

Book Review for 2/8/04 by Thomas Carnes

Title: "The Number: How the Drive for Quarterly Earnings Corrupted Wall Street and Corporate America"

Author: Alex Berenson

Length: 233 pages, not including notes and index.

Price: \$24.95

Reading rating: 8 (1 = very difficult; 10 = very easy)

Overall rating: 3 (1 = average, 4 = outstanding)

Greed is not good. That is the primary lesson of the collapse of the U.S. stock market bubble over the past four years, a lesson that is illuminated ably in Alex Berenson's "The Number." It was greed, more than anything else, that drove accountants, analysts, bankers, corporate executives, mutual fund managers, and yes, ordinary Americans, to make decisions that pushed stocks to unsustainable levels. Some of those decisions were criminal, many more reflected a lack of ethics - and eventually, it turned out the stock market couldn't feed everyone's greed.

The number that Berenson refers to is the quarterly earnings per share (EPS) that publicly held companies report. It has become the most important number used to judge a firm's quality and future potential. It therefore has the ability to sway millions of dollars in investment decisions. If a firm's EPS is growing and meets experts' predictions, the firm is more likely to attract investors, driving up the stock price. If a firm's EPS is falling - or is not growing as rapidly as experts predicted - the firm's investors may decide to sell the stock and look elsewhere for their rewards, driving down the stock price.

Berenson, an investigative business reporter for the New York Times, provides an entertaining, informative account of how "The Number" became a cult in the 1990s. As he writes, the decade was the perfect storm for investors. Executive pay became linked to stock options, whose worth was dependent upon stock price increases. Analysts who predicted quarterly earnings found their pay linked to the relationship their employers had with corporations, providing incentive to be sunnily optimistic regarding those corporations' prospects. Accountants - generally thought to be the public watchdogs regarding corporate misbehavior - found their paycheck size dependent upon lucrative consulting contracts with the firms they were auditing, removing much of the incentive to police aggressively the claims those firms made regarding their income. And most of us thought by 1999 that the stock market was a place where our money could grow by 20 or 30 percent a year - since it had done so for the last few years - so we didn't want to hear bad news. As long as companies hit earnings targets and the market kept growing, everybody was happy.

But earnings management - ensuring that a company met a quarterly earnings target - became earnings manipulation. Companies lied. Accountants and analysts let them get away with it. The Securities and Exchange Commission let them get away with it. And beginning in March 2000, the bubble burst. Berenson reminds us of the gory results - an

80 percent drop in the NASDAQ index, scandals at Enron and Tyco, examples of earnings manipulation at such companies as IBM and General Electric, a loss of trillions in market value, and a loss of investor confidence. He also questions whether the reforms enacted thus far will be effective in preventing future bubbles.

"The Number" is a valuable book for anyone who is concerned with the stock market - which, of course, is just about all of us. As Andrew Tobias, one of my favorite investment authors, says of the book, ordinary investors will want to read it: " 'So that's what happened to my 401(k),' they will say."

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