some of the serious defects. Then I would like to show you some of the factors in this relationship that are most important, as far as making decisions are concerned, and from that we might perhaps draw some conclusions. I don't know if they are good conclusions, but let's see if we can.

\[ G = [(D/E)(P)(ROI-I)] + [(P)(ROI)] \]

This is the so-called "growth formula." \( G \) is the rate of growth of earnings. \( D \) is debt to equity ratio on incremental investment: that is to say if you are going to invest $100 this year in new projects, and borrow $50 of that amount and get $50 of it from reinvested earnings from last year, then your debt to equity ratio in that incremental capital expenditure is 1:1 or just 1. \( P \) is the proportion of earnings retained, so if you are paying 30 percent of your earnings out by way of dividend, you are retaining 70 percent. \( ROI \) is the ROI I've been talking about. \( I \) is the after-tax cost of borrowed money for that project.

Now what we are saying is that the rate of growth will equal the sum of the earnings from the money borrowed on the new project and the earnings from the reinvested equity on that project. To be specific, let's say that last year I made $100 and paid out $30 in dividends. I had retained earnings of $70, and I borrowed another $70 and invested $140 in a project that came on stream January 1 of this year — instant investment for a simple example. The cost of money is 9 percent; the cost of the borrowed $70 is 9 percent per year.
I want to give you one more fact; you are trying to achieve an annual earnings growth rate of 15 percent per year, and in order to do that you have to have a 13 percent DCFROI on the project that you invested in. Now there are some real problems in this, because it doesn’t resemble the real world. Number one, it contemplates instant investment, which we don’t have. In other words it doesn’t take into account the time lag between the equity earning and the borrowing of the money, and the coming on stream of the investment. Over time that will tend to eliminate itself as a problem. More seriously, it does not take into account that your 13 percent ROI doesn’t tell you when those earnings come in and when that cash comes back. That assumes that it starts paying at the rate of 13 percent from day one, and goes on for the life of the project. Here again, over time that will wash itself out and if you really wanted to get complicated you could grind that in, but we certainly don’t want to do that today.

Nevertheless, the logic is there and the logic is sound. It says, however, you have to average that 13 percent return, and we all know that there are some investments on which you have to accept a zero return. For instance, you might have to make an improvement in a mill to eliminate air pollution or water pollution because of higher standards imposed by public policy, that in fact does not pay out anything. So you must be able to offset that investment with something else if you want to be able to achieve 15 percent earnings growth. Remember that my premise is that $G = 15\%$ per year. So we have to average higher. In certain markets you make unwanted investments in inventory and receivables that really don’t pay anything. As a matter of fact, sometimes they cost you.

You have some involuntary investments that you don’t get a return on and some investments that are voluntary, but which for one reason or another you will accept a lower rate of return on. This does not take into account any way of equating or evaluating the risk of any given investment. This is another real problem. However, there are other methods to get at that, which we talked about.

Let me talk to you briefly about sensitivity. The example I gave you, that if you want 15 percent growth, and the after tax
cost of money is 4½ percent, that is to say you are paying 9 percent for long-term money, and you have a 1:1 debt:equity ratio. For each dollar you earn you can borrow another dollar, which is certainly true in the forest products industry, certainly in the integrated segment of the industry. If you retain 70 percent of your earnings available for reinvestment, then with the money market at 9 percent you need a 13 percent ROI average to get your growth. With everything else remaining the same, let’s look at a range of money costs from 6 percent to 12 percent. Under those circumstances, the ROI range is from 12.1 at 6 percent to 13.7 at 9 percent. In other words, taking money at 9 to 12 percent only moves your required ROI up seven-tenths of 1 percent.

These are all relative. This the logic; I am not sticking on a specific number. This is relatively insensitive, in other words the ROI required for that rate of growth under those circumstances is relatively insensitive to the cost of money. Let’s say you up your dividend payout to 40 percent, so you are only retaining 60 percent. You are still only able to borrow 1:1. Your required ROI (at 6 and 12 percent money) goes up to the 14 to 16 percent range from the 12 to 13.7, which is quite a jump. If your leverage factor decreases to 50 percent, and you can only borrow 50 cents for each dollar of retained earnings that you reinvest in projects, then your ROI requirement jumps to a range (at 6 and 12 percent money rates) of 15 and 18 percent.

On the other hand, if everything else remains equal and you drop to a required 10 percent growth rate, then your ROI drops to 8½ to 10 percent in that range. Obviously you can play around with this formula and solve for a lot of different things, but the most important thing is it gives you a logic and some sensitivities.

Based on this, you can have a view as to whether you are in the right business. If you are in a money market like that of today, and in your particular business can only generate 5 or 6 percent ROI projects because of the economics of your business and you are trying to have a 10 or 15 percent growth rate, forget it. You are going to have to diversify and get into
something that is a little more lucrative from the return standpoint. It might have a little more hazard in it too, so you are in a real judgemental area at that point, because you are getting out of what you know and into what you don’t know and adopting more risk at the same time. Can you afford to borrow money in this market?

This is a function, and everything is relative in life – I don’t think it is just a question of whether I can borrow the money or want to borrow the money. It’s a question of, “If I borrow the money in today’s market, what happens to my growth rate; what is the ROI on the opportunities I have available to me; can I generate this kind of investment opportunity within my business to justify borrowing the money?” The fact is that we are relatively insensitive to the cost of money, and I think this is true of the Forest Products Industry. I think we have some of these big gluts in pulp and paper mills in the past because you could get the ROI way down without seriously affecting your problem here. The big problem is the availability of money, not the cost of money, relatively speaking. I have a feeling this is true in a number of industries today, and this is why we are seeing American industry go to the long-time market at a point when it is as high as it has been for many years, because they are looking at projects under circumstances where their growth rate is not significantly impaired by the cost of money.

I would like to go back through some of these key questions I was talking about, to the extent that I am able. Should I increase the dividend? As I said, if the dividend payout goes up just from 30 to 40 percent, it jumps the ROI requirement to 14 to 16 percent from 12 to 13.5, which is a big jump. In the paper business today, you can find 5 to 8 percent ROI projects in plenty, but who can afford them at this time? I don’t think you are going to see a lot of expansion in paper. You certainly aren’t in Weyerhaeuser Company, in the next 2 or 4 years. But these things change as various industries assume different return characteristics because of the changing market conditions. At any given time you are confronted with the
priority problem, and I would say that today, insofar as our company is concerned, we are not forecasting any substantial growth in paper in the next 2 years.

Can I afford to borrow money today? We can find lots of projects that pay from 5 to 8 percent, but we also are in several businesses where there are some substantial opportunities, particularly when put into our overall system. And we can get ROI that will justify an announced goal for growth of 15 percent per year, in average growth in earnings per share. This is the Weyerhaeuser case I've got here. We can find projects that will average above 13 percent and also give us the right timing of the earnings, so we can achieve our goal of consistent earnings growth.

Should I diversify? Weyerhaeuser has announced an intention to diversify but there is no reason for my getting into the particular economic justification for that. If you are in an industry where you only produce projects having a low ROI on today's money market, it is very difficult to find a reason not to diversify. As a matter of fact, it is probably an absolute necessity at some point over time.

What gross rate of earnings should we expect? I am aware of the fact that we come from a particular background in Weyerhaeuser (Weyerhaeuser was completely unleveraged until 1966, the first time it incurred any long-time debt), and for many years it did not exhibit any substantial growth. It did exhibit growth, but not substantial growth in reported earnings per share. There was a tremendous growth in the underlying values of the timber that are now being realized, so we are thankful in Weyerhaeuser for that particular advantage.

Before I came to Weyerhaeuser there was quite a debate as to what they should expect of themselves in terms of a goal for growth rate. And there were those who were always harking back to the old days, when growth was sought for on an unleveraged basis, who advocated that the best we could expect would be 6 percent a year. As they began to analyze this (this happened before I got there) and began to apply the logic to it, it became apparent that we can very readily expect, if we do the job right, 25 percent a year. It isn't easy, but it can be done, so
it is that ideal objective that Len Guss talked about, where it’s a little higher than we are going to get, but it’s there and it can be done. So we can and will reach for it.

What will happen to export chip prices? I just threw that in because, as a matter of fact, we were talking about that on the way down this morning, and it’s a completely different sort of thing than what we have been talking about. But it’s very important to us when we analyze projects that have to do with putting in chipping facilities, loading facilities, and so forth. We have come to the conclusion that we’ve got to build a pulp mill in Japan (on paper) and see what they are doing. In other words, chip prices in future export to Japan are going to be a function of scarcity, for one thing, but they will never pay more than the amount that they can afford to pay and make money. But in building this Japanese pulp mill on paper and seeing what kind of money they can make, we have to apply their capital structure to it.

As you know, Japan has the fastest growing economy in the world today. They have achieved this rate of growth, in part, because of their unique capital structure, which is really a creature of a unique partnership between the government and business. Businesses in Japan operate on a highly leveraged basis. It is common for their capital structure to be as much as 8 or 10 to 1 debt to equity, and a lot of that debt is short-term debt from government-induced programs, so that they have a very much higher debt to equity ratio. They grow their earnings, whatever their target is. Let’s say that 15 percent was a much lower return on investment potential in their pulp mill than we can foresee, because of that leverage factor.

In trying to determine what they can pay for chips, we should set up a model of a pulp mill in Japan with that capital structure, rather than our capital structure. At least that will give us one side of the equation. We are also working on the other, but that doesn’t have anything to do with this formula.

What do I think about a variable rate loan? As far as I know, there is now no specific proposal to apply variable rates to loans to industrial companies. This proposal is talked about primarily with reference to the mortgage market, but as Roger
pointed out this morning, public offerings are being made today of variable-rate Euro-dollar notes, that are 7- or 8-year term and have a rate that is pegged with reference to an index rate in Europe on Euro-dollar borrowings. It isn’t an unreal question, for two reasons. In our particular instance, we are multinational and have investment requirements abroad, but in any event, people are making Euro-dollar offerings – debt offerings – in Europe, and repatriating the money for expansion at today’s rate. They weren’t doing it a year ago, but they are today. If the investment opportunities available to your company are such as to give you some margin between the anticipated ups and downs of that rate, that is no reason why you should shy away from the concept of a variable-rate loan. As a matter of fact, people are doing it today, so I guess the proof of the pudding is in the eating. This is true if you keep in mind that growth is relatively insensitive to rates, like that gap from 6 to 12 percent, which is a pretty big gap.

So much for this particular formula and how it might be used as a set of logic by which you can examine some of the principal questions that you have to answer in connection with the financing of your company. You also have the alternative, of course, in a public company, of selling equity. The cost of equity is horrendous. It is difficult for me to see how money can get high enough to justify selling equity, except in certain circumstances, one of which is that you’ve simply outstripped your internal debt-to-equity ratio, and you have to have more equity if you want to go. Then you can accept a slower rate of growth by taking in equity money, but a big problem, if you have as your goal consistent growth and earnings per share, is that that is really a variable cost of money when you sell equity. The reason is that it costs increasingly more to service your earnings per share requirements on those new shares every year. It is a moving target.

In our particular instance, we tend to restrict the use of common stock to the acquisition of a going business that has a set of growth characteristics of its own. And we say, “If this is a business that has a debt capacity of its own, it has a growth rate potential of its own, it has investment opportunities of its own.
If they equal or exceed the rate that we are trying to achieve, then we can use common stock equity to acquire that enterprise.” We would be very reluctant under normal circumstances to use common stock equity to buy a pulp mill that has a limited set of characteristics.

In the acquisition business, it is extremely important that you buy companies with growth potential. If you don’t want to get in the acquisition treadmill — and some companies have gotten there, sometimes by accident and sometimes by design — the point is that if you buy a company that has a low growth potential relative to your own, even though you might buy it at a low multiple compared to your own multiple and get an earnings spillover, it’s a losing game in the long run.

If you are growing steadily, soon that line will cross and you will get dilution. Then you have to make another acquisition of a low growth rate opportunity that gives you an earning spillover that will ultimately catch up with your other earnings, and then you have to buy another and another and another. You ultimately run out of steam, because the government won’t let you go any further. That’s the big problem.

I may have suggested enough here to start an argument at least, so at this point I will try to end with a whimper and turn it over to you for questions and comments.

QUESTIONS

Is there an explanation of this particular formula available? Intuitively, I can’t see how these various factors would give you growth.

There is, though I can’t give you a citation right now. But let me see if I can make it plain. As to your growth rate in earnings, first you have to assume that you have an existing enterprise that has an earnings stream. Let’s say that it is level, and that you want to increase that earning stream. If you earn $100 last year, and you pay out $30 in dividends, you have $70 left. You borrow another $70, so you now have $140 to invest in a project that will produce a net income after tax of 135 on
$140, so you have to pay your interest on the $70 you borrowed. On the example I’ve given you, where you retain 70 percent and you have a 1:1 debt:equity ratio on the incremental investment, that will give you $15. You have made $100 last and by investing the $70, plus the $70 you borrowed, have run that up to $115 this year.

Now, you still pay out 30 percent of the $115, but you reinvest the remainder and borrow an equal amount, on which you will get another 15 percent, and that is how it steps up. Of course, that is perfect logic because it’s a closed system. When you start looking around, you will find flaws in it.

For instance, the present level of earnings that you started with won’t remain in place unimpaired without additional capital investments. We all know that. We have to (as a very minimum) put maintenance capital in every year just to replace obsolete machines and so forth. So, to achieve that kind of growth, you have to have better than 13 percent ROI, on the average, because it’s also going to have to take care of that investment that doesn’t produce an incremental return.

Bob Skyler from Weyerhaeuser Company, who is our Vice President for Planning and Finance, is here, and I asked him to come down to bail me out if I got into serious trouble. Perhaps Bob can tell you where the mathematical backup for this is. I know it has been in the Harvard Business Review and in other publications.

**Mr. Skyler.** This is sort of a mean observation. I’ll declare myself first, so if you want to shoot me, you can now, but I’ve foreseen and heard of this 15 percent growth of earnings per share as a goal and compliment it highly. It is very desirable from the banker’s standpoint, because it makes him feel very comfortable. But I also recall that 15 percent per annum, compounded, is about a 5-year doubling cycle. What that means is, that in 50 years, according to my rough calculations, the Weyerhaeuser Company ought to be earning, net after taxes, 133 billion dollars. This is great, and I think I’ll run out and buy some stock, but I’d like to know how you are going to do that.

**Mr. Knudsen.** I would, too, and I’ll be around to see you if you have any suggestions. This of course is the problem of the
millenium curve, and it is inherent in anybody's growth projection. I don't know how you solve it, except to say that in my experience of business or any other human activity, performance never equals the ideal. Furthermore, we have a real limiting factor in terms of government control. I think that this is a valid set of logic for what I would call a midterm range.

Whether we can double again in the next 5 years, I'm not quite as confident about that. In our traditional lines of business, I would be doubtful, although I would be a good deal more doubtful about the third 5 years, because I know in our particular instance, that in investing a billion dollars in the next 5 years, we are still pushing what today appear to be meritorious projects from an ROI standpoint out ahead of us to the tune of hundreds of millions of dollars.

The external circumstances are going to change in the next 5 years, and we might change our views. There is, however, inherent in any natural resource business, an ultimate limitation on growth, and that is the extent to which you can utilize the resource.

That is, even though it replenishes itself, and even though modern technology is giving you the means of increasing the yield, I think there is an ultimate limitation for a given resource as to how far you can go with it. That's the urge to diversify, because ultimately you are going to have to diversify to have additional opportunities available to you. This question you've raised is a most difficult question in the context of Weyerhaeuser Company because we are starting with a very large base. We have 60 million shares outstanding and it's just darned hard. It isn't the first act - it's the encore that worries me.

*Are you applying this formula entirely to anticipated or projected markets, or are you applying it also to acquiring markets that are presently available to others?*

Well, we do use our allies to evaluate acquisition, though I don't think that we have perfected that approach, because of the moving target problem that we have in acquisitions for stock. Certainly, though it lends itself to capital investment divisions, it doesn't lend itself too well to expenditure decisions,
though possibly it does. For instance, Avon Products has 26 sales campaigns a year, a very rapid rate of growth, and a very low capital base. They make a tremendous return on their capital every year because it's all in selling expense and inventories. You do have a little investment on inventory, but I'm not sure that this particular type of analysis will do you much good for that kind of a business, because it is sensitive to other factors than the application of capital, in this instance much more sensitive to the application of advertising expense dollars than it is to capital investment dollars. The method is primarily useful for capital investment decisions. I don't know whether I have answered your question.

I don't think you have. I don't think the wood producing industry is increasing at the rate of 15 percent per year, and if you're going to grow at this rate, it has to come from somewhere. I don't think that the market will consume one 2-by-4 more than it needs, and I'm at a loss as to where you are going to find this 15 percent.

Well, we're going to find it out of increasing our share of finessing in world markets. In our case, in part, because we think we have a resource position that enables us to do that better than most of our competitors. Secondly, of course, with a little pride, we can be made to hustle a little.

How does the announced policy of a 15 percent growth square with the tremendous amounts of capital that your company is pouring into land rehabilitation, getting new stands established, when it seems to be that about the best you could hope to recapture from those types of investments is, by themselves, in the neighborhood of 4, 5, or 6 percent at best, carried over a rotation of 50 or 60 years?

Part of that is the maintenance capital problem that I was talking about. As far as acquiring is concerned, we acquired a very large forestry resource last year, and frankly you couldn't justify that (the Dierks acquisition) on the price we paid for Dierks. But if you analyze the whole thing as an industrial development, not only the 300 million we paid for it, but the 200 and some odd million we're going to pour in after it, in additional conversion, in other words, building the enterprise,
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growing the enterprise up to the capacity of the forest, then it
does have, not just an acceptable ROI, but a quite good ROI.

I would like to comment on your 15 percent approach to
growth. The number seems to be directly comparable with the
one I recall Boise-Cascade issuing 2 years ago, which was 20
percent per year. After awhile, if your horizon is long enough,
given that the two companies are equal, you find a great
divergence because of the differential there. It seems to tax the
credibility of the investor.

The investor will be convinced only by a demonstrated
ability to grow earnings per share on a consistent basis.
Boise-Cascade demonstrated that very effectively. I don’t know
whether you’ve seen it, but the May addition of Fortune
Magazine came out, showing Boise-Cascade as having achieved a
14.69 percent compound growth on earnings per share in the
last 10 years. Georgia Pacific is 12. Weyerhaeuser is 7.50, so we
have a little catching up to do here.

On this subject of discount rates, when you are analyzing
reforestation decisions for example, based on a 70-year
rotation, do you justify reforestation and the carrying costs,
which take the point on the annuity over a 70-year time period?
Do you discount the revenue that you expect to get back at the
end of the 70 years?

The question was “Do we discount? Do we take a forest
area and start with a 70-year rotation and discount all the cash
flows back to present value?” The answer is “No, we don’t.” We
solve for what the most financially advantageous rotation
should be. And in most areas at least, this depends on site and
so forth. And on most areas, if I am not mistaken, it’s less than
70 years by a good margin.

What is your expected growth in earnings per share? Would
you have any comment on the Arthur Anderson proposal that
the change in the method be begun?

First, let me comment as far as Weyerhaeuser is concerned.
We have set our objectives, and we have a very ambitious
investment program, which will substantially reach, if we
achieve it, the 15 percent compounded. So we have a little left
over, which we target for an acquisition program. And for at
least unrelated investments where we have recently got into the shelter business. For one thing we are in home building and mortgage banking at this point, and recreational land development to a lesser extent. I wonder if we are talking about the same thing. Are you talking about the accounting principles?

No, I'm talking about the proposal referred to this morning, about Bob Jones speech to the President's forum on ACS and the accounting process for timberland programs.

I really feel this way about it, that the underlying facts are reasonably well known. And I don't see that there is any great advantage to Weyerhaeuser Company in changing its method of accounting. I think that if you are asking whether or not I think it has any practical value to Weyerhaeuser Company, I don't think it does today. But, of course, sometime in the future, it might.

Now I haven't commented on the principle involved. I've just commented on whether or not I really care much about it at this point. I don't. And maybe others here disagree with me, but that's my opinion at this time.

I'm puzzled by your formula. How can you talk about this being incremental growth when this tells me nothing about where you are now in terms of existing projects? I can envision a given year's operation producing 15 percent earnings on that increment, but I don't see 15 percent improvement overall.

Well, if you reinvest your entire retained earnings and every year get the earnings on the amount retained, then get it going steadily, that will mathematically produce that increment, that rate of growth. You can't do it at one time, but then who can? How can you grow any company by making an investment 1 year and then sitting back for the next 20?

You mentioned the discounted cash flow. What dollar value do you place on it before you go into that type of profitability determination?

The discounted cash flow, as a tool, can be used in two ways. If you decide that you don't want to consider any projects that don't produce an ROI of at least 10 percent, then
You lay out all your projects that are available for reinvestment today and knock out everything under 10 percent as a starter. Then you might have some other criteria; we do, beyond that. But at least you want to knock everything under 10 percent, in our case 13 percent today. Then you discount all those cash flows back to the present at the rate of 10 percent, everything that is zero or better qualifies, because it is producing 10 percent or better because of the 10 percent factor.

On the other hand, you can take a given project, and you can do this on a computer, using all the factors that apply. You can take your total investment in land, bricks, mortar, and net working capital, and that is your base. Then you take your total cash flows over the life of the project (you have to have a determinable period) and that cash flow will be the equivalent of having invested your total investment, and getting it back plus "x" percent a year during the life of the project. Some of the return may come back by way of a residual value at the end of the project, but that is out there and it is the 13 percent that I have been talking about.

You said that that was an abbreviated formula, didn’t you? So that you’d have to assume that you began by making 15 percent on everything you started with?

No. It doesn’t make any difference what you start with, because all you are trying to do is grow it. At a given rate, grow your earnings. I’m starting with $100, and I want to grow that earnings stream at the rate of 15 percent a year.

But, don’t you want 15 percent on what you already have?

Well, I’d like to. But I’m given that, and don’t have any control over it. Somebody else made those decisions years ago. So I have my today’s earnings, and I just want to grow from here.

What do you do, then?

When you finally have a view of a future investment, you are not to worry about what has happened to your past investment; you start that as a base. Now, if you are saying that in order to grow my earnings 15 percent a year, I also have to anticipate some decline in earnings for my existing projects,
because costs are going up. I'll say "Yes, that may be true, although prices may go up more."

But don't you project that you will maintain your present earnings, because increased prices will offset the cost?

We don't have to, in investigating a new project. We are talking about whether or not we think we can improve our earning of 15 percent a year. We either have to say we can make new investments at substantially better than 13 percent RO1, or that prices will keep pace with costs.

About the risk analysis that you mentioned very early in your talk: do you use simulation in your risk analysis, and do your operating people find this useful?

We have a pretty sophisticated risk analysis package. This is a 21-variable model using the Monte Carlo method, which is used at the operating level.

When a divisional manager of operation looks at capital expenditures for the year for instance, would he use this approach?

Probably not at that date. This is pretty expensive processing, as you can tell, but it will get wrapped around anything of any size. When we get down to a proposal in terms of an appropriation approval on any project of over half a million dollars — and we get many of those — we will use a risk analysis approach to it.

And on the DCF without the risk analysis, what level of formal appropriation request would you go down to with that? What is the bottom?

I can't tell you, exactly, but perhaps $100,000. It is really a matter up to the discretion of the operating management. We have developed a set of forms that make the mathematics of it mechanical. I mean they don't have to reinvent the wheel every time they make up an AR for a new electric truck. They might have to fill out a complicated form, that is all.

You mentioned the Arthur Anderson proposal for accounting for timberland. Aren't you substantially (in effect) adopting their recommendation in the Dierks situation? Arthur Anderson's proposal is to capitalize the cost of carrying the investment in timber land, and that is what you are doing when you capitalize the interest.
Well, this, however, is related to the project approach of that particular property. In other words, some of that timber was not utilizable, not from the standpoint of rotation but from the standpoint of a lack of facilities. And our program was immediately to embark upon a facilities expansion program to bring the harvest rate up to the full potential yield basis. Now under those circumstances, our approach was (and it was agreed to by Arthur Anderson and not originated by Arthur Anderson) that this was the same as any other construction expenditure. I couldn’t really comment on whether or not it is the same thing, for I really don’t know. I think it could very well be consistent. This is not a long-term capitalization program. It is a short-term construction program in our philosophy, so we haven’t gone the step of capitalizing long term, though we are looking at it, just as everyone else is, to see what the implications would be.

Are you saying that, in your woodland operations, you are going to ROI location by location, or within that division? Or on a profit-center standard, for the timberland division?

Yes, we not only are; we have. All of our main timber holdings are being analyzed on an area basis with a view towards the financial implications of our forestry management. This is what we mean when we say in Weyerhaeuser, “High Yield Forestry.”

Along the same intention then, do you establish a marketing price to the converting plant, to the container plant, and so forth? A transfer price? At market, not cost?

At market. This is of relatively recent origin in Weyerhaeuser; that is to say, I think it has been within the last decade that they have gone to transfer pricing. All raw material is transferred at market today from division to division, with the exception of the timber department, which gets the stumpage. They own the stumpage.

But isn’t this transfer basis also on an allocation basis for the best end use? In other words, the timberland raw materials must allocate a spin-off to the same mill, or to the plywood plant, or to the pulp plant for its highest yield, and not necessarily buying it at transfer price, and allocating it to them from that point of view. This is the decision of the timber department?
Well, it's a practical world. We all have the common objectives of maximizing the return to Weyerhaeuser Company from our operations. And sometimes, of course, you could possibly maximize a return this month by shutting a plant down, but it would take a little longer view all along. We have made some pretty wrenching decisions in the last couple of years. What I'm saying is that it's not just a matter of negotiation. There is a definite allocation process. It is to a very substantial extent computerized, and we have found it to be not entirely reliable, but we are developing a very high degree of confidence in it.

Let me emphasize one thing; I don't want you to get the idea that this is a formula by which we mechanically solve our problems. What it is, is a display of some logic, and it is the logic that is important to us, particularly the logic of what the trade-offs are between retained earnings and high dividend payout. What the trade-off is between a growth rate and leverage rate. What the trade-off’s are between equity money and debt money. What the trade-off’s are between cheap money and expensive money. At least with some appreciation of these trade-offs we think and we hope we are approaching the business less intuitively and more rationally than perhaps we have in the past.

Dr. Strickler. Thank you very much. I think you know what I meant when I said that I was intrigued by some of the approaches they were taking. It may or may not be a new approach. But maybe that is merely an indication of where the gap lies between academicians and practitioners.
Changing Patterns of Short-Term Financing for the Forest Industry

Mr. Lyman Seeley
Executive Vice President
First National Bank of Oregon

INTRODUCTION
by Professor Lester B. Strickler

OUR NEXT SPEAKER is currently Executive Vice President of the First National Bank of Oregon, and also serves as one of the bank’s directors. He is a graduate of Oregon State University and of the Pacific Coast Banking School, and has served as an instructor at the American Institute of Banking for four years. With First National since 1940, he served as Vice President of the Northwest district and as Senior Vice President before advancement to his current position. It is a pleasure to present Mr. Lyman Seely.

ADDRESS

THANK YOU VERY MUCH, LES. Coming on your program this late in the day, I have had the opportunity to develop some peripheral thoughts as I sit here and wait my turn. Some of these thoughts were stimulated just now by the man introducing me. I thought it was interesting that in order to tell this story about what happens to people like me at the Pacific Coast Banking School, that he had to be the man on the spot, so to speak. I hope you got the inference that he was there too. Whatever the devious goings on were, he was in a good position to observe them and no doubt participate.

One of the random thoughts that occurred to me, and which might be a good place to begin, was that I’m quite confident that we really are a mixed group. Many of my
competitors from the banking industry are here because they are interested in U.S. customers. I'm sure.

Maybe they are here to defend themselves. Because, after all, Chase has been on the program, and now for First National of Oregon. But we have bankers in the audience, quite a group of them. Within your industry itself I see a wide variety of kinds of backgrounds, not only in terms of personal qualifications, but because of the other reasons you are in the job you are today.

There is quite a variance among you, and though I don't know all of you by any means, I can observe. I note the fact that not all of you are in the same position in the industry that Cal Knudsen's Weyerhaeuser is. And you may have heard things discussed today that are a little hard to relate to in terms of Weyerhaeuser's problems, which is understandable. In thinking about that and in thinking about short-term lending, I am also conscious of the fact that it is 3:00 p.m., and I don't suppose "short-term borrowing" is the most popular subject in the world among borrowers, if you stop to think about it.

It must be far more exciting to contemplate a 15 or 13 percent return on investment than it is to think about borrowing money that has to be paid back in a short time. I suppose that is not very exciting. Then I am reflecting on my topic itself, which is a fine topic, in terms of fitting it into an agenda. It seems to infer that there might be a bag of tricks in short-term lending. There might be a source of magic, and this is sort of a continuous innovation that goes on, and maybe by getting me up here I could bring you the latest in the bag of tricks. And then you could go home with something you didn't have before and put it to work in your own company.

I rather doubt that that is going to happen. In the first place, I am not convinced that there is much new under the sun in financing problems or any other subject that we contemplate as deeply as we are trying to contemplate this one today. And bear in mind that all of us are really talking on the same subject. We are dealing with a lot of the same factual material, each from a point of view, and now I am asked to bring to it the point of view of the practicing short-term lender.
Even that gives me a smile, because some of the longest
term loans in our bank started out as promises to pay in 90
days. So I don’t think I will lead you to expect that I’m going
to unveil a lot of new techniques and gimmicks. There is
innovation in financing, sure. And maybe before I’m through at
least perhaps I will allude to some of the things we are doing.
Not that I don’t think you already know them, but just in case
you want to be reminded to throw questions at me about how
these gimmicks are doing. I really think that I would rather
treat this subject in terms of what happens to be my personal
philosophy, that there isn’t much new in the way of financial
problems. They may seem new to the guy expressing them; they
may seem new to the guy trying to solve them, but chances are
pretty good that the problem has been around before and is
now coming around again. Perhaps it is disguised in a little
different clothing; it may even be that you will find some
variation in the way we treat it, but I doubt that the underlying
cause of the financial problem is something that is without
precedent. Usually, it’s because we ourselves have not observed
the precedent.

So I am going to bring you the point of view that the kinds
of things that you might call “changing patterns in lending” are
more likely to be a lender’s reaction to changes in you, and the
way you conduct your affairs, the kinds of problems you face,
the kinds of competition that you engage in, and that he reacts
to these because your lenders are competing with each other,
too, for your favor.

It is not likely that they invent new things unless there is a
need for them, any more than it is likely that you change
something extraordinarily profitable unless there is a need for
it.

I am conscious, as I look around the room, that I am
talking to people with considerable and varied experience.
Accordingly, I am going to try not to preach to you; I am going
to try not to teach you, because I doubt that I could. The
innovation that you see in banking I think tends to reflect the
desire to serve some real need or something you have appealed
to us to do, or something that we have seen and imagined that
we could solve. Maybe it is helpful to look at the change in the industry itself. And this is a terribly hazardous thing for me to try to do, because I am talking to people who have lived with this most of their adult careers. So what shall I do? I have talked to you about changes in your industry, or am going to, just for the sake of perspective.

I want to have you think of these changes (and I'll run through some of them) from the viewpoint of the man who has been out of school longer than I like to remember. It is 32 years since I studied Secretarial Science as a way of getting a job. Taking shorthand was one of the early lessons I learned in finance – that I could get a job and support myself if I knew how to take shorthand, and that I did. Then, I abandoned it as soon as I could find a way to earn a living another way.

I ask you to look at your industry through my eyes, in the light of how that might have affected lending patterns. The whole purpose of doing so will be to try to identify the change and try to see whether there are any insights that might come to us from these changes. We are all young in terms of history, so maybe even at this date it is possible to get some insight into what kinds of conditions have caused these changes in patterns and what can we identify in the way that both you and I handled ourselves in response. During these periods, what can we identify in the way we've handled ourselves that might suggest an improved pattern of short-term financing for the future?

Let's go back to 20 years ago, when the number of sawmills in Oregon was officially listed as 1,530. And that is considered a weak figure because they only counted sawmills with four or more people, and many had less than that number. These mills were in existence in 1950. Ten years later, in 1960, the number had been divided in half, and stood at 767. You are aware of these things, but we are thinking about them now in terms of bettering the effect on short-term lending patterns, and what their significance is for today. Then by 1969, the number was almost halved again, and stood at 433.

What were the financing conditions when there were 1,530 sawmills in Oregon? By today's standards, you would have
thought that most of those mills were pretty weakly capitalized, and that is an understatement. Many of them did not have an owned or controlled timber supply. Some were operating downstream from somebody who did have a timber supply; some were just doing the best they could by buying logs; some had timber that they regarded as their primary estate in life, and they sawed logs when it seemed profitable. By and large, the idea of an integrated timber supply backing a variety of products was not part of the picture. What did this do in terms of financing?

One of the things that I recall about our bank in those days was that we had over hundreds (I can’t remember a precise figure for 1950) of log storage lines of credit. Short-term lines of credit to accumulate the logs are still around. I am not suggesting that these are antiquated systems that no one uses anymore, but simply that most of the short-term financing was on one of these kinds of bases, which I’ll now describe. The banks financed log lines for the storage of logs. This occurred even if you owned your own timber in many cases, because the cash out of pocket cost of logging was pretty high in relation to the stumpage price even then. So it did require cash to put it into ponds or to put it in log storage of any kind. It was a risky business for banks, which should reflect the kind of risk it represented. There were banking people who tried to understand it, but they might not always be as knowledgeable as the guy trying to borrow the money, who knows about the true value of those logs.

There were a lot of hazards facing them, there were fire hazards, there were hazards of the inherent quality in the logs, there was a question of whether or not there were liens on them. How could you be sure that the stumpage lien had been discharged through payment? How could you be sure that all of the hauling costs had been paid, that there wasn’t a labor lien that would carry through and deprive you of your security at the time when you needed it most? These were some of the problems that made such transactions rather hazardous. But I want you to think about the fact that the financing did occur. It did get done. This meant that there was a pretty close
working relationship between the borrower and the lender, and maybe that's a peripheral thought, but I would like to have you tuck it under your bonnet as I review some of these other characteristics.

We had a further line of credit quite often for the same borrower for the storage of lumber, because his control of his marketing was not anything like it is today. He produced the lumber on a speculative basis, quite often hoping for a sale. The question of when he sold it was not often clear, nor were the questions of when or whether he was going to get paid. Yet the bank, doing business with the community, had a strong interest in seeing that those payrolls didn't cease. Accordingly, they worked hard to find a way to stay with such financing so that the lumber could continue to be produced even though it wasn't necessarily clear where the income was going to come from. Then, as it was sold, because it wasn't paid for immediately, and because there was some in transit, and some time until delivery, there was a need to finance the accounts receivable. And receivable financing was a fact in the lumber business, particularly.

I am going to allude to just one of the conditions that has been improved in this state through the passage of the Uniform Commercial Code, which has given us a better lien on inventories and receivables. But in those days, it was necessary to proceed through notification if you wanted a really good lien. And even then, there were some problems in trying to handle it. So these were the kinds of financing that were involved in short-term lending. They were considered hazardous; they were hazardous. It was difficult to know the accounting system, the cash forecasting, the kinds of formulae that have been discussed here today, and it was not always easy to know exactly how your customer was making out in the marketplace and what his chances of survival were.

Now, we as bankers, however, were able to look favorably on these lines of credit and were able to keep them open. Why were we able to do that? I think this is important because it's going to represent a change I am going to refer to.

Because we were able to collateralize them with current assets. We were able to develop a knowledge of the value of
those current assets; we were able to put some control on the amount that we were willing to advance against them, and the conditions under which we were willing to advance against them. We were able to take what was viewed as a secured position. How did we do this? In logs, I can well remember that you had to have a field warehouse. You thought that if you really wanted a fully collateralized position, you would try to construct a field warehouse. This is costly to the borrower. It meant that you had to establish custody and control, which meant that somebody had to be on the site, making certain that the logs were checked in and out; and you had to protect yourself against what was called "highgrading." In other words, if you were going to advance $20/M on a log in those days, you had to be sure that the logs that had a higher value weren't all sold out, leaving you with cull logs of a lower value. The reason was that they were coming in quite often on a field-run basis. Seldom, if ever, did you have the kind of grading that you might like to have, or were able to separate them on a basis where you could feel that you knew what the value of each log was. So you controlled this through your advanced stage, if you were a good banker. But how did you set that advanced stage? I want to mention this to you because it illustrates what you have to do under conditions that are not quite like those today. I was taught to calculate an advanced base on logs, on a basis of "What did I think I could get for those logs in the next best market? Where would that be?"

If this is a sawmill somewhere up in the hills of Coos County, where is my next best market? And what would be the cost to me of getting the logs from where they are now to that next best market? How do you make out in liquidation? What happens if the guy is broke? What do you do with your logs and what can you get out of them? So you put them in an advanced base, which is always unpopular with the guy who stored the logs, because it looks low in relation to his costs. These were the techniques, these were the patterns. The same kind of technique had to be used if you were going to advance against lumber.

This was considered even more risky, because by that time, the log manufacturer had been committed. There wasn't nearly the flexibility in the utilization of the log that there is now of
course, but there was some. At least until it was manufactured, it could be hauled away as a log. After its manufacture, it is lumber, so the next questions are its worth, who is going to buy it, how well has it been manufactured, and are we going to be able to take care of it and keep it in prime condition until it is sold?

Again, visualize the kind of relation that you had with your lender, when you were seeking and obtaining credit based on this kind of sheer knowledge of the real value of the aspects that you were dealing with. It is a closeness of relationship that did facilitate what was certainly regarded by bankers as “marginal lending.” But it took place in large quantity, and those manufacturers who were able to keep afloat found that there was money available. Now this is another point that I want to bring up, because it is going to be pertinent in the context of my talk. In this relationship, the lender had an acute awareness of the needs of the customer. And it was an almost day-to-day awareness, because he (the lender) was watching log prices. He (the lender) was checking for his own protection, but in the process he didn’t get very many surprises out of his relations with his customers. I want you to remember that, because that is going to be one of my exhortations to you before I quit. The relationship with the lender is one of the “thou should” types of things. It can be a beautiful one if devoid of surprises.

In all of this, it was a little rare to see a term loan. Not that they didn’t exist, for they did. We had customers then who had vast quantities of timber, and you could lend to them carelessly, because of their controlled timber supply. So there were term loans, in a sense. They probably weren’t scientifically scheduled like we do them today. In most cases they weren’t, and one of the usual reasons was that there didn’t exist the accounting systems nor the financial management within the company, let alone in the bank, which was trying to analyze them.

The term loans tended not to exist. Now there was another reason for that, though. I said it was considered a pretty risky business, and I guess I don’t have to document that, any more than I did in reminding you of the history of the rise and fall of sawmills, if you want to look at it that way. Companies did go broke; sawmills did abandon. One of the trite expressions that
was brought to me as a junior lender was that when you started looking at the value of a sawmill (the machinery, equipment, and so forth) you valued it at what you considered to be the value of the scrap, less the cost of transporting this equipment to a scrap market. Well, that probably was overdoing it a little—but was it? Because I have been on fishing trips where I have run into some rusting metal in those days, and maybe you know of some. It wasn’t unusual in some of those terrible cycles that you have all been through, to see abandoned mills. So it wasn’t entirely facetious to say that there wasn’t very much merit in making a term loan against the iron that would be used in manufacturing lumber. On the other hand, if you used today’s kind of ratios, the volumes of credit that were extended to these revolving lines to support their lack of working capital in some cases mounted up into pretty large figures—far larger than would have been prudent to extend on a term-loan basis.

What were some other reasons why a term loan wouldn’t have been very good? Now, many people could forecast a term loan based on the expectation that management can control a cash flow, sufficient at least to discharge its debt service, plus whatever other things it wants to use a cash flow to do.

We have been talking about using it for creating things like a 13 percent return on investment. So much for those conditions. What were the changes that took place? I have already mentioned that the biggest change that took place was their disappearance, like flies. Where, how, and why did they disappear? Our customers, these sawmills, either failed and left the scrap metal rusting in the woods, or they consolidated for survival, or they simply grew stronger through profitable operations to survive. Or they discovered somebody who had higher manufacturing ambitions than they did or more self-confidence, and were willing to pay more for their backing of timber supply than they were willing to speculate it was worth. Maybe they were getting older, and so they sold. But in any case, there is this great change in lumber mills and in their concentration, and I have suggested to you some of the reasons, which I am sure you know.

Regardless of what the underlying economic reasons were that persuaded the owner to part with his timber or to quit milling logs himself: whatever his motivation, it almost seems
that invariably it was a feast or famine type of price cycle that provided the straw that broke the camel’s back. This was the big decider, that periodically we go through these cycles, and each time we go through one of them, someone else drops off, for whatever their particular reason. Unfortunately, this last problem I have identified, this cycle of price change, hasn’t particularly lent itself to solution. It is interesting to speculate whether or not maybe some of the things happening today, like the futures trading, might tend to stabilize the price. If we develop a really solid market in futures trading, I suppose we could hope that it would have the same kind of stabilizing effect on our commodity it has had on others, as in the case of agricultural commodities.

But among these changes as this consolidation took place, there were some other things happening; it became more and more a capital-intensive industry. Technology itself, the need to develop more new products, the log price escalation, the need to own or control larger quantities of timber, and of course the practice of highly leveraging these things by debt, high in relation to what had been done before—all were contributing factors.

We could observe then as lenders. How did it look to us? Throughout this period, if you could forget about those situations where you lost money, the industry was continually coming into stronger and stronger hands. We are observing now an industry whose financing needs are more easy to serve in one way, because they are not quite as subject to the cycle. They have more resistance to it. And all these changes in the customer’s affairs then gave him a different look to us. As a borrower he began to look different to us. He began to develop a more predictable income pattern. He developed the capital support necessary to survive some of these hectic price problems that he and we knew he would face periodically.

Then he developed manufacturing and marketing capabilities, so that through the very diversification and the skill of his trade, he was able to help at least to cushion against those shocks. It hasn’t been a completely fool-proof type of a cushion, as you well know. But there is at least some
contracyclical balancing of things – paper tends to be a little bit
contracycl to some of the other products, and there has been
at least some flexibility in moving from one product to another.

Another thing caused him to look different to us and
causd us in the longer run to begin to move away from this
closely collateralized position. For one thing, as he grew he
began to hire people like you, to think about managing his
finances. This caused him to begin to develop more
sophisticated support for the kind of thing we later began to see
in terms of loans. You began to plan his financial requirements
on a longer time frame. We have talked about this type of
planning and the need for it. During that point of time you have
made full use of term loans, and you have even used commercial
paper. Some of you have used other fancier gimmicks. We have
helped you do some of this.

Now I want to point to something that perhaps is one of
the lessons that we ought to try to hold in our bonnet, at least
until the next cycle. It seems to me that there was a great
temptation that came along with that feeling of a little more
positive control of the company. Along with that comes a
temptation when the projected pay-out on a new project, or an
acquisition or a timber purchase or whatever, seems so good and
so short and so beautiful, in the times of the good price
structure, that it would cause you to be interested in that
project in the first place.

This presented a great temptation to fund it, either
completely out of the current earnings as was often possible, or
out of short-term debt in the bank, on the assumption that
things can’t get that bad that quickly. But anyway the bridging
of the problem was short-term debt. In concept, you were
thinking of it as something that would be funded. The concept
you were projecting was repayment out of earnings and
depletion and depreciation and so forth. But you financed it in
another fashion – short term. It is easy to use hindsight,
especially at this point in time when everyone has a problem he
can relate to that kind of thinking. I don’t want to get trapped
into the position of naming names, or even saying things that
could be identified, but somebody made the comment this
morning that there is a difference in the culture of a company. There is a difference in the way the head man thinks.

Dr. Guss pointed out that we have come through the period of production orientation and then sales orientation. I am talking about top management orientation — and finally legal and financial orientation. It may just be that if you want to look at all the records of how people fared with their financing problems in the last 3 years, you might find that those with the financial orientation at the top did just a little bit better. It may just be that they recognized the need to maintain a discipline within their organization, which required all levels of management in the company to calculate the possible effects of the change in plan.

I well remember all during the time of the high prices a year ago, when during all that price period your profits were beyond your fondest dreams. I don’t know of anybody in the industry who wasn’t predicting that it couldn’t last. As a matter of fact, many of you more responsible people in the industry were saying you hoped it didn’t last, because you knew it spelled disaster. The longer it continued to work, the worse the disaster would be. I heard many people saying that, and they nodded in agreement. I wonder if in all those companies the people making those statements insisted that a projection be made of the precise effect on cash flow if the prices went to where they really thought they might go. Or if perhaps you made such a projection in your organization and couldn’t get anyone to listen to you.

I know of situations where that happened — where you find that the financial man had made his projections, but it was too heavy a climate to be listened to at that point in time. The opportunity looked too great. Well, I’m moving into the “so what” part of my comments, where I am hoping to derive some kind of insight that might help us in the future. I think there are some lessons to be learned. I think that we should inquire rather thoughtfully into the wisdom of financing capital projects with short-term funds. I think you could write that down as a principle and address yourself to it, when you are tempted to do so. At a time like that when it looks like you might have the
money, it almost looks like a sin and a shame not to use it, because you are going to have surplus working capital.

This was true in many, many instances last year. But I wonder if a careful projection of what could happen would not have said to you, "It really isn't surplus capital, if I take into consideration the possibility that my working capital will be depleted through a prolonged period of price problems." It might be that having looked at that kind of schedule alongside of a more heavy schedule of what was actually happening would have caused you to say, "Well, I better fund it, even though I don't like the price of the rates being quoted to me today."

If a person has created excess working capital, he could say to himself, "It has an investable value, because short-term rates are right up there along with long-term rates." It will not cause an extraordinary drain on the profitability of the company to preserve more liquid reserves during that period of time.

These are hindsights — I'm confessing that — I'm not lecturing to you. I am discussing some things that might well prompt you to ask me, "Why the devil didn't you point that out last year?"

Another lesson — is there a rigid discipline in the organization, which can keep you on course when the climate is heavy? I really think that there is sort of an intoxication that comes into a company when its profits are extraordinary. And I think of the things that we know so well you don't have time to think about, when you are worried about how many trips you have to make to your money vault each day. The thing that I heard most people talking about in the first half of last year was "Can you help me find some way to reinvest this cash? I must have some place to put this cash. It's running out my ears. What will I do with it? Can I have some investments? Can I have even lower ROI standards during that period of time to try to find some way to get rid of it?"

If there is any value at all in going into a period like today, there is at least the opportunity to think back over recent history and see whether there is a lesson to be learned. I suspect that in all our businesses, and I don't exclude the banks from this either (I am trying to learn this lesson for myself as well as
suggest it to you), that it is important to have a rigid discipline in a company that will tide you through periods when all signals are "go" and it is pretty hard to exercise restraint. The discipline I think has got to be more than just with the financial people. I have witnessed some rather excruciating embarrassment on the part of companies who really didn't know how many triggers they had pulled in their company, really did not have an added, totaled-up figure of how much money does it take to finish all these things we said "yes" to.

These are not little companies without financial managers in them either. As I said, it is embarrassing to realize that the climate has gotten away just a little bit and we have approved everything that had a payout without trying to determine what was the timing of the payout. Will it create a money shortage in 1969, even though the payout looks good on a 10-year program? Or what is the cash flow going to be? And what would it be if the price came from 130 to 70? I didn't see cash flows presented to us like that, and maybe I should have asked for them — what would actually be the result? I was interested in the show of hands in this regard earlier when someone asked, "How many of you halted projects?" I suspect that if you didn't halt projects, it is prima facie evidence that you did have a discipline of timing within your organization, if you had projects authorized at all. I suspect that if you did have to halt them it is almost prima facie evidence that we didn't have the alternate plan. In most cases that I know of, it was not a second thought about the payoff that caused you to postpone the plan, it was just the sheer inability to raise the funds, or the undesirability of trying to raise them under the conditions that prevailed.

I'll move now to a few of the changes that have taken place in lending, just to acknowledge them in passing. There are some changes in short-term lending. For one thing, we are trying to lend short-term. When we write the note short-term we are trying to be sure that is what it means. We are trying not to write 90-day notes that have no prospect of being paid within 2 years. We are trying to make those into 3-year loans, if that's what it appears they are, or not make them at all, if we are not willing to.
We are trying to do a little better job in analyzing what is short-term credit and what isn't. Then there are some technical changes under the Uniform Commercial Code. We can get a better lien, and this has been a very great service to the young and growing companies particularly. It has meant that we could give a very good asset support on a growth basis, and that we could approve lines of credit that were related to the amounts of money needed to store logs, and in many other industries, to store the raw inventory and also the processed inventory, and to carry that lien on through and have a good receivable that was proof against other exterior claims. So the amount of money that a bank can lend in relation to the capital support is much higher under these kinds of programs. We are in a better position that way.

There has been some liberalization, as you know, of controller regulations. Timber loans are a good example of that, although they are not regarded as short-term loans. Neither are intermediate loans and equipment loans. As you probably know, banks now tend to do direct equipment leasing and personal property leasing. It had probably more value, and we found more application for it while the investment tax credit was alive, because there were circumstances where the tax credit was worth more to us than it was to you. It could create a mutually better yield, a better cost, although we are still doing it. It is a vehicle, a method.

We are able to finance exports better than we used to be able to. There are things like the export-import banks that we can tie in with, and which our bank has done, and many others have. This is a little more applicable to some of the capital goods than it is to your type of manufacture, but it means that we can, with a little advance approval time, set up credit to handle contemplated sales abroad and guarantee that you will not have a collection problem resulting either from credit risk of the purchaser, or from political risk.

This can also be done on intermediate loans to the Export-Import bank, and we do some of that too. There are some changes, some innovation in banking, but again I submit that such as it is, it is more likely to come out of our desire to be of service. In trying to be of service, we are trying to
estimate your requirements and change to your requirements. Now, I've got just one final point that I want to make, and perhaps the most important thing that I will say.

The thought that I hope to plant with you is going to seem terribly self-serving, so I will have to ask you to place your confidence in my own integrity and believe that I plan to be with the bank a few more years (I've been there 30 already), and I hope to give advice that I can live with. But I honestly believe that we have come to a period in time when the absolute value of a dollar in these cash flow projections and in your return on investment calculations has caused us to take an approach to our borrowing-lending relationship, that perhaps leaves something to be desired. Now, I'm not suggesting that you have to be in bed with your banker and that you have to subordinate yourself to him in any way. I am not even suggesting that this is limited to bankers, but I am suggesting that you should realize that we in the lending business are human beings also, seeking to run our own business in a way that we view to be our long-range advantage.

In troubled times we are going to have to pick and choose, just as you have to pick and choose between alternate uses, and sales and whatever. One of the hardest things for a banker to do, in periods like we have just come through, is to make up his mind that some of his customers are going to have to go, simply because there isn’t enough money to go around.

Who do you think goes under in a situation like that? How would you pick and choose? Let me make it even more real. I know a man (and I won’t even get close to identifying him) who, out of a long period of business management, is absolutely, utterly, thoroughly, and irrevocably convinced that in your relations with lenders of money, you should treat them as any other supplier. Because they are going to get the highest yield they can get, and are going to make their decisions on a basis that is in their interest, it is not in your interest as a borrower (his reasoning goes) and therefore in effect everything goes out for bid every time. I am not suggesting that we should have anything but a fully competitive climate, but I am suggesting (and I have happened to watch how this particular
man has made out in terms of success in tapping lending markets) and have found that his lenders were just as willing to
go do something else when it came time to bid his project as he
was to go do something else when they were approaching him.

I don't think that we should find that strange. I think that
is just as normal and natural as anything can be. So I am
suggesting that you look at some of the most successful national
companies and what they do in terms of their lending
relationships (their borrowing relationships, depending on how
you want to look at it). How much effort do they put into
making sure that they are dealing with lenders who want to deal
with them, who are taking the trouble to understand them, and
who feel some responsibility to stay with them? Now I'm
suggesting that in your own self interest, if I were going to do
something else besides banking based on my own experience in
the bank, I know one thing that I would give a high priority to.
I would put in some time trying to identify the bank or banks
or bankers that I thought would make the best members of my
team, and then I would get them on my team. I wouldn't want
to have any doubts. I would want to be just as sure about that
as I am of any other aspects of managing my business.

And I wouldn't want that to be limited to short-term
lenders; I would want to have a long-term lender in my stable,
even if I didn't know exactly when it was that I might want to
use him. I would want to have somebody cultivating me. I
would want to have established a relationship. Because I can't
always tell when I might want to fund one of these projects.
Now, why do I say to do that when you don't need it? Why
should you cultivate those relationships when maybe you aren't
calling on them? Well, I would like to suggest to you that one of
the things that has happened in the last few years is that in this
concentration of timber product companies, in these larger,
stronger, better capitalized, better manufacturing companies,
one of the things you have done in escaping from the extra cost
of the kinds of lines of credit that prevailed earlier has been to
finance your requirements on a term-loan basis, to a far greater
extent. You haven't always done that on a long-term basis.
There has been quite a tendency to place it in banks. You might
very well ask me why am I objecting to that; I was soliciting you to do that very thing, wasn't I? Well, yes I was, because I didn’t want to be left out in your relationship.

What I am suggesting you think about is that in the process we may have been guilty, and you may have been guilty, of getting so much of your credit on titlement. Now that is an expression that probably isn’t very handsome. I am talking about this relationship that you have with a lender, which he sees as a responsibility he is willing to recognize. Have we used all that up as we have gone along, in term loans, leaving no room to expand into an alternate plan that contemplated invasion of our working capital by lost operations, or by having to go ahead with projects that weren’t funded? Did we leave any room for that financing, or did we not because of what appeared to be a temporary rate advantage?

This is what I honestly think happened. I don’t think there is much question about it. When you looked at your financing alternatives in 1967 or 1968 or 1969 and looked at the cost of funding, you said, “I am not borrowing at the bank; they will lend me X millions of dollars, and I have already got the deposit there, so I’ll use that.” “That is much cheaper.” you said, “than to go fund it.” Well, sure it was. But what was the price you paid for that decision, when it became necessary then to try to fund a problem that was really a working capital problem? And the working capital problem that occurred in 1969 should have been solved by making use of these lines of credit that you have been earning through your deposit relationship with the bank.

So I think one of the things that you got into, and we allowed you to get into as bankers, was to do too much of your term lending, to the point that we didn’t have too much more that we could do for you, except by doing some rather extraordinary things. Many of your banks did do some rather extraordinary things; we certainly did. Though I didn’t mention all these gimmicks, I know that when some of our best customers reached our legal limits and beyond, we couldn’t at that late date go out and try to find new relationships, so we stayed with them and tried to put the problem to ourselves, if they meant enough to us, and solved it one way or another.
In some cases, it meant arranging Euro-dollar credits for people whose credit was not well enough known internationally to be able to command it directly. Sometimes it meant attaching our letter of credit as a document to that transaction, to enable us to go, which we could do, and did. We attached said documents to some commercial paper for customers who meant an awful lot to us and were able to get some huge sums of money to them that had not been planned for, and which was done on a spot basis. Look at what happened in 1969 – it was done at a loss to the bank. I'm sure that many of you would confirm that there is a lot of such lending.

When we were using these extraordinary sources of funds to lend at the prime rate in 1969, you can bet that your relationship was being sorely tried. I am suggesting to you that this is one of the things that you might think about. It is a terribly self-serving argument for me to make. I make it anyway because I can honestly tell you that, if I were going to run some other kind of business than a bank, I would give first consideration to establishing borrowing relationships that I consider strong and valid and that would create obligations I thought would be honored during periods of stress in my company.

QUESTIONS

You mentioned in one part of your talk the possibility of the futures market stabilizing prices. I would really like to direct the question to the audience – by your show of hands, how many companies are represented? Then I would like to know how many companies are actively using the futures market at this point?

How many? I'm curious to know what kind of activity they are in.

Okay, how many of you are presently involved in the use of the market? I see that only two are doing so.

One observation that has been made to me, is that there is some helpful growth in the futures market, in that it begins to look as though there is something in it besides just initial
speculation. It may be that some true hedging is beginning to take place. Do you agree with this, or is it too early to say?

No, I think we have speculated some. We made a little money that way. Generally, when we make money on a speculative basis we are losing it in our operations, so we are not in it on a large enough scale.

Can I ask you a question that a psychologist might ask instead of a student of that market? Will people who control timber products, and manufacturing companies, find it within their bones to play a hedged game, or are they native gamblers who will not want to hedge down a profit potential of the future?

I think, Lyman, that you can’t generalize that much about the industry, I think it makes it immensely more complicated and thus for some people a more interesting crap game.

Mr. Seely. I guess my question is directed at the point that we don’t yet have a really good market that you could rely on. Am I right in thinking that that is necessary — to get a good market whose prime people are in it as a way of life? It won’t be much of a market unless there are a lot of people in the industry who use it as a true hedge. Am I right in thinking that?

Yes, I’m sure this will come. There is a learning curve involved in this, as there is in manufacturing operations. We are getting more and more involved as a matter of financing our own operations. It requires capital, although not much. So that weighs against further interest in it right now.

Do you see at this point what role the bank will play in this? Will there be anything new at all?

This is why most of us in the banking business have been staying away from your futures meetings, because we don’t want to answer that question; but because you have asked it, I guess I have to. I think it is a little premature to jump in and start financing futures now. I’m not sure how to analyze what kind of a market it is as yet. But I would certainly think that the banks would be in it when it is a fully developed market or a well-developed market. I don’t think I answered your
question, but that is the way I personally regard it. We wouldn't be the first ones in it.

I wonder in the lumber products industry where you would feel short-term financing should be utilized? On the basis of the seasonal build-up each year?

No, I think we probably all agree that if we could control our destinies that sharply, and if we didn't all have these cyclical periods, you probably would confine your short-term borrowings to those things that have seasonal fluctuations. And you would probably try to fund most of those that you wanted to pay for out of something other than asset liquidation. The problem we haven't always dealt with by using hindsight as well as we would if we could go back and do it over again is the problem caused by these cycles, and the temptation that causes us to use what appears to be surplus working capital to fund a project that was really conceived to be a long-term project. And that in so doing, we soak up not only our working capital but maybe our short-term borrowing capacity.

Do you admonish this group to avoid short-range looks at an excess of working capital? Is it possible that in the next 10 years the banking system may find itself with some excess funds on the basis of failure to anticipate the role of commercial paper or a variety of other new devices coming in to take up some of this slack?

Well, it is certainly possible, because anybody as old as I am has spent as much time under one set of circumstances as under the other. All during the years following World War II, there was surplus of supply of credit in relation to the demand, and this is why we chased all over trying to get people to borrow our funds. I was interested in the comments that Roger made about his expectations for the 70's, and this is not an uncommon expectation. If I had to write one down and be responsible for it, I'm sure I would opt on the side that rates are more likely to be high than they are likely to go back to those periods immediately following World War II. I don't see that as a likelihood. I see it far more likely that we will have more
demand for funds than we can supply. Now you may have asked me another question: “Are the banks going to be alert enough to maintain their role in all of this?” I hope so.

*Did you and your colleagues anticipate the soaring importance of commercial paper? I mean, are we developing a private banking system?*

Very much so. I can remember hearing theoretical arguments among bankers about whether they were smart, or whether they were in effect gouging themselves when they provided lines of credit that subsidized the issue of commercial paper, because they were creating the potential for the customer to disintermediate the bank itself. And in many cases they weren’t getting very much for that line of credit, because it wasn’t used when commercial paper was issued. I don’t think there is any question about the fact that we have been party to a chain of circumstances that has enabled our prime customers to bypass the bank, except for the line of credit that supported them.

The commercial paper back-up line stipulates that the line is made available on conventional terms, with one important stipulation – that rate be determined at the time of borrowing. The point of that is that we all recognize this is an emergency situation, because the understanding is, that it won’t be used except on the condition of a time of trouble in the market place. Our recourse then will have to be – we will get the money. We are saying to the customer, “We will get the money, but we don’t know where we are going to get it now, or what it is going to cost us. So you are going to have to pay us that plus whatever we think is fair for brokerage at the time.” Obviously, what we are thinking about in present day terms is the Euros: using the Euro-dollar market to provide the funds to support the commitments.

I agree with that. The rate is one of the ways you can protect yourself. You can either make it possible by the money to discharge the obligations through rate, or in the process you can put it out of the customer’s reach and get out of the obligation that way. We have in fact set up an extra
outside-the-bank source of funds for prime borrowers, without necessarily requiring a banking relationship. This is especially true because some companies are finding they don’t have to have a 100 percent back-up line of credit with the bank. One of the reasons that I included this comment in my remarks is that I think if I were running a major company or were involved with the financing, I would give thought to the possibility that there is nothing very personal or loyal or obligatory about any of these money instruments. I’m not sure I would want to have my company, in my own planning or lack of it, completely at the mercy of the money market. I would like to have a lender on my side, one way or another.

One of the problems about commercial paper growth and the problem mentioned about not setting a rate is the artificial nature of Regulation Q, which I am not certain is familiar to all the people here. Would you please comment?

Regulation Q limits the amount that the banks can pay for time deposits. I should mention that many bankers feel that one of the solutions to this disintermediation problem is to scrap Regulation Q and let us bid for money in the market place, so we don’t have to go around looking for these irregular sources of funds. It is clear that some of the Euro-dollars that we bought back at high prices were caused by money that might have otherwise been available directly in this country, moving into channels where it could then be converted into Euro-dollars and bought back at prices higher than the process would have allowed, had Regulation Q been effective all around the chain.

There is a feeling that our business and probably yours is more dictated to and controlled by politics than by economics. I wonder whether you or Mr. Keefè would mind giving us your ideas on whether the present administration is going to hold to the hard money policy for killing inflation, or are they going to capitulate?

It’s been said that whenever politics and economics collide, politics always wins. That’s the basis of a kind of projection that Pierre Ronfrey makes. He is predicting that we will not
cure inflation, and he has been predicting steadfastly since last fall that we will have a short-term decline in interest rates as a result of those attempts that have already taken place. Then he says that that will be short in duration, by the end of the year we will probably be reescalating rates, inflation will not have been checked, and we will be seeing further up thrusts in the inflationary cycle. I don’t like his outlook so I may not be very objective about it. I personally like better the argument that says that we are getting, or have a pretty good chance of getting, an administration commitment to this goal of restraining inflation.

For one of the reasons, look at the public utterances of Arthur Burns, both since he has been in his present office as Chairman of the “Fed” and prior to that (which may be even more important), because he was an outspoken critic of the Fed’s actions in 1968 when the money supply was being overly inflated. He was very critical of that, and has said that he is not going to make the same mistake. He has a lot of swallowing to do if he gives in. The President would have an awful lot of swallowing to do if he gave in on his announcement. So I would probably put my guess on the side that we will make some restraint of inflation this year, and I suppose that if that is true, then we have to worry about how hard it is going to make it for us to come out of the recession we are in.

The economics research people at our shop feel that Mr. Nixon was elected, among other things, on the basis that he was a sound money man. He appealed to the wage earner with Social Security to look forward to, to the prospective home owner who wanted to buy a new house, who has seen that in recent years the purchasing power of his salary lessened through both our progressive tax system and inflation. Regardless of the political popularity on a very short-term basis of easing back, letting things slow up, making everybody feel a little more wealthy because his paycheck is a little bit bigger, Mr. Nixon would be cutting the heart out of his voting base by allowing inflation to regain the upper hand.

Regardless of the pressures that might be brought to bear, it is time to back off a little. Our general view of the political
urgency as well as the economic desirability both tend somewhat in the same direction. What he obviously is trying to do in what Roger called the Game Plan this morning is to back off just enough, soon enough, but not too soon.

Anybody else want to express an opinion? I'd be curious to know how you people feel. Everybody has an opinion on this subject. Would you be willing to say whether you think that inflation will be curbed?

I felt it is imperative that the present administration do something about inflation. It is something that we can't live with the way it has been going since last year. I feel that our future depends on the present administration maintaining itself as they promised us. Two or three weeks ago I was in quite some doubt that they would. I thought that the pressures would be such that after the first quarter they would give up on fighting inflation and would have it again worse than it has been or is. I have never doubted the President's integrity and intelligence but I didn't know how much guts he had. The last couple of weeks gives me more confidence that he will stick by his guns the next 6 months.

Question by Professor Strickler. I guess I have some academic liberties by virtue of the station I occupy on the campus, but I have a feeling that the kids you see dissenting on the campus are going to be a force to reckon with. When they set out to clean up the environment, they are not kidding. They are going to get it cleaned up. I have a lot of respect for what they are going to do. This is perhaps not a popular topic among people in your industry, but I can say it is one you have to recognize. What I want to ask is “Given the fact that we have a Republican administration, and given the fact that they want to involve the private banking system, versus governmental falling back of expenditures – is it possible as you look down the road that you might find the banking system wrapped up in helping make loans under some sort of governmental program to support the cleaning up of our environment?” That's a whopping big project.

Well, I don't suppose that there is any doubt about that. The banks would be involved in it. There may be a related
question as to whether or not it need get to that point. I suppose one way to look at it is in terms of the way I like to raise my own kids. If everybody cleans up his own mess, then he is not at a disadvantage with anybody else. Maybe we have enough laws.

If I am in an industry that creates more smoke than one that doesn’t, I suppose the burden is not equal, but at least it is equal within the industry. And maybe if that is made a part of the financing, if we come to regard it as a cost just as surely as the cost of severing timber, or any other cost we are subject to, perhaps it fits into the financing structure without necessarily making a great big government deal out of it. I would rather think that way if I could. We wouldn’t turn down a customer’s loan application for the purpose of installing antipollution control devices that would add nothing to his net income. But if he could service it, and if they all did it, I suppose he could service it. Because I would suppose that his price patterns tend to reflect the true cost of manufacturing his product. I hope it would fall into balance like that, and not be set up as some other problem to be dealt with separately.

During war periods some of the aerospace defense contractors really weren’t strong enough to do that, and thus the V-loan program. So for some of these marginal credit situations you have a very real point, I think, unless everybody does it.

Professor Strickler. The point I’m making here is that I think the young people are saying they are not interested in your answer of just waiting until the job gets done. They are as impatient as they are about the war. Now, whether you agree or don’t agree, you know they are impatient, and maybe we could continue to procrastinate.

Mr. Seely. I might comment on the statement that the kids want it now. Because I think that is what they are demanding. In some cases those demands are really entirely unreasonable, in terms of the state of the art, much less in terms of the state of the financing. However, if we remain a full employment economy to the extent that we have been the last 4 years where less anxiety exists with respect to whether or not people are
going to have jobs in the labor force, that demand will continue. If we are moving into a period of relatively high unemployment, I think that demand will abate to a more reasonable level. It will not be abandoned, but I think it will somewhat abate, as the problem of finding and providing additional jobs for new additions to the work force becomes more difficult.

Professor Strickler. I have the feeling that the tenor of the time is such that we would not want a government program that interfered with our private system. We want maximum freedom for the private system to solve it, but with some governmental assistance in the form of such devices as tax credits, or whatever it would take to get industry pushing into whatever equipment could be installed, or what other measures could be taken to help our environment. And I really believe that we are going to see some of this in the 70’s.

I apologize if I’ve appeared to be belaboring a point. As Bill Padgham knows, I’ve been intrigued by the idea, as a teacher of finance, that finance people generally do not recognize the role of social involvements that are coming up. I think perhaps they are the last persons in the executive ranks to sense the involvement that they are going to have. I think it is natural for you to oppose most of this because it can’t be reduced to dollars and cents, at least in the usual way.
Impact of the Computer on Financial Managers

Mr. Wallace B. Smith
Corporate Director of Information Systems
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INTRODUCTION
by Professor Lester B. Strickler

THE NEXT SPEAKER in the opening part of our program today is going to address himself to the increasing impact of the computer on financial managers. Based upon the difficulty that some of you and some of us may have had of assimilating the elementary arithmetic, you’re going to have a real challenge, Wally, in talking about this subject. We are looking forward to hearing this, I’m sure. Wally Smith of Boise-Cascade.

ADDRESS

I PRESUME that you’re all well rested and had a leisurely breakfast as I did this morning. I’ve enjoyed being on the campus. One of the things that certainly happens to you as a businessman coming back to a campus is that you end up being really challenged. At dinner last night I asked Earl Goddard if there was any difference between the students of today and the students of ten years ago. He said “No.” Of course that immediately started a conversation, which lasted for an hour of very intense debate. I really think it’s a good thing for the businessman to have the opportunity to come onto the campus and have such exchanges. As we get out into the business world, we tend to set our ideas about a lot of things, and I find it very satisfying to come back and be challenged.

In the discussion this morning, perhaps I am going to do the same thing. I am going to ask you to take some ideas that you may have in your mind about computers and reexamine them. I hope that the discussion this morning can be a useful
dialogue between us. What I would like to do is give some input to you in terms of the kinds of things that I see happening in the computer field and use them (hopefully) to stimulate some discussion.

I would like to start by saying that it is fashionable in seminars like this and in the business press today to talk about the rapidly increasing influence of computers, and the manufacturers of computers aren't shy either in this regard. Perhaps you have seen the RCA advertisement depicting the computer as a giant octopus with its tentacles reaching into every part of the organization. Have you seen that ad called the "Octoputer," or something of the sort?

There is one large group of technicians and their business prophets who envision such electronic nervous systems penetrating into every aspect of business. Their arguments are beguiling, and their biological analogy is appealing. They see every department as a nerve center and every manager's desk as a nerve ending, communicating via complex communications networks to a central computing facility where all the facts and transactions are current and accessible, ready for instant decision-making. Does this description sound familiar? If this tendency to describe the computer this way doesn't exist in your firm, there are plenty of sad examples in our business community. Take the airline that I use frequently, for example. Two years ago, they set out to spend $40,000,000 on a project to develop just such a total information system as I have just described. That contract has recently been cancelled, with the project bogged down in its hopeless complexity.

"But we are able to overcome the technical complexity of placing a man on the moon," the technician would respond to me; "Why can't we do the same in just one business firm?" I think there is an answer to this paradox. The business firm has a dynamic quality of organization that isn't present in the analogy of the human body or the space program. In these two analogies, the specific functions to be performed are very clearly defined, and the nervous system that controls them can be painstakingly perfected. The evolutionary process of perfecting man's nervous system, which has taken place over millions of years, doesn't have to contend with the merger of a
third arm or hand to the organism, or the introduction of a new manager with a different style of management. In the case of the moon missions, I believe one of the reasons for the outstanding success was the very clear definition of the functions necessary to carry it out. Any good systems engineer will tell you that the first requisite of an effective information system is a clear definition of the requirements.

If these attempts at introducing the computer into business organizations as a total information system have failed, what is the impact of the computer on the financial manager? If we are honest with ourselves, I think we would say that up to now there has been relatively little impact on the decision-making process of any of you who are sitting here today. There may have been an ulcer or two, if you have been responsible for the computer project. The impact which has been so widely heralded has been primarily on the routine and operational processes of business, the processing of invoices, payrolls, demand deposits, accounting, check clearing, and so forth. Many of you have lived with the problems of applying the computer to these types of operational activities, because traditionally the financial officer has been responsible for the accounting activities, but the work of gaining efficiencies by computerizing routine clerical tasks has been largely accomplished. There are few further dramatic gains left in these applications.

The purpose of my talk today is to ask you to begin to think about the developments in computers and information processing technology as providing opportunities for you to broaden the scope of financial management in constructive new directions and to do the traditional jobs of the financial manager in more effective ways than ever before. It is also a challenge in your fields, to use your knowledge and experience in financial management for shaping the direction of future developments in computers and information sciences so that they may contribute directly to the advancement of your profession.

The remainder of my talk will cover three broad topics. First, I would like to talk about some of these capabilities that you can exploit, some of the current possibilities in terms of
Financing Forest Industry in the 1970's

exploiting these capabilities, and how do we go about doing it? The first part of my discussion will be directed at trying to give you some input. After that, maybe we can get some discussion going. You have heard a lot of people refer to the computer as a tool. If we are to use this seminar to create some useful dialogues, first we ought to talk about some of these developments. I would like to discuss seven developments, not in terms of technical capability, but rather in terms of what they will allow us as managers to do.

*Time sharing* is one of the fastest growing areas in the computer field. Time sharing allows a number of people to use a large computer simultaneously. Each person uses the computer from a small typewriter-like terminal, which is frequently just a teletype machine. Since the person typing on a typewriter moves so much more slowly than the computer, it appears to that user as if he's the only one using the computer, when in actual fact many people are using the computer at the same time. This allows two things. First of all, it makes a very large and powerful computer very cheap, because it is spreading the cost among a lot of users who are using it simultaneously. Secondly, it allows the power of the computer to be extended right into the manager's office. In my office, for example, I am frequently called on to evaluate the alternatives of either lending, leasing, or purchasing pieces of data processing equipment. My secretary, who has learned how to program the computer terminal, wrote a program – and I think that this illustrates that it's getting a lot easier to use if my secretary is able to do this – wrote a program which introduced the decision rules that we all use, and the formulas, into a time-sharing computer. Each time I'm called upon to make an analysis, I merely borrow a teletype machine, go to my office and plug it in, enter a few factors such as the lease payments and the opportunity rate and the economic life and so forth, and the program which is stored in the computer is able to perform and prepare the analysis for me in just a minute or two. Because it is cheap (in fact the cost of an analysis like this is probably only several dollars) I can make several different tries at different opportunity rates, for example, instead of spending
45 minutes or so with paper and pencil working out each alternative.

The second capability is the ability of our *communications networks* to handle data. In the case of the time sharing example that I just gave, we merely dial Portland via a private telephone line that we have, where we connect to another private telephone line leased by the computer utility, which happens to be located in California. So, though I am sitting in Boise using that computer terminal, the computer being used is actually located in San Francisco. Using the computer in the case of the time sharing example is just as simple as dialing a telephone number and placing the telephone receiver on a special holder on a teletype machine. Telephone lines are also actually able to carry quite a series of data messages simultaneously. This is making it possible for us to locate actual processing of data at quite a distance from the location of the actual user.

A third development is something I will call *bulk storage of data*. Today, it is possible to store literally billions of characters of information on large mechanical storage devices in such a manner that it is almost instantaneously accessible. This allows us, for example, to store far more detailed data which we might use when we are making analyses.

A very important area, and I think rapidly growing, is one of *user-oriented, packaged software*. Although you have probably been reading in the business press that we don’t have enough programmers and are going to need 500,000 more in another ten years, some people are predicting that programmers, apart from a small group of specialists, will not exist in the future, because programming will be far easier. I think there are two important trends here. First is the type of programming which extends the use of the computer closer to the end user. A good example of that is the ability of my secretary to describe the formulas she used to do the lease-purchase analysis. She was able to put that together, and in her case it was the first program she ever wrote. It took her about two days to learn how to do it. The other type of package software will be generalized programs to perform
specific functions, such as payroll processing. Up to now, companies very frequently have hired their own staffs and spent a lot of time developing a fairly generalized use of the computer. In our own company, for example, we decided to assume the responsibility for some processing which had been done outside the company. We found that if we were to program it ourselves, it would have cost us six times as much as though we went out and bought the software to do that job. I think that both these software trends are important, because they will free us from worrying about making the computer work, and allow us more time for thinking about how to make the computer work for us in solving business problems.

The fifth area is with collection devices. It is now possible, for example, to buy equipment that will read hand-written input, or devices which will make possible the collection of data as a byproduct of a primary operation, for example, the ability to collect data from an actual paper-making process. It used to be that the way to determine the profitability of a paper mill was to keep track of what raw materials were going in and what rolls of paper were coming out, and month by month you would establish profitability. But the new collection devices that can be attached directly to the paper-making machines are beginning to make it possible to collect information about the costs of individual orders or runs on the paper machine.

The sixth development, which I have called display devices, includes such things as cathode ray tube displays, the television type displays you have seen. In fact, they are the type of device that are illustrated in the RCA ad I was talking about. Another is the audio response units, which make it possible to output information quickly and directly to the user in the form of spoken words that he can understand easily and absorb readily. These devices should help us speed up the information dissemination process. It will eliminate a lot of paper flow when a hard copy isn’t needed and enable a wider group of people to interact directly with the system.

Finally, the seventh point, that the development of data analysis, model building, and forecasting techniques provides the user with tools to investigate and understand more fully the
environment in which he operates. And based on that understanding, they permit him to predict with greater confidence the future effect of alternative strategies under several possible environmental situations. I think that we saw some illustrations of this type of thing in some of the talks yesterday. For example, linear programming is a technique that has been known for a number of years, and its potential for optimizing a resource allocation problem has often been demonstrated. But it was not until fairly recently that we have been able to solve very large and very complex problems using this technique. This is a matter of perfecting the ability to handle technically, within the computer, very large sets of variables and equations.

I have talked about seven capabilities which make the computer potentially useful to us as managers. I think the overall trend of these capabilities has been to bring the computer closer to the end user, not only in terms of the input and output devices and the communications capabilities, but also in terms of the software that frees the end user and allows him to spend more time thinking about the manipulation of a large amount of stored data, for example, on storage files using some of these analytical techniques that are also being perfected.

Taking these seven trends as input to the discussion, I would like to stimulate discussion by giving some examples of the kinds of innovative possibilities for which these evolving computer developments can be used. I have already talked briefly about using the capabilities of time sharing to do a better job of analyzing investment and financing decisions when we are considering acquiring data processing equipment. I was able to very carefully think out my decision logic, worked out exactly the way that I wanted to have it; I am able to store that decision logic in the time sharing computer, so that each time that I have this kind of a decision, I don’t have to go back through that thought process again, and therefore I am able to explore a whole series of alternatives where I probably wouldn’t have taken the time to do it before. Hopefully, the result of this will be that we will be making better decisions.
As the other illustration this morning, I would like to discuss in more detail an example of an innovation that is based primarily on the use of linear programming. I was pleased as I sat yesterday and listened to the discussion that I'd chosen this particular illustration, because I think that it touches on a number of things that we were talking about yesterday in terms of planning, in terms of servicing debt loads. Linear programming is perhaps the most powerful of these various analytical techniques that is available today for financial analysis in a usable, practical way.

Linear programming, as you know, is a mathematical technique used to find the best policy for problems that can best be described as allocation problems. I am not going to attempt to discuss this morning how linear programming works. I think the thing that can be most useful for us is to recognize that it does work and the technical problems of using it are solved, and it is a tool that is available for us.

An allocation problem is defined by the following conditions, and really a resource allocation problem is the kind of financial decision which almost every one in this room is faced with almost every day. First, the problem must involve a choice of alternative courses of action. This is perhaps a trivial point, but it is critical. Next, the choice must be partially limited by the existence of restrictions. That is, at least some of the jobs can be done in different ways and using different amounts and combinations of resources. Finally, some criterion is necessary by which the comparative merits of these projects may be measured. Frequently, this criterion is a profit contribution or some kind of a similar financial measure. This technique, although not inherently dependent on the use of computers, requires a sufficiently large amount of calculation to make the computer a practical necessity to solve most of the problems. The technique is most useful when the alternatives are numerous and the restrictions complex, so that the individual cannot fully evaluate within the time available for decision making.

The development of linear programming stemmed from work done by Leontief in the late 1930's and Dansig for the
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U.S. Air Force in 1947. The ability to handle large, complex, and practical linear programs has not been available until fairly recently, but since the technical problems of using linear programming have been solved, let us turn our attention to a rather interesting use of the technique. A prototype corporate planning model has been developed within Boise-Cascade. The objective of this linear program has been to evaluate alternative investment opportunities and at the same time determining an optimal financing policy, while insuring that financial feasibility is maintained. The model was primarily designed to examine the effects of adding various investment alternatives to existing corporate financial structure. That is exactly the kind of discussion that we were having yesterday by Weyerhaeuser, when Cal was talking to us. The basic input required for each new investment includes some of the things that were mentioned yesterday — incremental capital and sales, other income, depreciation, depletion, and so forth.

The model can be run in many different modes. For example, we can run it to maximize profits, or to minimize return on investment, or to maximize earnings per share, or to maximize return on stockholders’ equity, or to maximize stockholder equity. Depending on what situation you are in, you may want to look at different optimizations. Conceivably, these different objectives might result in different investment and financing policies. The time horizon in this model can be any number of years and in any time increments: in months, quarters, or years. The model contains a projection of the balance sheet and a profit and loss statement. In our case, we have set it up as a demonstration, for a five-year period, assuming no capital expenditures. This is referred to as the base case, and in yesterday’s discussion the first part of it was the starting point that Weyerhaeuser uses. Where are we today? And the base case is assuming no additional incremental investments. In other words, we have described within the model a corporation as it exists today, and have also inserted some assumptions about our growth rate if we made no further investments for the next five years. The base can be contained in the model to any level of disaggregation, which means split
down to plant level if we want to, for which accounting projections are available. We can, for example, insert the sales price of assets for each plant, and they could be included as a source of funds in the capital requirement section of the model. The model will then evaluate each existing asset on an equal footing with each new investment in determining the optimal plan for achieving the chosen objective. Here, again, the interrelationships between existing assets would need to be considered in formulating the model.

In a typical run, one or more investment opportunities are included within the model; for example, the relationship of interest to the sum of profits, taxes, and interest, or the relationship of debt to net tangible assets and so forth. If any of these constraints are inhibiting the growth of the company, this fact will be determined, and the explicit cost to the company can be measured. In one equation within the model, cash flow is subtracted from the capital required. If there is extra cash, long-term and/or short-term debt is reduced. If additional capital is required, each separate source of funds — stock, convertible debentures, secured bonds, unsecured bonds, commercial paper or bank borrowing — is evaluated to determine the optimal funding pattern subject to the constraints of the model.

At present the financing logic is fairly simple, with the anticipation that it will be expanded to reflect our financing opportunities and policies. It should be emphasized that our financing plan and our capital expenditures plan are solved simultaneously within the model in a manner that optimizes our overall objective. It is our feeling that this ability to look simultaneously at both capital expenditures and financing is one of the major innovations in this approach.

Several of the additional constraints can be contained within the model. For example, the year-to-year growth rate in sales, assets, or earnings per share can be constrained to be greater than some lower limit or less than some upper limit. A ratio such as the debt-equity ratio of loans to net worth and the current ratio could be upper bounded and lower bounded.
There are some other interesting uses of the model. For example, sales and profitability estimates for our existing assets reflect our best judgement regarding future market conditions. It is possible, using the Wharton Econometric Model, which we use for economic analysis, to ascertain sales and profitability estimates for a range of optimistic and pessimistic assumptions. It is also possible to assign probabilities to these various estimates. In this manner we could obtain probability distribution for Boise Cascade's sales and profitability over a given time horizon. With the proposed model, it would be possible to find which level of sales and/or profitability would either no longer service current and planned debt loads, or no longer meet our loan covenants. The probability associated with that level would be the probability of the corporation becoming insolvent. Obviously, this probability will fluctuate as debt fluctuates, and this evaluation may be useful in planning future debt loads.

It is interesting that this model is fairly inexpensive to run. The evaluation of a single investment might cost only $20 to $40 in computer charges. The evaluation of a series of investments, for example as we might do in our strategic planning process, might cost $200. Although we have just developed the demonstration model so far, we believe the total cost of developing this model would be somewhere between $15,000 and $25,000.

In summary, the model I have described is a flexible and easily usable management tool for evaluating investments and financing decisions. The model is powerful in that it considers areas of financial feasibility, loan covenants, financing opportunities, and investment opportunities in reaching an answer. The model can be used to evaluate different objectives rapidly, and in each case the answer provided is an optimal answer, in contrast to simulation models.

Although my example of this investment planning model is primarily an illustration of the kinds of innovation that new developments in computers and information technologies make possible, we do have it in operation in order to demonstrate
that such a technique will actually work. I am convinced that the impact of the computer on the financial manager is the innovation that potentially can result from the application of our understanding of the capabilities of computers.

An excellent study of computer systems management was made in 1968 by McKinsey Company. They studied 36 major companies in a range of industries in this country and abroad. From a profit standpoint, their findings indicated computer efforts in all but a few exceptional companies are in real, if not acknowledged, trouble. Faster, costlier, more sophisticated hardware, larger and increasingly costly computer staffs, increasingly complex and ingenious applications — these are in evidence everywhere. Less and less in evidence, as these new applications proliferate, are profitable results. What has gone wrong? An historic reason for this I have already touched upon. When computers were first introduced into business, they were primarily used to displace the cost of doing the routine, clerical function — most typically the accounting function. There were two reasons why it was easy for management to delegate the responsibility for computerization of these tasks. First of all, these functions are quite well defined; the tasks to be performed in accounting are clearly described in accounting principles. The job of the technician in terms of solving the problem is merely one of performing the routine, repetitive tasks more efficiently by machine. The business problems to be solved are simple, easy to understand; and the technical problems of making those machines behave occupied most of the time of the technicians. Some of these factors have been changing, though.

The machines themselves have become cheaper and more efficient. The problems of making the machines operate more reliably have been largely solved, and the technicians have turned their attention to more challenging and complex tasks. One of the results of this trend has been a change in the ratio between equipment costs and EDP personnel costs, which at the present time stands at 2:1. This growing elite in what Townsend calls “The computer priests” has been allowed by a great many management groups to make decisions concerning
where and in what ways computer resources will be spent on computer projects. Not only has management seriously overdelegated this responsibility, but in many cases they have abdicated it altogether. The technicians have already demonstrated that they are quite capable of establishing the technical feasibility of a great many computer projects. But typically they don't have the business experience or even the management training nor the perspective that is needed to make management decisions about the economic and the practical feasibility of computer projects.

It is necessary for management to take the time to understand the capabilities of computers, which we discussed today, so that they can exert some influence over the selection and direction of resources spent on computer projects. The managerial functions are plainly familiar: the setting of objectives, including economic ones, the direction of the planning efforts, and the auditing and control of projects once they are underway. Techniques used to do this are no different than they would be for any other kind of a project that management would undertake to direct.

There are just four questions that a manager can ask himself in order to explore these new opportunities we have been discussing. First of all, what are the things in my function that I have to do really well to be effective? Two, what are the key decisions that I have to make in supporting these competencies? Three, what are the kinds of information essential for this decision making, or is there any information which, if available, would allow me to make a better decision? And four, how can these information processing capabilities allow me to more efficiently or effectively obtain the kind of information I need?

Boise-Cascade, as you know, is a highly decentralized company that is tied together primarily by financial control and strategic planning. This year, as each of the operating units puts together its strategic plan, we are asking the managers of those operating units to ask themselves these same four questions. Through this process, we hope to begin to achieve some overall planning in the use of computers as it applies to the
management of divisions, rather than have the technician make this decision. As these various projects move from the strategic planning process into operational plans that are reviewed by our finance committee, we are asking that each project meet the test of economic justification, just as any other investment is required to do, and finally we are encouraging the managers to exercise the same kind of control in involvement and review that we would expect for any other kind of a project.

My aim this morning has been to encourage you to think about the computer as providing you the opportunity to put its capabilities to work in your profession. I have suggested that the capabilities have far exceeded our ability to use them, and the technical problems should no longer stand in the way of solving business problems with this new power. The illustration of applying linear programming of the corporate planning tool was intended to suggest the kinds of innovation that are now possible. These innovations will depend on your involvement and direction of the computer resources at your command.

Thank you.

QUESTIONS

Wallace, Boise has a lot of major development and redevelopment projects. Can you tell us a little of how you might use the computer to provide information to control some of these activities that really don't fit into the routine area?

Well, I can think of two examples in the development area. The first one is, as you know, that in our urban development division we operate basically as an entrepreneur, in that we put together a project, let's say an apartment house complex, for an investor. Our primary function is to bring all the various parties together. Typically, the series of calculations involved in that kind of thing are complex, especially the financial calculations. What is the return, given all the various factors? We might use some of these time-sharing techniques I was talking about in that area to make those kinds of calculations. Another example of that kind of thing: one of your purposes might be to optimize the development of the land. Let's say it is a complex that includes some apartments, some business space, and some
parking lots, each one of which has a certain economic value. It is possible, using in this case linear programming, to optimize the relationship between floors of living space, office space, parking lot and so forth, to get the maximum return from that particular piece of land. The problem in each of these two examples is not one of routine accounting such as we typically find in the land development area — lots of mortgages to keep track of, send out the monthly bills for the mortgages, and so forth. That is a task in which all a computer does is just perform those clerical functions instead of having clerical people doing it. Obviously, there may be some benefit from doing such work, but the real returns come from some of these other projects such as solving the land allocation problem.

Will you differentiate between an optimal and a simulation model?

There is a good example here in terms of cutting timber. The best way I can think of to illustrate that is to have Russell Milliken describe briefly what he is doing in terms of managing woodlands. I think it will describe what optimal means, and I’ll describe then what simulation might be. I think it is a very interesting use of linear programming techniques.

Mr. Milliken. It might be quicker to use the chart. I won’t go into great depth. Wally and I were talking last night about a linear program developed by the University of Georgia, and we discussed the point. Some of you may be familiar with it. Basically, what this program does is divide the planning horizon into ten 5-year periods. You are trying to decide when you are going to harvest to maximize the present value of discounted cash flow. In our combinations, each slot represents 5 years. Which one of these combinations of harvesting produces the maximum present value of future cash flow? After we apply the constraints, we run it through linear programming to give a harvest schedule that meets the minimum-maximum requirements and optimizes the present value of cash flow.

Who is responsible for determining what these various constraints are?

Mr. Milliken. The foresters. We run this program, completely optimizing it, developing the harvest schedule and the maximum present value of future cash flow. It is very cheap
once you get the program and the input data in. Then we play sensitivity analysis games, putting in various minimum-maximum restrictions. It really doesn't have any effect on the schedule. It doesn't cost you very much either. Tighten up the restrictions, then determine how much it will cost. Every time we impose a restriction, we are costing in those factors that affect the amount of the future cash flow. Keep on tightening up the restrictions, and you will reach a point where the cost of reduction of present value of cash flow by meeting that restriction can not be tolerated.

What is the main result or benefit gained from this? Is it in the answer you get from the computer, or is it in getting your foresters to recognize the constraints?

Mr. Milliken. Even more difficult is getting your foresters to use it. We've worked on this with the University of Georgia since 1965. Our foresters have now been using it for about 2 years, and are thoroughly delighted. For 3 years they fought it like hell. Once they understood it and started using it, they were completely delighted.

How many millions of dollars would you say this has been worth?

Mr. Milliken. Millions. This was applied to a million-acre forest in the southeast, which took about 3 years to do, and the increase in the present value of the cash flow was absolutely fascinating. It was incredible that we had achieved even half of what had been expected. The main thing was that it showed that 80 to 90 percent of the forest should be cut in the first 5 years and reforested.

How much do you require your foresters to know about LP and computer programming in this process?

Mr. Milliken. Not an extensive amount, because we hired a young fellow from the University of Georgia who wrote his doctoral dissertation on this application, and on the U.S. income tax effect of optimizing the harvest schedule. That was the second phase. Another student had written his doctoral dissertation on the application of this concept. The fellow we hired as the director of operations research has a Ph.D. in forestry. He knows computers as well as anyone we have in the
Mr. Smith. I think that's a very exciting story. I can't resist pointing out that it would take computerizing a hell of a lot of payrolls to equal the benefit of this one kind of application.

Before I answer another question I will come back to your original question which was "What is the difference between simulation and L.P. for optimizing?" I want to use this as an illustration. I think there are about 1,500 alternatives in Russell's example, if I remember all the different lots and when you cut them. By simulation with a set of mathematical equations that represent a harvest schedule, basically what you do is ask a series of "What if...?" questions. "What if I cut this combination? What if I cut this other combination?" And with the discussion yesterday of the Monte Carlo technique, all that is doing is making a series of random tries. You come out with some answer, but it is not necessarily the best combination. Linear programming is a technique to give you the best combination, and there is a place where you could use either technique.

Wally, you said that one of your utilization problems was to get projects out of the technical hands and into the operating hands. How do you get the knowledge of what the computer can do, into the hands of the operating people? What prompts the forester to think of this kind of application? There is a communication gap between technical people and the operators.

First of all, you must decide that it is important for you to get interested in it, and not let the technicians make the decisions. My answer to that question is that everybody in this room ought to take the time to learn something about it. I can ask Roger to illustrate how he became involved. Would you take a minute, Roger, to explain the program that you told me about last night?

Mr. Keefe. Well, some very bright young guy that I had a great deal of confidence in (personally) said something to me
one day that he regarded as very important, and I didn’t know what he was saying. Because I had personal confidence in him and realized that he wanted to say something to me that he couldn’t say, I simply went to IBM with four other fellows. IBM, in this case, put on a tremendous show for us for 8 days and explained the basics of making decisions using the computer. Since that time, I believe that by now all of our senior group from the bank have gone to IBM and done the same. At least we have begun this “walk-around” that Wally is talking to, and we regard it as absolutely critical that you can get technicians, you can get managers, but so far the “walk-around” guy has not been really developed.

Mr. Smith. Thanks very much, Roger. The point I’d like to make is that every one of you in the room ought to take the time to do the kind of thing that the top management at Chase has done, for example, because until the managers running the organization understand what the capabilities are and are enthusiastically supporting them, the next line of managers down in the organization is not going to get interested either. Anyone who has been in business more than 15 years just hasn’t had the contact with computers unless they have used some approach like this. They didn’t have the contact in school that some of the younger people have. It is a new tool, and you must take time to learn how to use it.

Does time sharing really add to this? In the fact that someone can have a terminal in his office, plug it in, and gain access to the computer?

I think it does, for this reason. You can take the time to put a time sharing terminal into your office. I personally don’t have the time to sit down and write all the programs either, though I have done it enough to know how to do it. My secretary was able to learn how to do it, which illustrates how easy it is to use the computer. We are using a big computer in California, which I am using to solve problems I have in my job, as opposed to something I am responsible for, such as some routine processing. And that is why I think time sharing is an important new tool that can effect people making decisions at this level.
We had a management development seminar within the company for some of our division management people. The fellow running the seminar had one of the time sharing devices there, and we learned how to use it while there. He said, "I want you, when you go back, to pick out some problem that you care about yourself, not some other person's problem, and see if you can write a program to solve it." So one of the vice presidents came in one day to find one of our programmers, one who could review the program he had written, which was to calculate the value of his stock options.

**What could a small company do to acquire some of the brains and linear programming? Is there a place in the market where you can buy this information?**

Some of the consulting firms offer this kind of capability. I think the time to go for such technical capability is when you can't afford it on a full-time basis yourself. I have one piece of advice I would give, and that is, don't abdicate to the consulting firm the basic things that you want to have the machine do for you. In other words, if you decide that you need a certain kind of information, you should decide what it is that you want before you ask the consulting firm to come, or they are going to be rewriting your whole business, at a hell of a bill. In terms of extending computer power, I think again the example of time sharing is an illustration of a very, very inexpensive way to bring a computer into a small firm. For example, a teletype terminal rents for $100 a month, and each hour of time that you use costs about $10, with a minimum charge of about $100. So you can very easily do quite a bit of computing for $200 a month, which is not a major project, doesn't involve hiring a lot of people. That would be a good approach for a small firm and I think — yes, the techniques could be available.

**Comment by Mr. W. G. Reed, Jr.** Wally, responding to the question that Professor Yoder asked, I would like to relate some experiences we in Simpson had about operating people accepting some of the managerial approaches, such as linear programming. We have an integrated operation in which we wanted to optimize the flow of logs to a couple of alternative mills. We wrote up what we still think is a pretty sophisticated
linear program to optimize the flow of logs. The problem that we found in acceptance I think could be classified into two areas: The manager said that it didn’t give realistic answers. For example, the program may have come out with the answer that you should sell a large volume of small diameter hemlock logs on the open market, as opposed to running them through our own mills. And they said “We just can’t do that.” And I’ll come back to the validity of that in just a second. The other response that they had was, “We knew all along that we were going to do this; it firms up what we were going to do.” The second response has been focused pretty strongly on my management. I think we have gotten people to realize now that it has taken a couple of years to see that it is a guideline. It doesn’t give precise results, but they are guidelines; they are answers that were not readily apparent. This is just a matter of people accepting the computer as a source of knowledge somewhat superior to their own minds in some cases, and they were reluctant to do this. I think in their own minds they abdicate to this very impersonal force.

The first objection that I mentioned, the first response, that this isn’t a feasible solution; the answer to that was provided by the linear programming model itself in which we get something called “a dual variable” out of the model. I think most LP programs provide this. It tells you the cost of eliminating that restraint. For example, it might tell you how much you can afford to lower the price of hemlock logs in order to sell them on the outside, and what is the value of lowering it, by one dollar or five dollars a thousand. When you can determine these trade-offs – this is really a sensitivity analysis in itself – you can really counter some of the arguments that, “That’s not feasible.” This is an outgrowth of the model or an output of the model that has been very valuable. In another more tangible respect, it has told us, for example, how much we can afford to spend to increase our dryer capacity in order to eliminate our restraint. This has been a great aid to capital budgeting, the development of capital projects. So that’s our experience, or at least part of it.
Mr. Smith. Two comments. One is that it is hard to get managers to accept it, and they are never going to believe the results unless they understand what goes on. You don’t have to understand all the mathematics, but if you get one who can talk the manager's language as well as the mathematical language, and explain what is happening, then the managers understand what is going on. It is only as good as the assumptions that are in it. If you don’t do this, you won’t get success with it, in my opinion.

The other point that I’d like to make is that the examples of linear programming we’ve had here this morning were applied to operational problems. And it reminds me to reemphasize that the illustration I gave was of application of linear programming to a financial problem, as opposed to an operation problem. I want to make that point, because that’s the job that you are doing all the time. You are not allocating the harvest schedule; you are not allocating your logs through a mill; you are allocating capital flows and earnings flows. You are making these resource allocation decisions all the time, and you have a tool that can be used in that area. And not many people are using it. I suggest that the techniques are perfected to the point where they can be, if you take the time to learn about it. It is a decision process that many of you are going through constantly.

First of all, in balancing priorities between the record-keeping side of the business as in accounting and payroll, preparation and the analytical side, as in linear programming — how do you balance computer use from a time point of view? Let’s say the first week of the month, everybody wants computer services at that time. Then how do you structure yourself, organizationally speaking, in Boise or some other company, to handle these things?

The problem of the computer being plugged up at closing time is probably going to be with us. The constraint of the closing is not going to change. Frequently, the analyses don’t have to be made immediately. They can wait a week. Boise Cascade is quite decentralized. We have a series of computer centers, in fact about 25 of them, though I don’t know the
exact count. Those computer centers either report to a division or a group; they are a part of the operation of the various divisions. There is an advantage and a disadvantage in that, and that is why my job was created. The advantage is, and I think a very important one, that the computer is there to support the decision making in the particular division that wants it and has decided that it should spend the money on it. The disadvantage is that we duplicate a lot of activities.

We found when we reorganized ourselves, that when we want to move one information processing system to another place, it won’t fit, it is not compatible. We have had a lot of expense in that regard. So we formed a corporate staff department, and that is my responsibility. This department has two missions. One is to encourage some of the kinds of activities we have been talking about today, for example getting the managers off to schools, of the type that Roger talked about, or working with them. My group of people is basically not technicians, although they know enough about it to talk to the technicians. They are basically business oriented.

Our job is to provide that bridge between the technicians and the managers, in support of all the divisions, with the mission being to encourage and accelerate the application of these techniques to the businesses. That is our first mission. The second mission is (from a corporate vantage point) to look out across the whole company and begin to provide some direction, some philosophy to determine how to apply these new tools to a whole corporation in a decentralized environment. I can assure you it is not an easy philosophical question. We are frankly in the formative stages of trying to understand how we do this. I feel that one of the things we have to do is to develop some uniform ways of describing information across the company, so that we can exchange information.

*You mentioned today that the cost of personnel is about twice the cost of the equipment. Is this considered a desirable ratio?*

I think the answer to that question is that it depends upon whether the total investment in equipment and personnel is making a return within the company.
What is the trend?

The trend is toward a larger and larger personnel complement. As a percentage, you start out with the equipment being the largest proportion, and that has become smaller and smaller. The cost of the equipment processing is getting less and less, and the cost of the people to use it is getting larger.

Do you believe the systems analysts and related personnel should be in your MIS group or information center or back in the division working with the operations?

My opinion is that the systems analysts ought to be in the operations. It doesn’t matter to me where the processing utility is that does the work. That can be organized in many different ways, in fact I’m not quite sure what the trend is. We’ve been seeing both the growth of the super-computers that have remote processing capabilities and also the mini-computers, which provide a lot of power for very little price. I don’t know exactly where we are going to come out in terms of equipment, but there are a lot of different ways to organize equipment. If you try to have some central group of systems analysts dictating an information system for some division that they don’t understand or understand well enough, I think you get in trouble. I am very strong on supporting systems analysis activity as taking place within a division. There is one exception to that: there are some kinds of information that we need to consolidate at the corporate level, as for example, financial information. You need some corporate level systems analysts to look at corporate level information systems.
Evolving Shapes in Long-Term Financing for the Forest Industry

Mr. Robert A. Malin
Vice President and Director
Blyth & Company

INTRODUCTION
by Professor Lester B. Strickler

THE SPEAKER FEATURED NEXT on our program joined Blyth & Company in 1960 in the Corporate Buying Department and is currently serving as Vice President and Director. Prior to joining Blyth, he served as Assistant to the Controller, Biddle Purchasing Company in New York. His educational background includes St. Edwards School, Oxford, England; Dartmouth College, where he received an A.B.; and Amos Tuck School of Business Administration where he received his M.B.A. I am most pleased to present Mr. Robert Malin.

ADDRESS

MANY THANKS. First, I want to say how very glad I am to be with you. And second, hard on the heels of that, I want to tell you why I’m so glad. To begin with, I’m absolutely delighted, despite the seemingly unending obstacles that United Airlines placed in my path last night, to be away from New York, which has too many people, not enough trees, no mountains at all, and is home to the world’s financial markets, which I’d just as soon forget right now. You have seen the morning papers. I want you to know that it’s worse right now. I read a comment in this morning’s paper, “How now, Brown Dow?” The Dow-Jones are off 9 points and the bond markets are weaker. As a matter of fact, in thinking of how I could most profitably use the 45 minutes allowed to me, I thought that perhaps 40 minutes of funeral dirge music on the organ, followed by 5 minutes of
fervent prayer would probably be the most appropriate way of going at it.

Just as important as being away from New York, I'm delighted to be among forest products people who, besides being generally the real "salt-of-the-earth" types, have accounted for and been responsible for a number of the more notable and more profitable transactions handled by my firm. Investment bankers live and die by the way in which they serve their clients, and to us the forest products industry has always held a very special position in our firm because of our opportunities to be of service to that industry.

Lastly, and very significantly, my senior partner, Jim Miller, a long-time Portland resident, who numbers among you many of his close friends and who asked me to bring his special greetings today, was my own special mentor and guide and close confidant, and he was the first one to explain to me that, although only God can make a tree, it takes man to realize its value. This, of course, has been a large part of the history of financing in the 60's of the major forest products companies.

What I want to talk about briefly is what I think is likely to happen in the next several years as the forest products industry, responding to the growth in its various markets, attempts to finance its expansion. Now, just so I won't be accused of launching a teaser campaign, let me telegraph my punch by saying that it isn't going to be easy to finance that expansion.

To set the scene, let's look back in this decade that we've just completed, the one that Fortune Magazine dubbed "The Soaring '60's," which I suppose most of us red-blooded guys called "The Sexy '60's," which the educators called the "Student '60's," and which I'm worried the historians are going to call the "Sick '60's." But for the forest products industry they were 10 years of enormous progress, development, and expansion.

Let me illustrate in broad terms some of these key developments. The ten largest forest products companies today, which are, in alphabetical order, Boise-Cascade, Crown Zellerbach, Georgia Pacific, International Paper, Kimberly Clark, Mead, St. Regis, Scott, U. S. Plywood, and Weyerhaeuser,
ranged in 1969 sales from about $1.75 billion down to about $0.75 billion, so we are talking about very large companies, indeed. What did these ten companies as a group do during the '60's in terms of their capitalization? The most important single development was the use of debt, both on the balance sheet and off. Let me illustrate. In 1960 at year-end, the total long-term debt, as a percentage of total capitalization, was about 14 percent for these ten companies taken as a group. There was about $600 million worth of long-term debt outstanding; total capitalization was then about $4 billion. Five years later, the debt had about doubled from just under $600 million to about $1.3 billion. Total capitalization had increased from $4.1 billion to $6 billion. In 1969, at year-end, long-term debt as a percentage of total capitalization was 33 percent, which in traditional Wall Street convention is about the limit for industrial companies.

There are special reasons why forest products companies can and do exceed this limit, but as a general rule of thumb, we normally say "33 percent, and that's it." Note 14 percent debt in 1960 and 33 percent in 1969. The numbers at year-end 1968: over $3 billion of debt, just over $9 billion in total capitalization. Debt in those ten years increased six times, total capitalization a little more than doubled. During this period of time, net margins, i.e., net profits as a percentage of sales, were pretty stable for these ten companies, taken as a group. In 1960, 6.5 percent; in 1965, 6.7 percent; in 1969, 6.2 percent. Now, I know that these figures are distorted by mergers, acquisitions, shifts in product lines, and so on, but as a group average, I think they are broadly illustrative. The return on net worth for these ten companies, taken as a group, improved strikingly. In 1960, it was less than 8 percent; in 1969, almost 12 percent. The numerical increase, 4 percentage points, may not sound too dramatic, but it is a 50 percent increase, and it is in the toughest place to increase earnings — return on stockholder's equity. Obviously, leverage played an important role here. Now, this particular statistic happens to excite common shareholders probably more than any other group. But for the forest products industry and for the ten largest companies in that industry to record that kind of progress is a very remarkable
development. Very few other large companies in the United States today can point to that kind of progress in return on net worth. This fact has been obscured because we've had such a very strong overall economic growth during the '60's.

What were some of the influences during the '60's which affected financing decisions? Where did this debt come from? Very important, of course, was the fact that the investment tax credit, when enacted, did encourage capital spending. The cash flow aspects were very favorable, and plugging that effect into return on investment decisions caused a lot of capital investments (which otherwise might not have been made, or made as fast, or as big) very attractive indeed. Another factor was the availability of the industrial revenue bond financing. I say this with some embarrassment, since we were one of the firms which held to the precept that this kind of financing was an abuse of the Federal tax exemption for state and local entities. It really wasn't the state and local financing entities, obviously; it was the corporation for whom the financing was being done. And we and a number of our esteemed competitors stood aside, and of course a number of major corporations also felt that, as a matter of ethics, this was not the way to finance. However, as the interest cost disparity grew, the pressures on corporations and on investment bankers grew also. Eventually we, with a number of these same esteemed competitors, yielded, and this technique became a very effective and well-used financing vehicle. Owing to changes in tax law, we don't have it any more, at least in large offerings, but it was used very heavily during the '60's. Because of differences in accounting, it's tough to get a good handle on how much industrial revenue financing was employed, but probably somewhere near $0.75 billion in facilities cost was financed by these industrial revenue bonds during the '60's by the ten companies that I mentioned earlier.

Obviously, the use of accelerated depreciation for tax purposes, with its impact on cash flow, had very much the same kind of effect as did the investment tax credit when corporate managers were cranking out their return on investment calculations, in making their expansion decisions.
Two other special influences that apply particularly to the Forest Products Industry, of course, are timber depletion allowances and the capital gains tax. The overall tax rate, as all of you know very well, on major timber holding companies generally runs, depending on harvesting and other factors, significantly below that which would otherwise apply. The cash made available by the application of these two tax benefits was, of course, extremely significant. It was recognized by lenders as being a unique characteristic of the Forest Products Industry, and therefore there was an awareness of the financial effects and, hence, an enthusiasm for making long-term loans by insurance companies, major banks, trust accounts, and other institutional investors. These important advantages appear to us to be obvious today, but as little as ten years ago, they were not universally recognized concepts — these special characteristics affecting debt service capability that the forest products industry has, by reason of these unique tax benefits affecting cash flow.

With these benefits, why did the Forest Products Industry have to do external financing? You all know much better than I do, but I think I would just point to the growth of markets. Also, increasing wage rates, increasing competition, larger units being formed through mergers and by internal growth — all these factors brought a certain compulsion to corporate managers to expand, with the recognition that there might be excess capacity, but with the clearer recognition that a much worse cost, an unbearable cost, would be the failure to have the capacity when needed. There was, of course, in the forest products industry as in practically every other industry during the '60's, a merger fever. Part of the urge to merge was to acquire timber lands, part to acquire markets, part to acquire people, and part to acquire facilities. The prices of standing timber, about which you are all much more familiar than I, skyrocketed during the '60's. The improvements in efficiency that were required by the escalation in wage rates brought intense pressure in capital expenditures. Capital expenditures in the '60's by the ten largest companies that I mentioned earlier rose in 1960 from approximately $0.5 billion dollars to over $1
billion in 1969. My guess is that the rate of increase was at least matched by the rest of the industry, and possibly exceeded.

Looking back at the '60's, we had (1) a big demand for external finance, (2) utilization of some vehicles for external finance which do not now exist, and (3) recognition by institutional lenders and others of the special, unique financial characteristics that apply to forest products companies with significant timber holdings.

What of the future? First, we've had a rash of legislative developments, and we no longer have an investment tax credit (except for pollution abatement) of any significance. Industrial revenue financing is out except for very small projects and pollution abatement. The capital gains tax rate has been changed. Another change that is almost akin to a legislative change is the merger accounting rule changes, which haven't been approved yet, and to which I will come back. Then very importantly, the much more stringent pollution abatement laws, which will require lots of nonproductive investment. If there is an expression that Wall Streeters hate, it is "nonproductive investment." And I assure you that this will not escape the security analysts and others. They could say, "This is an investment of $100 million over the next several years, of which $15 million will be nonproductive." With the pollution abatement factor and today's money costs, I don't need to tell you the kind of chill that runs through a financier's heart. Maybe all the whiz kid analysts in New York are wrong when they say 15 percent out of the coming investment dollars in the forest products industry will go into pollution abatement. But if they are wrong, my personal guess is that they'll be wrong on the low side.

Back to fundamentals. We have big markets, growing markets, which must be served. We have an increasing trend toward integration within the industry. There is no way I can see that we will escape the demands for additional capital of substantial proportions within the forest products industry. I wish I could hold out some hope for you that this is not going to be true, but the only hope that I can hold out is that I've been known to be wrong at least 50 percent of the time! But the trend seems clear, and I don't see any interruption in those trends, certainly nothing on the horizon right now.
This shelter market about which we've all heard so much for so long has got to take hundreds of billions of dollars — and that's not an exaggeration — hundreds of billions, if this demand which people are talking about really is going to be satisfied. The necessity for more efficient production and the need for at least preservation of present margins are factors that will lead to additional requirements for external financing by the forest products industry. I don't mean just conventional debt financing. Certainly, we've seen other avenues available that haven't been knocked out by legislative and other developments. One is joint ventures. Now, no one has a greater built-in resistance to the theory of a joint venture than a Wall Streeter. Our classic definition of a joint venture is when two people get together — one having money and the other having the expertise — and at the end of the project their roles are reversed. So "joint venture" is not one of our sexier "go" words.

However, there have been a number of very good examples of extremely productive joint ventures. One that I'd like to point to is the Boise Southern mill, which has just come in. I believe the first machine is six months ahead of schedule and under budget. I think that I may speak for Boise-Cascade and Southern Natural Gas when I say that they are delighted with the partnership.

All kinds of wrinkles in timber financing — for instance, leasing arrangements and cutting contracts, have been utilized, and undoubtedly we will see more innovations in the future. I might say as a personal aside that I don't think that's the way to go. I realize the immediate attraction. Sometimes it's really the only feasible method of acquiring a lot of timber in a short period of time and getting it financed. However, timber has such special, unique values for credit purposes, that to the extent it can be preserved as a general corporate asset and cash source and earnings source, I think it is more effectively used in that manner.

Another possible trend we have just seen illustrated is Boise Cascade's captive finance company's recent public offering of $75 million. This is an entirely new kind of financing vehicle for the forest products industry, and Boise is using it, as probably most of you know, to finance the
receivables on land sales for recreational and second-home sites. As I will explain later, I think possibly that kind of technique is more broadly applicable — perhaps not now, but in the future.

On these merger accounting rules changes, first let me say that I am naturally biased. Secondly, let me say that I think most of what you've read on this has been pretty accurate. The reporting in the newspapers and in the financial journals has been pretty good. However, the impact of the proposed changes, I think, has been misunderstood. A lot of people seem to have the feeling that this is just a punitive measure against Jimmy Lang and some other high fliers, and that "It can't hurt me." The fact is, it can, and most of the mergers in the 1960's that were accounted for as poolings of interests would not be so accounted for if these new rules go into effect as they are now proposed. The crucial theoretical point is, why should current values be recorded when a change of ownership of assets occurs when a purchase is made, but historical values preserved when a pooling is made through the issuance of stock? That is a neat theoretical problem, particularly in days of rising inflation, when the disparity between historical values and current values is becoming more apparent. But the Accounting Principles Board has gone at this thing piecemeal, and they have tried to retain the old concept of pooling, which essentially is not an accounting concept at all. It's an emotional concept of about two parts romance and one part arithmetic. They have attempted to preserve that concept, but greatly restrict its use to what they refer to, informally, as the "true marriage." Just by that very terminology you can see that it basically is an emotional approach to the preservation of pooling, rather than an analytical and theoretical approach. And the accountants are getting pretty badly tangled up in their own underwear. This new draft opinion on merger accounting was supposed to have been effective at the end of last year. My personal guess is — and I'm pretty close to the situation — that it won't be effective until near year-end. I don't think it will be retroactive. I don't think the 3:1 size rule will stay. All those things will be modified. And once the opinion does go into effect, the chipping away at it will commence immediately, and eventually
we'll be back about where we were. The accountants will then have to face the fundamental theoretical problem. However, in the meantime so long as everybody is under the same rule, I don't think any of us will have any problem with it, so long as it has some logic and makes practical sense.

Now I come to the sad part of this program, because I'm going to talk about today's capital markets. If I had some crepe, I'd hang it now. Very simple, the bond market is flat on its back. It is the worst corporate bond market in the history of the country. And bond people being what they are (the first bond statistician came over on the Mayflower, and we've been keeping records ever since), I'm sure of my facts. The world's largest corporation, AT & T, with Aaa rated credit, is forced to come up with about a $1.5 billion dollar emergency financing. No corporation likes to put out hundred dollar pieces of long-term debentures with \( 8/4 \) percent on them, plus two stock purchase warrants, in order to get needed expansion capital. The fact is, lest my remarks be misinterpreted, the regulatory authorities, both state and federal, vastly misjudged the capital needed for additional telephone equipment nationwide, and now you have the world's largest and strongest corporation forced into distinctly unpalatable financing.

Another indicator, the seemingly absurd rate of 10 percent on major corporate bond offerings is now becoming commonplace. Yesterday, Bethlehem Steel, Aa rated, paid 9 percent. The bulk of publicly owned U.S. corporations would be rated by the rating agencies two notches below that Aa, and I guarantee you there are 100 basis points between a "Aa" and a "Baa", where most publicly owned United States corporations are today. And there's no sin in that; Baa is where most corporations should be, or they are probably not using their credit as extensively as they ought to, or growing as fast as they ought to.

Another indicator: the U.S. government financing just completed was almost a flop. It would have been a flop had it not been for the Federal Reserve, which had to abandon its recently adopted policy of watching monetary aggregates rather than the state of the bond market. The government financing
literally came within an ace of failing. It was the worst reception for any government financing since the early 1930's.

The reason I dwell upon the bond market at length, and in such dolorous terms, is that the bond market is a lot more important than the stock market. The stock market has not been used as a major vehicle for capital expansion. As a matter of fact, during calendar years 1960 through 1965, exclusive of utilities and bank holding companies, which have special regulatory problems, only about three dozen firms listed on the New York Stock Exchange raised capital by direct issuance of common stock - only three dozen out of some twelve hundred. So the stock market is not the way major corporations raise capital. A side note: of course corporations do issue convertible debentures for cash, and those eventually do convert into common stock.

Now, just to talk about the stock market for a minute, it is, as you all know, at a seven-year low, and this despite the fact that we are experiencing rampant inflation, by historical terms. Theoretically, at least, the stock market is a hedge against inflation. When you have a moment, take Fortune's new 500 list and run your finger down it and I think you'll be astonished at how many of those companies are selling below ten times earnings and have dividend yields near 6 percent. It sounds like "shades of the middle '50's," and it is.

Looking to the future - we've got what most commentators are calling a strong need to rebuild corporate liquidity. I don't know where we get all these "buzz words" in the East, but basically what they are talking about is to obtain more and better current assets on corporate balance sheets so as to provide more flexibility for expansion. Remember "the acid test"? It almost sounds Victorian to speak of the "acid test" today, but I think soon we'll be talking about this traditional measure of liquidity. The '60's saw almost a compulsion among corporate managers for financial leverage. The criticism of "lazy money" and the familiar "Let's get those dollars working as hard as our plants are working," are words that we've all heard many, many times. Corporate financial officers responded to that challenge and today there are very few major corporations
who can point to any "lazy dollars." On the contrary, they are working overtime. The development of the corporate financial officer himself has been a factor here. Fifteen years ago he was in many respects a "green eyeshade type" on a high wooden stool and wearing sleeve garters. He was a custodian of cash and not much more. Today he is a dynamic profit center in his own right and generally has a much higher role within the corporate structure; he has vastly increased authority and he is truly responsible for not only earnings performance, but cash position and, of course, overall balance sheet strength.

Right now, the corporate rush for long-term debt is running at about $25 billion annually. This is much higher than it has ever been. The previous high was roughly $16 billion, and of that about $4 billion was convertible debentures. So looking at the fundamentals of supply and demand, we've got a lot of demand by corporations for cash, and we don't have many people very anxious to put their money to work at fixed interest rates. Part of the reason for this, of course, has been the pervasive inflationary trend. But from a very human point of view, I think you ought to consider the position that the bond buyer finds himself in today. He hasn't made a "right decision" in five years, and that's a long time to be wrong. It's a particularly long time to be wrong when you are compensated for performance.

We have seen corporate bank borrowings restricted during this period of credit stringency, and if you look at some statistics, it appears as if there is some actual reduction in bank borrowing, but I urge you to also look at the commercial paper statistics. You will see there a phenomenal growth. Many of your companies are active in that market.

Nobody likes to finance in today's bond market, but the fact is that some people have to, and others (who don't have to) think it might get worse, so they're coming to market. You may recall that several years ago U.S. Steel declined to come to market when the indicated interest cost on their debentures looked like 6½ percent, and we all nodded our heads and we said "U.S. Steel is pretty smart; they have this bond market all doped out." Well, they didn't and we Wall Streeters didn't, and
Steel has still not done that financing. If they were to do it today, it would cost about 9 percent. By mentioning U.S. Steel, I don't mean to point to them as a unique example. Theirs is a very common situation. Many corporations increased bank borrowings in lieu of doing long-term financing, because long-term rates were so unattractive. Remember that when you finance long-term these days, you accept those high rates for at least a decade; you are locked into them. We have a situation where long-term financing will be done to some degree; it must be done, and the rates that are currently applicable will be paid. Don't think for a moment that the forest products industry will be specially favored. It won't be, and part of the reason it won't be is that the investment community thinks that the forest products industry is going to be one of the very large sources of demand for capital funds in the coming decade.

If we're really ready to hang crepe, let's talk about the residential housing market, especially single-family dwellings, what you and I call "houses." Let me say that when I joined Wall Street ten years ago we were being solemnly assured by a number of people who I thought were geniuses, all the really top analytical pros, that one thing was absolutely positive, and that was that we were going to have a housing boom, that it was imminent, that it was substantial, and that it was going to be never-ending. I took it as gospel. I think, frankly, that any reasonably diligent guy who wanted to could have obtained that same kind of assurance from at least some professional analysts every single week of the whole decade of the '60's. And yet here we are today, still looking for that housing boom. Now, we happily talk about the 26 million houses that need to be built by 1980, and that's 2.6 million a year, and just think of all those kids getting married and all the discretionary income, all the pent-up demand, and on and on. You have heard it all many more times than I have. But I wonder whether it's really going to happen unless we solve the financing problem. I don't see any way it can happen unless we solve the housing problem.

Right now there is no incentive, other than a political boot in the tail that some of our major financial institutions are getting from Washington — there is no incentive to put money
into housing as it is currently financed. As a matter of fact, there’s a very strong disincentive. Secretary Romney said the other day that he thinks the only answer is mandatory credit allocations. He said we must have some way to offset the power of corporations to flood this bond market. Well, I would like to talk to the Secretary about government financing and who really has the power to flood the market, and who, when they’ve got a problem, get the Fed in to help them. We’d like to have the Fed in to help us now and then. Now the basic problem, of course, is one that we’re all familiar with, and it’s that the demand for capital exceeds the supply. If I get a chance to talk to the Secretary, I’d like to ask him whether he thinks that a reduction in the $30 billion annual expenditures in Indo-China might not help us a little bit in financing housing, but I guess he has heard that one before. Certainly, from where an investment banker sits, a lot more would be done in terms of effective help to finance housing by reducing government demands on the credit market, than would any half-baked system of controls. I think that the Forest Products Industry would be hurt if there were government credit controls, because a disruption of the private markets operating in a free and unfettered fashion is clearly not to your advantage. You can’t be benefited by controls, even if the intent of the controls is to funnel more money into housing.

There have been extensive discussions on this question of how you raise money for housing, and I’m certainly not going to review all the alternatives. But I do want to hit one point, and that is I think the forest products industry has to use its credit to build houses, and not just build them, but to sell them and to help people own them. Now that may sound far-fetched, particularly when I’ve talked earlier about the forest products industry already quintupling its debt during the last decade, but look at Ford, GM, Chrysler. They finance what they make. Sears, Penney’s, Ward’s – they finance what they sell. International Harvester, Deere, Clark, White Motor – they finance what their dealers and their customers own. I know a car is not a house, except perhaps to some hippies, but, as a matter of fact, that reminds me of what I think is a true story.
Mr. Stein, one of Nixon's Council of Economic Advisers, was making a speech a couple of weeks ago in San Francisco, and it was replete with statistics, as those kinds of speeches generally are. He had some magnificent figures for housing starts in March, and everybody was incredulous. Finally it came time for the discussion period, and apparently Stein asked the question, "What do you think about those housing statistics?" And somebody got up and said, "I think they're grand, but I could do it too, if I were to include mobile homes." And Stein said, "Wait till next month. We're gonna put four-door sedans in there!" And he probably will, he probably will. Housing starts are getting to be a political indicator, not an economic one.

Well, a car isn't a house, and we all know the difference, particularly those of us in the credit markets. But I think some way must be found to make housing financing much more efficient and much less costly. I think to break the bottleneck is going to take a massive infusion of credit; I don't think enough is going to come from the government, and I think, therefore, some has to come from the forest products industry. And this is where I think the rub comes, since houses can be made of materials other than wood. The steel industry, the aluminum industry, and the fiberglass, cement, chemical companies—all of them have credit, but most of them do not have the kind of return on investment that you are used to seeing, or the profit margins. To them, this housing industry boom may look to be a real bonanza and something into which they can plunge their productive capacity, their management expertise and talent, and their credit, in order to sell their products and increase their profits. Remember how many of these companies don't really have a proprietary product now. I am not predicting anything, but just saying that there is an opportunity that they may well seize upon, and they have credit. Maybe these 2.6 million dwelling units a year will be built. The question is, how many of them will be built out of what you are selling?

I don't have a message, but I do have a suggestion: perhaps there is some way to direct your credit (and remember you have that unique asset) direct your credit into the housing industry,
so that occupancy of a house can be obtained much more efficiently and effectively and at a lower cost. I think that is the fundamental problem and opportunity facing the forest products industry, as far as financing in the '70's goes.

The 12 hours it took to transit the country last night – the only slower trip I know of was done by our great-grandfathers in Conestoga wagons – gave me an opportunity to read several times *The Lure of Oregon*, appearing in United's fine seat pocket magazine. I just want to close with this quote from it because, with a day like this, and with a group like this and with a market like the one we've got, this has some real impact for me. It says, "Why grow old and frustrated in New York when you can stay young and relaxed in Oregon?" Many thanks.
Optimizing the Financial Structure for a Forest Industry Complex

Mr. Loran L. Stewart
President
Bohemia Lumber Company

INTRODUCTION
by Professor Ray A. Yoder

WE HAVE NOW COME to the part of our program that should have the greatest appeal to the pragmatists among you. The next speaker is the president of Bohemia Lumber Company, a firm that has made itself increasingly conspicuous on the northwestern forest industry scene in recent years. Beginning with an outmoded sawmill and some borrowed capital in 1946, this modest beginning has since been parlayed into a highly diversified series of holdings. Diversification in this case includes a country club, a golf course, and so forth, though none of the owners play golf, as I recall. They have a well-deserved reputation for smart management and excellent leadership under the guidance of Loran Stewart, who, I'm proud to say, is a graduate of our School of Forestry. He has a record of distinctions and honors far too long to enumerate here, so I'll refer you to the statement in your program. He will discuss optimizing the financial structure for a forest industry complex in the 1970's. Stub, we are delighted to have you with us.

THANKS VERY MUCH, Ray and gentlemen — and especially my two bankers in the audience. You know, a year ago when we needed some money, the bankers fired the janitor because I was in the bank on my hands and knees all the time crawling around, so they didn't need any janitor work.

I thought perhaps I might review a little of the history of the Bohemia Lumber Company and from that base develop a
lead as to what we can anticipate in the future. We have had a rather varied experience. The Bohemia Lumber Company started in 1916 with a couple of gentlemen, and my father joined it right after World War I as head of the logging arm of the company. They went along for years as a four-man firm, until finally two of them dropped out. After World War II the two remaining partners retired, after having made a little money. The mill was run down because they didn’t have the resources to do anything with it. The logging camp was also run down. And so they decided they would sell.

Well, I learned in Portland—I was working for Pope and Talbot—that they wanted to sell the outfit, so I immediately went down to see what I could do, because we (my brother, brother-in-law and I) decided we wanted to run it. We finally talked my father and his partner into selling, but Dad said, “I won’t pay a damned thing to you kids for giving my half to you. you’ve got to pay the gift tax.” So he gave us his half, we paid the gift tax, and we bought out the partner, Mr. Garoutte, with money borrowed from Morrison and Merrill, of Salt Lake City. This was our first borrowed money, and we paid it off on schedule at a flat rate per thousand feet cut, as part of a contract with them to sell them half of the yard stock that was developed. As you know, right after the war lumber was hard to get.

The arrangement went along fine, but we had to start modernizing the mill. One of the first things we had to re-work was the lumber plant. We started by going to the bank and negotiating a loan of $25,000 to re-do the planer installation, though we still had the original debt hanging over our heads. And here is where we learned, I think, an important lesson for those of us in our industry who work with finances, and that is, in working with the bank or our other financial people, anticipate a long time ahead what you want and intend to do. Have your projection completed, and don’t come in and say “I’ve got to have the money tomorrow morning.” If you plan six months ahead, you will get the money, provided you have a good history of prompt and full repayment.

That is the story of our first borrowing. Later, we borrowed to buy log trucks. However, we developed another
rather interesting method that we used extensively in financing some of our improvements, beginning in 1950. Weyerhaeuser had built a pulp mill in Springfield, and nobody in our territory at that time had installed a chipper. We decided, since we had a veneer plant at the time, so had some debarked logs, that we wanted to install a chipper and sell chips. So we went to Weyerhaeuser, though we didn’t have the particular amount of money needed to put it in. They said, “Fine, we will loan you the money and the chipper if you will install it, and we’ll take the money out of the chip payments at so much per unit on the deal.” This was our first venture in that type of financing.

Later, we decided to build a new sawmill and install a new chipping plant, a barker operation, and so forth. This time, we went to Crown Zellerbach, as a new outlet for chips, since Weyerhaeuser didn’t want any more. Crown Zellerbach said “Yes, we will loan you the necessary money and will buy the barker for you, and help you with the installation.” So we proceeded on that basis and this also worked out very well: we used their money, we got the chipping facility, and they got the chips. Everybody was happy and they were paid off according to plan.

We also worked out a trade with Publisher’s Paper Company, which wanted to buy hemlock logs from us. We needed some more logging equipment — shovels, tractors, and similar items. We said, “If you will finance us on that kind of equipment, we will sell you the hemlock logs and have you take the payments out of the amount you will owe us for the logs.” We got a lot of logging equipment this way. We have worked this approach to financing to a frazzle, and have found it very much to our liking.

In the meantime, we plowed back all the money that we were generating, and we were also continually borrowing some from the bank. This was money that we could use and usually at a pretty cheap rate.

Then we wanted to modernize our mill at Lakeside, Oregon, by putting in a barker and a chipping operation. And, lo and behold — International Paper had built a paper plant at Gardner, so we went over and got the money from them. They are all paid off now, and both parties are satisfied.
We finally wanted to build a plywood plant at Culp Creek, and here again we were a little short of funds, so we went to U.S. Plywood and said, "We'll give you a 75 percent sales contract on our plywood if you'll loan us $750,000 so we can build a plywood plant." They came through, and again it worked out fine.

So these were, generally speaking, the ways that we financed our business. For us, it was a very satisfactory approach. At the same time that all this was going on, we maintained a close relationship with our bankers. We would go in, talk to them, and give them our annual report. I made it a practice to go in at least every two months and make a pretty detailed report of what was going on and what we had in our minds. This has proven out over the years to be extremely important.

As many of you probably recall, in 1959 Georgia-Pacific bought out Booth-Kelly down at Springfield. They made quite a lot of timber available to other people to help them pay the debt off quickly. And with this reputation of being able to pay our bills that we had built with the bank and with other companies, and with the help of G.P., we went back to the Prudential Insurance Company in Newark and borrowed $9 million. I think we had a net worth, at that time, of $3 million. Now that, I thought, was a pretty good reputation. They loaned on that deal primarily on the reputation of the Bohemia Lumber Company. The pay-back was on the basis of so much a thousand as we cut the timber. Well, we overpaid by quite a lot on that basis, so we still have much of that timber that is already paid for on our books at a pretty reasonable price. The debt is all paid off, but the insurance company really helped us out and G.P. did a marvelous job in helping us, too.

Along with this we were building up our assets, while the three major partners — my brother-in-law, my brother, and myself — were not taking money out of the company. This prompted our accountants and attorneys to say, "You can be in real serious difficulty if you don't do something about your estate problem." So we thought that one over for awhile and decided that if any one of us left the picture we would be in
really serious trouble. So we looked to U.S. Plywood with whom we had been getting along very well on our plywood deal. We went to them and said, “We would like to sell you 50% of the Bohemia Lumber Company, exactly 50, no more and no less, for twice the book value, and we want the money in round dollars for us so we can have something in our estate, because we don’t have any money at all.” We had never declared a dividend up to that point. And they bought the deal, and we got along fine, so that’s the way we solved that problem at that time.

Then we moved in and we bought the Rickini Lumber Company. We issued some stock and borrowed some money from the bank for that purchase. During this period of time we bought the Cascade Fiber Company in Eugene. We borrowed money from the bank to pay for it and didn’t issue any stock – that was a cash deal entirely.

In the spring of 1967, we could see some trouble coming with U.S. Plywood, because they had merged with Champion Papers. This gave us real concern because we could see U.S. Plywood losing its dominance and we were getting to be such a small frog in a hell of a big puddle that we were concerned about it. We had when we joined up with U.S. Plywood a little mechanism of a buy-and-sell arrangement in the contract that either party could trigger, based on book value. So we went to them and said, “We want to trigger the mechanism, because we are concerned.” They looked it over, thought it through, and made a stock offer to us which we didn’t think was enough. They then said, “All right, we’ll take cash.” So we paid them all the cash the company had, then went to our banker in Eugene, got $4 million from him and paid off U.S. Plywood.

All this immediately compounded our problem again, because the same stockholders were there and now we owned all the company, so if anything should have happened to us then, there would have been a forced liquidation of the Bohemia Lumber Company to pay the inheritance tax. So we got busy on that problem, and the only course that we could see to go on was to go public. We had been preparing for this for perhaps a couple of years. We have had certified audits; we
had done the things that you need to do before you can proceed to go through the S.E.C. business. So we made our decision to go public, and in doing so we chose what we though were the best accountants – national accountants – the best attorneys in the business, and the best of the underwriters, to make certain that we would get the job done as it should be. We lucked out on every one of them. On November 14, 1969, we went public, and our stock has done creditably well since then. We had an awfully good year, as you may know, in 1969. We piled up a considerable number of dollars, and by the way, we still have them, because we are guarding them jealously since we don’t know how long this present economic situation is going to last.

Later, we purchased the Umpqua Navigation Company, which you know builds jetties, is in the rock business and the towing business and so on. We bought it for stock. Then we purchased Century Homes because we wanted to go into modular home building and the real estate business. We had considerable real estate which we had purchased for cash and stock. A rather interesting feature of our Century Homes transaction was that we paid them a little stock and at the same time hung a carrot out by agreeing, “If you make so much money over the next four years, you get so much more stock.” That arrangement worked out very well for both. Now they are properly financed, and they can do a much better job.

Looking a little ahead to the future, so far as the Bohemia Lumber Company is concerned, we have one policy that as far as I am concerned is not going to change, and that is that Bohemia Lumber Company is not going to merge with anybody in such a way as to lose its identity. We have a really good second string coming along, a really good bunch of boys who are working hard, and I’ll be damned if I’m going to sell them out. They are going to run the company and I am looking forward to that day when they shove me right out of my chair, but I am not going to sell them out.

The number of opportunities to merge with other people is amazing to me. I am astounded at the number that come at us who are bigger people, and the number of other people who
come to us who want either to be bought out or acquire some stock or something of the sort. As least one or two deals a day – this is almost unbelievable – come across my desk from people who want to join with us. Well, we are very selective and study all these offers. We never let one go by without taking a second look at it to be sure that we don’t miss a darned good deal, like the Century Homes trade. We took a run at that one a couple of times and it has turned out to be a dandy, in our opinion.

Now for a look at the future of financing in our firm. Our present thinking is that we will lean primarily on borrowing from the bank and what we can generate within our own company. But I think the time will come, and I’m sure it will within the next year or two, when we will have to have a secondary stock offering, because some of the people who have joined with us by taking stock need some cash out of the trade, so we will have a secondary to convert some of their stock to money, which they need. At that time, we probably will sell some treasury stock to raise some money, if we have something to do with the matter at that particular time. But in my opinion, money is going to be awfully hard to come by for the foreseeable future. I just don’t see a real break-through in obtaining a lot of money for a long time. I don’t see how the interest rates can come down very much because the pressure on money is tremendous. Everybody wants money, and when you hear the economists and others talk, as I did in Washington for the last couple of days, it is rather frightening to know of the amount of money needed to keep this country going, and the competition for that money.

In closing, I think that our funding is going to have to be from borrowings from the bank, plus what we sell in additional stock to the public and what we generate in our own house. But I think that will be enough to continue the growth of the company. Our growth has been rather steady; it hasn’t been like G.P.’s or Boise-Cascade’s. I’m not sure that we people are geared that way in our thinking. Instead, we want to grow slowly and steadily and not become a large public concern. Thanks very much.
I would like to lead off the questions with this one. What do you foresee as the future for the Flying Scotsman venture?

First, let's be sure we get our nomenclature right. The Flying Scotsman was a test run, which has been liquidated. But you are talking about the balloon operation. You probably read in the paper the other day where we were successful in taking Goodyear on for size, to the tune of $600,000 on the balloon lawsuit. But this is not a condemnation of or against the balloon operation. It is a matter that Goodyear didn't play fair with us, and the jury believed us. I think the balloon operation, within two or three years, is going to be an economical system, and you are going to see it all over the country. In my opinion, whether you like it or not, the environmentalists are going to force it down your throat. We are logging now on Deception Creek, just below Oakridge, logging across a beautiful stream with this balloon, and there is not one piece of mud or dirt or anything going into that creek. Not one tree has been damaged in the little alder stands which shield either side of the stream, and it looks beautiful. Of course we are showing off the operation to all the do-gooders we can. And we are also happy to announce (I guess it is public knowledge) that we now have a partner, I shouldn't say a partner, but another party going into the balloon-logging business. That is Boise-Cascade; they have ordered a balloon and will go into operation a little less than a year from now, probably in April or March. This will be in Idaho, in country that the Forest Service is afraid to allow to be logged any other way, because if you put bulldozer roads in it and cut around the hillside, the whole hillside goes in the creek. The soft, unstable soil just falls apart. So Boise-Cascade is going to try it on a sale of 30 million feet. The logs will be lifted aerially and taken down to the bottom of the canyon, to the road. The Forest Service in Alaska is putting up a sale of 250 million feet on Prince of Wales Island with a “balloon logging mandatory” tag. If this works, the allowable cut in Alaska goes up 400 million feet a year, right now, because of gaining access to timber that they can reach by balloon logging, but they can't
reach now. So, Ray, I have really high hopes. I have had since it started; it has cost us a lot of money and a lot of effort and heartaches, but it is going to work.

What criteria do you use to establish optimal financial structure in the complex?

That title was given to me to talk about. I really don’t know what it means. I do know this, however, that we of the Bohemia Lumber Company will spend all the money we get our hands on in improvements, or in merging, or in other ventures of this kind, as long as it’s a good deal and we have enough money left over for the stockholder’s dividends. So exactly what optimizing consists of – I don’t know either.

I guess I must have done a real good job. There are no other questions. Thanks very much, gentlemen. It’s been a pleasure.

Professor Yoder. Well, from the last response, I would think that you did know what the subject matter of the title meant. Stub, you’ve done your usual very fine job of handling whatever topic has been assigned to you, and we are most grateful.
Conglomerate and Congeneric Trends and Their Financial Considerations

Mr. Harry J. Kane
Executive Vice President
Georgia-Pacific Corporation

INTRODUCTION
by Professor Ray A. Yoder

I WOULD LIKE TO HARK back to a time when I had an office along the western shore of Mobile Bay. I recall the first move out of the State of Georgia of Georgia Hardwood Lumber Company, which moved onto the Tennessee Coal and Iron Company tract to the east of the bay and built a little plant at what was called "Steelwood." My coming to this University shortly thereafter coincided with a westward expansion of the same firm, which then became known as Georgia-Pacific Company. In their early days here, their move to the West was viewed, especially among foresters, as the South's answer to the carpetbaggers. And the trouble with this westward move was that, in the very astute view of many in the industry "establishment," the firm could not possibly survive in this highly competitive field. Our next speaker was largely responsible for insuring, not only its survival, but its highly phenomenal growth over the years since that particular time. He is no stranger to this campus. He has been here on several occasions before, especially on matters of forest taxation and similar expertise; and I'm sure that since he is well known to all of you, at least by reputation, you will be more than glad to hear from Harry Kane. Harry, we're glad to have you back.

ADDRESS

THANK YOU. You are going to find out that I have a funny way of expressing security. I was given credit for being part of
the Georgia-Pacific team. It went a little further than that, but that’s really what it is. When I was first approached by Oregon State to come down and spend a few moments with you this afternoon, I thought, “Boy, you know, this forest products industry is a complicated son-of-a-gun.” And when Ray called, I said, “Ray, I’ll do anything in the world to help you out.” Some weeks later someone at Oregon State sent me the title of what they wanted me to talk on. Now in order for me to make sense, I went back and picked up Webster’s dictionary, and found, much to my amazement, that “conglomerate” is “miscellaneous materials gathered from various sources.” Then of course I ran into that other term I’d never heard of before, “congeneric”; and I found out that the meaning, according to Webster is “all of the same kind.” Therefore if I attempt to define for you what I am going to speak on today, as near as I can come to it, it is “miscellaneous material gathered from various sources which are of a kind that will enable us to determine financial considerations.”

Well, with a topic such as that and having a deep conviction that the forest products industry does pose some really perplexing problems, especially as you look into the 1970’s, I took the liberty of looking up 15 companies that are in this industry, and put together some statistics that maybe you will find to be of interest. These 15 companies, so that we will determine no bias between us, will remain unnamed. But I think the first thing that happens is that you are going to find that those 15 companies represent 750 thousand different stock ownerships. So I thought it would be interesting if we put these companies together, and then you and I will sit as a group as though we were the board of directors with a company (whose scope I am going to give you) and determine what we would do as directors as we face the 1970’s. The very first thing that you will find in our company, which will be a conglomerate, if you will, is that the market value of our securities, that is prior to today’s market, was $16 billion. You’ll find also that if you take a quick look at our company whose financial condition I will portray for you in a moment, that that $16 billion was roughly double equity of about $8.2 billion. Now you are going
to find another thing, as you look at our company. We had, and hopefully still have, a price-earnings ratio, that is a relationship of profit to the fair market value of what we have, of roughly 18½ times. And something that I found that I thought was interesting: our fair market value of $16 billion only exceeded the value of the products that our company sells by one billion. Our sales total $15 billion.

Now, as we lay the foundation for what we are going to discuss, let’s take a look at the thing we call “financial condition,” because you will find that our company has working capital of $2.3 billion. You will find that we have an investment in timber and timberlands of $1.5 billion. You will find that we have an investment in property, plant, and equipment of just short of $6.9 billion, and we have other incidental assets that total about $2 billion, a grand total of about $12.7 billion. Now, I would like to tell you the source from which those assets we possess come. First of all, we have long-term debt of about $3.6 billion. We have incidental long-term debts of $0.9 billion. And we have equity of $8.2 billion. The first thing that strikes us is, where does the market tell us that excess of $8 billion should be placed? Should it be put on working capital? Should it be put on timber and timberlands? Or should it be put on property, plant, and equipment?

Rather than open this meeting up to you as directors at this time, I’d like to pose and discuss with you, using that background as our basis for discussion, the following five questions:

1. Have we got the proper debt-equity ratio?
2. Are we providing the correct depreciation charge?
3. Are we doing the forestry job that is necessary to provide for a profitable future operation?
4. Are the plants that we own and operate being used in the most economic and profitable fashion?
5. Are we as a company using modern management techniques to determine profit
responsible for two classes: first, people; and second, the people that make up the divisions of our company.

Well, those are five. I'm sure that if we open it up to you to bring forth more questions, we would broaden the coverage, we would expand, we would contract in certain areas, but we would point up one thing about the forest products industry that needs to be pointed up. It is not a simple industry that can be solved each day as it moves out into its respective operations. So, if you will.

I would like to go back now, and let's discuss these five questions. The first one — the debt-equity ratio. This is a ratio that from my observation in the forest products industry has either been neglected in its understanding, or blatantly ignored. If you disagree, can I take you back to the profit and loss statement that we just discussed and expand that just a bit?

You'll recall that our profit was $0.8 billion. Depreciation, which was included in those costs and expenses, ran about $0.6 billion, and as near as I can determine the depletion ran approximately $0.2 billion, a total of $1.6 billion. Remember those debts; $3.6 billion if you will, or if you want to add the other incidental, $4.5 billion. In my opinion, something is wrong with our company, because the debt is entirely too light. But what gives insight into a debt-equity ratio? Well, of course, it stems from an intelligent understanding of cash flow and its eventual utilization. In order to have this take place you don't "luck" into the study that goes into it. You work at it and you become involved. And in order to become involved in cash flow, you have to be knowledgeable about what each division and each department is undertaking to do.

Time plays an awfully important part in debt-equity ratio. Oftentimes you and I have heard, "There is a time and a place for everything." There is nothing that could more accurately describe cash flow and its importance to the debt-equity ratio. Some of the considerations that at least one company in that group has found to be helpful in looking at the proper debt-equity ratio go somewhat as follows: How well, how deep, and how involved is our goal planning? Goal planning has a
definition that "yours will be different from mine." You may call it "budgetary control." You may call it, as we do, "standards." But after all, it is setting a realistic target. How deep, how well, and how involved does that process become for our company, because it is going to play a mighty significant part in more than just the debt-equity ratio, but certainly a major part in that determination.

Secondly, when you look at a debt-equity ratio, what is the time period that our goal planning covers? One, three, five, seven, ten years? In my humble opinion, if you are looking at debt-equity out beyond a three-year period in detail, you are doing an awful lot of guesstimating.

The third thing in this particular point that I believe is important is "What has been our experience of actual results compared to the goal plan that we had?" Basically, if you aren't making a comparison, why waste the time in setting the goals in the first place?

Fourth, and certainly far from that position, because it probably should be listed as number one, what do you, as the chief executives of our company, think of goal planning? Are you only giving it lip service, or do you actually get down and make it work, and give the guy the feeling through adequate communications both ways that I, as the chief executive officer, am looking over your shoulder? I think that is important.

Fifth, and finally on this point, is our goal planning of the ivory tower type, or does it possess the gutty attributes of a successful plan? My definition of "gutty" means that it starts out there, not up there. It means that as that plan is developed it connotes a responsibility that is expected of that individual and that he in turn has a chance to have his plan reviewed before the fact and not after the fact.

Well, enough on that. Let me turn our attention to another field that is going to play an awfully big part in the success of our company. It goes to the point "Are we doing the forestry job necessary to insure future profitable operation?" You know there is a modern-day phenomenon taking place in the forest products industry today that if we were to have met back in the mid 50's, you would have heard an occasional voice that said.
"Somehow, some way, we have to cut the growth cycle on trees. We have to increase the yield per acre." They were in the minority, because everybody thought, "Gee, that’s a great ideal, but it will never work." Well, remember what we said, "There is a time and a place for everything"? Well, time and the cost of money finally have caught up with the forest products industry, to a point that what once was idle chatter has now become a reality, and no longer is it a minority position, it is a majority position. What caused the change? Real simple. In the 50’s we were talking interest cost of 4½ to 5 percent. In the late 60’s and early 70’s we are talking interest of 10 percent plus. We found in addition to this that there are alternative uses for land. We found that we have end-product versatility, and finally, if we didn’t realize it before, we certainly did after hearing the State of the Union message. The modern environmental problems now demand that a quality job be done in the forestry end of the business.

Well, what do we as directors have to do? We had better get to know the calibre and content of the forestry department. We had better become involved in what the genetics are that are being followed in our forestry. And we had better do one other thing. When the financial guide puts the mathematical rule to the sum of both of the others, you had better make sure that you know the mathematics he is following.

I worked out an example for our Company which I am sure to some of you will not be a shock and maybe to most of you it won’t be a shock. If you take $83 and invest it today in one acre of land, in site preparation, cost of the land, and planting, and you spend two to three dollars a year in management costs and property taxes, I am sure that it will come as no shock to you that on a 45-year cycle you are going to go broke. There is no way, absolutely none, with the 10 percent interest costs, that will make you able to capitalize all of those costs and at the end of the period show the value of the tree covering that deferment.

You have heard a lot of talk recently about the fact that the Bureau of Internal Revenue has in mind that many of the costs of growing trees should be capitalized and deferred to future periods. Hogwash! If we didn’t have income tax
considerations to offset part of the interest costs, part of the management costs, part of the property taxes, an awful lot of land is going to revert back to Uncle Sam to have him take care of it and (hopefully) furnish this raw material requirement for $15 billion worth of sales.

And, of course, that brings me to another point. We said, “Are we providing the correct depreciation charge in our company?” I surely didn’t have in mind that somebody was sitting down and dividing the dollars by years and units and making certain that that figure comes out absolutely correct. That wasn’t the reason for the question at all. The reason for the question is, “Does our depreciation policy take into consideration the factor of obsolescence?” Have we also reckoned with the fact that the cost of rejuvenating a plant has been increasing with each period of time that passes? May I use an example for you? I don’t know what the experience has been with regard to all 15 of these divisions that make up the company we are discussing. I am sure (if you go back and look) in 1965 they probably could have built a plywood plant, a good one, producing maybe as much as 120 million square feet each year, and it probably would have cost them $5 million. The interest would have been only 4½ or 5 percent. The fixed cost from those two sources would be somewhere in the area of about $5.50 to $6.00 per thousand square feet of production. Now come with me for the following five years, up to the year 1970, and we are going to duplicate that plant. You know what we are going to pay this time? Nine million dollars, or thereabouts.

Do you know the interest we are going to pay? Sure you do – there is a whole group of bankers sitting here in the room. We will be lucky if we can borrow it from them for anything less than 10 percent. What has happened to our cost? It is no longer $5.50 or $6.00 or $4.50; you pick the figure. It is a figure now that gets out into the teens. You say of plywood plants, “There’ve been some efficiencies that have been innovated.” Sure there have! And in some cases, a part or all of that increased cost has been recovered by efficiency. You didn’t luck into it. Remember what we talked about a moment ago? You got people like yourselves to become involved, to
understand, and to innovate, to keep that unit cost from going from $5.00 to $15.

The same thing happened on the forestry end. You say, "Why in the world are we investing $2.5 billion, or if you will, the entire market increase of $8 billion?" It goes right to one thing. It goes to what the investing public is saying about our 15-division company. The only asset that you have that is any different from that of any other industry is timber and timberland. Put the $8 billion there. That’s $8,000,000,000. You’ve got a $9.5 billion investment.

If we are going to have to plan for a cycle that goes out 35 to 40 years (if you are in the South), or as it is here on the West Coast, 50 to 80 years, we had better jolly well know how we are going to do it, or that asset that the investing public is investing its dollars in isn’t going to turn out to be much of a return on investment item. But I can tell you as we stand here – and I am sure there are others who are in the forest products industry who may even be able to do a better job – that with modern forestry techniques, the profit expressed as a percentage of the investment in the trees has quadrupled in one company’s case in the short course of a ten-year span of time.

The other question has to do with the topic, "Are Modern Management Techniques Being Followed to Insure Continued Profitability?" I would not want in any way to step on the shoes of anyone in this room; I don’t want to become critical of computerization, linear programming, or the operations research techniques. The good Lord knows we need some and possibly a lot more of each, but there is one thing that I think we in the forest products industry have to be terribly careful of – don’t let us forget the dignity of an individual. I don’t know of your experiences; I know not of your likes or dislikes, but speaking at least as one representative of the group in this room today, I think that our industry could stand in its entirety a bit more delegation of authority.

We no longer are an industry, if we possess $16 billion worth of value, in which one man or 15 men can make all the answers come out perfectly. I think that for many of us, we have to go back to an old adage, "The most important asset we
as a company have is our people.” Those are idle words, unless you make the adage work. Those are idle words when you talk about goal planning, when you talk about forestry, when you talk about obsolescence, when you talk about construction, even when you talk about the overhead, the bookkeeping department – they are idle words unless the individual in his particular sphere of responsibility understands the parameters within which he is expected to operate.

We have covered the five points. Now I’d like to give one man’s opinion of what he sees as he peers into the 1970’s, and as it relates to the forest products industry. This no longer has to do with our 15 companies, because I’m sure you would get 65 different answers, depending on whom you ask. But there were 4 or 5 things that I observed as we roll into the 70’s that we in forest products are going to have to heed.

Number one: I think we, as much as any other industry in America today, are going to characterize the 70’s (when we get to the 80’s and look backward) as a capital-hungry industry. We are going to need more, and not less, dollars. This means that the finance department of each of the companies involved in the forest products industry is going to have to keep you abreast of many things, but there are a couple that are, in my opinion, relatively important. One thing that has a meaning to most of us today, had little or no meaning to us not so long ago. It is called ROI – Return On Investment. There is another thing that is going to become a really critical issue as we look into the 70’s, and that is we are going to ask, “How soon do we get that investment back?” We are going to come to know in good, full, hard, concrete terms what “cash flow” means.

The second observation I would make as it relates to the forest products industry, is that the use for wood fibre, domestically as well as foreign, will see the price of stumpage throughout the entire United States double once again in the 70’s, and it would be my personal guess that the doubling will come closer to the midpoint of the 70’s than it will toward the end of the 70’s.

The third observation as I look out into the 70’s is that the increasing need and cost of capital for forestry as well as
property, plant, and equipment will see the marginal producer in ever-increasing numbers join forces with the integrated producer (I hope, for goodness sakes, there are no Federal Trade men here), to the betterment of the consumer from both a quality point of view and a competitive pricing situation. It's got to come if you sit down and take a look at what the financial facts are. I, for one (I suppose the bankers can give you a much better appraisal of this than I), don't think - despite the fact the stock market went off 18 points today - that you are going to see a return of 4½ or 5 percent interest rates. As a matter of fact, unless you have been fed a lot of poppycock, the entire American economy is going to be characterized as "capital-hungry." If that is true, money still doesn't grow on trees. I think we have that stopped now, according to what I read from Mr. Burns. Inflation is a thing that we are making inroads on, even while the whole nation is going broke.

My fourth observation is that the forest products industry, from a profit point of view, is going to be severely strained in the 70's. and that unless it develops this thing called "strong, responsible management," which delegates this authority throughout the organization with communication working both ways, they are going to have problems.

Finally, despite the somewhat pessimistic outlook (I don't think it's pessimistic), I believe that when we get to the end of the 70's. and were we all to come back in this room, and each of us had to say, "How would I define that ten-year period that I've just been through?" I can't think of a better way to define it than to say as we look backwards, "We just lived through the unbelievable 70's." Now, I don't want to start something like we had in the 60's. That was known as the fantastic 60's, that blew out halfway through. The 70's, in my opinion, are truly going to be unbelievable. They are going to offer a challenge to each of us who has as his livelihood a salary check from a forest products company. I think when we get all through we will account for our stewardship, including that market value of $26 billion that we added up for our 15-division company. If we do the job right, we'll have to be able in the 80's to account for
double the $8 billion we just added to the timber in the 70's. Thank you very much.

QUESTIONS

Professor Yoder. I’d like to exercise a chairman’s prerogative and ask the first question. I recall, Harry, several years ago your telling a group of us that in your financial planning you had received a charge from the chairman of the board or the president (I don’t recall which one), to the effect that you were to arm yourself against the worst possible contingencies that might arise, in other words to weather the storm as we weathered the depression years in the 1930’s. What have you done about that since the time you made the comment?

Mr. Kane. Well, there are a couple of fellows sitting in the room here. I’m going to look them right straight in the eye as I give the answer, because back at the time I made that statement, and I think we all knew it, we were a heavy user of debt. As a matter of fact our debt-equity ratio, if I recall the figure correctly, was 80 percent debt and 20 percent equity. You had to be pretty certain that the planning you were doing was fairly decently and soundly conceived from a financial point of view. It was both Owen Cheatham and Bob Pamplin who held the position you mention. When we make our plan, as nearly as we could determine, the length of time in the 30’s that we were in that so-called depression was 32 months. Therefore, everything that we make in the way of a move in our planning has to span as though we were in the depths of a depression for 32 months. The job has become somewhat easier, because our debt-equity ratio at the present time is about 1 to 1. Our payment schedule in the short term is probably a slight bit heavier than we would like to see it at the present, but therein lies a secret, at least as it relates to our company. We still think we are a good credit risk, since as each day goes by, we free up more of the bank lines. That’s another prediction I forgot to make for all my buddies in the banking field. I am darned certain that money isn’t going to stay tight throughout the
entire ten-year period. I see they are smiling, so they must agree, too.

*Trying to look ten years ahead, do you think there is any real threat to the special advantages, which are crucially important, as you emphasized? Do you think there is any threat of their being reduced or taken away?*

You are referring, Bob, to timber capital gain? I think that the last time they really made inroads into the timber capital gain that applies specifically to the forest products industry was in 1963. At that time, we used the government’s own statistics as a group. We met with the House Ways and Means Committee. My memory is not quite good enough, but I believe that the rate of return with capital gains for growing timber on the West Coast of the United States was about 3 to 3½ percent per annum. Because of the different cycles in the South, whether it’s a pulp or saw cycle, the range on rate of return was something like a minimum of 12 percent and maximum of about 20 percent, both before taxes.

I would think that with each meeting of Congress we are always going to have to sustain the forestry job that we are doing. We are going to have to make certain they understand it. I think we, as an industry, are going to have to do a better job of portraying to the Ways and Means Committee the tremendous costs and the tremendous risks there are in growing a forest, because of what happens in forest products companies. Even in the South there’s an initial period of 15 years of no income, then you bunch the income from the first cutting or thinning on wood pulp. Then as you roll on toward the 35th or 40th or 45th year, depending on what cycle you’re on, you bunch another group. You have to give recognition to that fact, and I believe that when we get all through, we will be able to sustain it. I was sorry to see that we got hung with a preference tax on timber capital gains. I think it’s wrong, and I think that time will prove that basically what will happen is that the acceleration in stumpage value, maybe not so much here on the West Coast of the United States but certainly where private lands are important, is going to increase that much faster to give the fellow the compensation that he requires, net after taxes, not net before taxes.
Harry, I remember when I first came to Oregon State about 15 years ago that there was talk among Eastern bankers shortly thereafter of the unbelievable character of your debt-equity ratio in G-P. I have a couple of investment bankers sitting in front of me. How did you feel during that time and would you explain how you came to the conclusion that you were right?

Well, I joined Georgia-Pacific about seven years after Marion Talmadge, and he was my teacher, and he's a hell of a teacher. But I think that probably it all started in about April or May of 1956. We, as a company, at that time had total assets of about $49 million and they were well divided. $37 million was in equity and $12 million was in debt. In July of that year, we acquired a company that has been part of us ever since, down by Coos Bay. I think the price was $70 million, and as we finished that acquisition we moved up into Northern California in a like sum, I believe around $70-75 million.

We did all of that on the sale of $25 million of convertible debentures that our friends at Blyth helped us with. We ended the year with $200 million worth of assets, and whatever 80 percent of that is, $160 million was in debts and about $40 million was in equity. At least once a day some of the friends that I used to have at Arthur Anderson's would call up and say "Gee, Harry, I understand that you passed an interest payment." Or, "Gosh, I've got it on good authority; the check bounced on the principal payment."

Then of course, we heard from all the people who were investing in the securities because they were listening to the other side, too, and I think it only fair (I am not being critical at all) everybody waited to go to the funeral of Georgia-Pacific, because there was no question it was going to happen. It was maybe a week away or maybe a month, but certainly not more than two years down the road. As the security analysts would come in and ask us, I said, "You know, I think the one thing that gives us the real enthusiasm that the avenue we have chosen is right, is knowing who has the biggest stake in the decision that we just made." These were three banks and two insurance companies. And I said, "I think they like their dollars, too." I said, "All we did was portray our program." We did a lot of the
things that we are talking about right here, about planning. We took the plans to them. They reviewed the cold, hard facts. And back in those days timber wasn’t as liquid as it is today. We took the facts to them and they loaned us the $160 million. I would like to say, “Without any security,” but I’d be lying to you, because there was a time when Marion and I used to have to salute each other as we went through the door, because we weren’t sure that we had everything just exactly right.

As time rolled on — I think the year was actually 1962 — we completely refunded all of the indebtedness. If my memory again serves me correctly, we put on the books $220 million that year in totally unsecured debts. I think the only answer is yes, we had some anxious moments. It is sort of like sitting here today and hearing everybody say, “There are some great buys in the stock market.” Everyone of us agree with that, but we don’t know which one to select. So you have some anxious moments.

Comment by Mr. Keefe. Harry, from a banker’s point of view there is a much more realistic answer than what you have said. In the first place, the assets you were buying were tremendous buys. You bought much more than the public knew about, and even fairly knowledgeable people knew about. You bought at very, very substantial discounts, so that there was a tremendous balance sheet item there that a banker, when he investigated, and went over it with timber people or flew around it in an airplane, could get a handle on. Another thing was that you had done great planning as to your own use of the timber. In other words, it was well located, it was available to your plant, and you were going to provide a cash flow out of your normal operation, which was very important. I think it gets back again to the matter of planning; there was nobody in those days who used to come into the bank with the kind of planning that you exhibited then. There are people today who did it, but at that time it was unique.

What is your policy or attitude toward continued acquisition of timber lands into the 70’s?

Speaking for our company, we will buy any piece of timberland that we believe to be the asset that will give us the profit return. May I state it another way? In 1962, we said we had gotten the last piece of really good timber there was
available. I think it was either the fall of that year or the spring of the next, we found now it’s the last good piece of timber that we will get. Fortunately for us, we have said that a sufficient number of times, to where our ownership has grown from the beginning of the 50’s at 1 million acres to the present level of 4.5 million.

We think that an investment in timber and timberland, properly set up and properly managed, will be every bit as good as to rate of return as the ratio we now enjoy on profit to sale, that is net after taxes. But you have to work at it, because it takes all kinds of ways to put them together. You know every seller has a price, and every piece of property can be purchased, but trying to put them together under today’s tax laws with all the ramifications that you have, trying to put it together in a combination of cash or stock or some other form of security – it is getting to be a lot tougher. I think everybody in the United States today is out to do one thing, to pay just as little as he can to Uncle Sam, and as long as you can keep him (financially at least) thinking that is what he is doing, then we will be able to get some more timberland.

Let me take you back to a period that is not really much unlike the one we are in right now. We tell this story in our own company because we are a little proud of it. There was a time in 1962 when it took the kind of guts we are talking about right now – you know, there are a lot of good buys in the stock market, but I just don’t know which one. We had a chance to acquire the Crossett Lumber Company, which was an exceptionally fine company, both from the standpoint of assets and personnel. We knew that this was in the long-range program for our Company, to insure the continued growth that we wanted to maintain. The day before Memorial Day in 1962 the stock market had its largest volume since 1929, with its greatest drop since then. We have repeated that several times during the last couple of years, but it was a real thing because we met on that day with our banker friends. We had to have $127 million to put the Crossett Lumber Company deal together. They granted us short-term credit.

One of the conditions to get the short-term rolled over into long-term credit was that we had to raise $40 million in
equity between June the first and December the 31st of 1962. I remember the day very well, because our stock fell to its lowest point in modern history. It went down at that time to 29, which on today’s price is probably (adjusting for splits and everything else) the equivalent of about four. We said, “We vote to go forward,” realizing that if you make a wrong decision here, everything you have worked for goes right out the window on December 31st, or shortly thereafter.

We took the gamble; we spent another $20 million in Fordyce, Arkansas. We spent almost $275 million in completely rechanging the Crossett operation. What are the results of the decision? Well, the published figures for the Crossett Lumber Company are history. At their last report, their 1961 sales were $49 million; their profits before taxes were $7.4 million, or after taxes $4.6 million. With the same people, the same assets, a little timber added, facilities that no longer have a sawmill but have plywood plants, pulp and paper plants, chemical plants, and flakeboard, the sales volume has just a little more than doubled. But you don’t bank on sales dollars. What you really bank on is the net profit, and with the completion of the expansion in this year which will be completed in June, the net profit of that operation will be ten times, before taxes, the figure of 1961.

So you know when you hear a guy get up and start telling all about planting and all about other forestry work, all about a debt-equity ratio, all about depreciation, you say, “well what does all that mean?” The concrete example is that planning does pay off, and it pays off really handsomely, far more than anything you can ever envision. But you must have one secret ingredient. Whoever the head honcho of the company is, he must believe in it or it will never work. It is a complete waste of time. We can tell you a lot of stories about that, too.

Well, I hope that after tomorrow’s market all of us connected with the forest products industry can smile. I think we are living in one of the greatest periods of challenge ever, and I think we are going to do really well.
Concluding Remarks

by Professor Ray A. Yoder

AS WE ANNOUNCED to you at the beginning of this Conference, and as you noted on your program, this is a cooperative venture of the Schools of Forestry and of Business & Technology. We would like to have your reactions to it, so we can do this kind of thing better. You recall that in our early discussions we talked about planning and about the feedback involved in planning efforts. We would like to benefit from your reactions to what we have done here so far. If you would like to express yourself as to this kind of meeting of the minds between the two disciplines of forest industry, on one hand, and those people who are in the financial institutions, on the other, we'd be glad to have your comments. We don't want entirely brickbats, but if you would like to voice your opinion as to one particular part of the program, or the whole concept, we would be grateful for it.

I also would like to inform you that this is only one of a series of similar efforts. We have other joint ventures with the Business School that would attract people of the same kind who were here today, and some others that perhaps would be more appropriate for some of your staff people, as for instance the tax planners.

On behalf of the two Schools and on behalf of the University, I would like to express very much their appreciation for the contribution made by the financial houses on one hand and the industry upon the other, in providing us these very fine speakers. My thanks also to you participants. You have endured a lot of long, hard sitting; your questions and comments have been very provocative and very much to the point, and we do appreciate it. Our meeting stands adjourned.