

# **Barbarians in the Classroom: The Case of RJR Nabisco**

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## ***ABSTRACT***

*This paper describes how the wide variety of a teaching materials, including a Harvard Business School case, best-selling book, full length motion picture, and articles in the popular press related to the takeover battle for RJR Nabisco can be integrated into a financial management course to provide students with a multidisciplinary (and multimedia) perspective on one of the largest leveraged buyouts in history.*

## **INTRODUCTION**

Teaching finance and other business disciplines poses the continuous challenge of linking the wide variety of theories, conceptual models, and analytical techniques to actual practice in the “real world.” Many students lack the organizational frame of reference needed to understand and appreciate the relevance and context within which the subject matter applies.

To help students place and finance in its corporate contexts and gain situational problem formulation skills, many instructors use the case method, either to supplement lectures or as the basis for a separate course devoted entirely to cases. The benefits of the case method as a pedagogical tool have been described by Banning (2003), Barnes, Christensen, and Hansen (1994), Merry (1967), Roulac (1975), Simon (1979), Springate (1974), Trahan (1993) and numerous others. Cases help students develop skills in problem identification, situational analysis, evaluation of alternatives, and decision-making in ways that simply cannot result from the lecture method of instruction.

Students find cases to be an enjoyable, change-of-pace experience. They perceive cases as providing more “real world” approach to understanding and applying the concepts, models, and theories of finance.

The purpose of this paper is to describe a multifaceted approach to teaching one particular case study that can significantly enhance an advanced course in corporate finance or mergers and acquisitions -- the leveraged buyout of RJR Nabisco. The battle for ownership of RJR Nabisco occurred in 1988. It involved a highly-publicized bidding contest between members of RJR Nabisco management and the investment banking firm of Shearson Lehman Hutton (Management Group) and the leveraged buyout firm Kohlberg, Kravis, Roberts & Co. (KKR).

This particular case study provides an excellent teaching opportunity for several reasons:

- (1) The leveraged buyout of RJR Nabisco, with a purchase price of about \$25 billion, it is still one of the largest leveraged buyouts ever.
- (2) There are a variety of teaching materials that make the battle for control of

RJR Nabisco an excellent case study that can be taught in a variety of ways from a variety of perspectives. These include a Harvard Business School case, RJR Nabisco (289-056), a best-selling book chronicling the company and bidding contest, Barbarians at the Gate: The Fall of RJR Nabisco by Bryan Burrough and John Helyar (1991), a movie, *Barbarians at the Gate* (1993), and numerous articles written in the popular press during and after this widely-followed and buyout. With these materials, students can follow the case from beginning to end and see it all turned out. Students can learn about the history of RJ Reynolds Tobacco Company from its inception in 1875, to its numerous food company acquisitions in the 1970's and 1980s, its acquisition of Nabisco Brands, Inc. in 1985, the historical takeover battle in 1988, the junk bond crisis in 1990, the law suits of the 1990's, the Master Settlement Agreement in 1998, the sale of KKR's last shares in 1995, and returning full circle to its present day status as an independent tobacco company.

(3) It involves a combination of colorful personalities, power, greed, ethics, and egos – a combination guaranteed to capture the interest of business and finance students.

The remainder of this paper describes how this case study is integrated into the Cases in Corporate Finance course at Washington and Lee University (W&L) and previously at Bucknell University.

## **COURSE STRUCTURE**

Cases in Corporate Finance is offered each fall at W&L as an undergraduate elective for seniors who have completed the basic course in managerial finance. The case book used in the course is Case Problems in Finance by Kester, Ruback and Tufano (2005) which in its twelfth edition is a widely-used compilation of Harvard Business School cases. The case book is supplemented by Higgins' Analysis for Financial Management and various other selected readings are assigned throughout the course.<sup>1</sup>

In general, one case is covered during each 90-minute class period. Students are encouraged to form and use study groups to review and discuss assigned cases prior to class. They are encouraged to attend class by requiring that, for any class missed, they must submit a written analysis of the assigned case.

Twenty-five percent of each student's grade is based upon classroom participation. This is a challenge for many students who, as undergraduates, have been conditioned to be passive listeners in more traditional textbook/lecture environments. Their general reluctance to speak in class is compounded by the unstructured nature of cases. However, as the course progresses, students become more comfortable and willing to participate in classroom discussions.

During the first half of the course, I lead discussions of cases involving company valuation, capital structure policy and financing decisions, mergers and acquisitions, and leveraged buyouts.

During the second half of the course, advanced multiple-issue cases, are presented by three or four person student groups. A typical example is Friendly Cards, Inc., a comprehensive case that involves three major decisions: (1) whether to purchase new equipment for in-house production of envelopes, (2) whether to acquire another greeting card company, and (3) whether to issue new common stock. The presenting groups are asked to assume the role of a highly-paid consultant who has been retained by

management to make recommendations regarding the decisions posed in the case. They are asked to prepare a written analysis for presentation to the class. Copies of their written report, which is typically about ten or so typewritten pages plus exhibits, are submitted and distributed to the other students in the class during the class meeting prior to the scheduled presentation. Students not involved in presenting a given case are asked to assume the role of management (the client) and read the case along with the group's written report. They are asked to submit a written critique of the presenting group's report, commenting upon the quality of the group's analysis and whether they, as management, agree with the recommendations. They are also asked to recommend a grade for the written report.

The presentations are scheduled once a week, alternating with cases taught by me. Each group takes about 30 minutes to present its report. At the end of the presentation, other members of the class ask questions and challenge the assumptions, analysis, and recommendations of the presenting group. These exchanges can be quite lively due to the fact that the non-presenting students' preparation of the presented case included a written critique of the group's written report.

A video (DVD) is made of the presentation. Once the group report and related critiques have been evaluated and graded, I hold a "debriefing" meeting with the presenting group to discuss its written report and oral presentation. At the beginning of the meeting, the group views the DVD of its oral presentation. In preparation for this meeting, I compile a list of student comments from the critiques. I share this information, along with the distribution of the recommended grades, with the presenting group and announce the final grade for the group project. The final grade may or may not be consistent with the grades recommended by the members of the class. Grading is not democratic.<sup>2</sup>

Thirty percent of each student's grade is based on his or her group's grade on the group report/presentation, with each member of the group receiving the same grade. Thirty-percent of each student's grade is based upon the grades received on the critiques. The remaining 15 percent is based upon a "reaction paper" to the book Barbarians at the Gate: The Fall of RJR Nabisco. The integration of these assignments, along with the related HBS case, movie, and other readings, is described in the remainder of this paper.

### **The RJR Nabisco Case Study**

One of the cases assigned to a student group is RJR Nabisco, a case that focuses upon the 1988 bidding contest and related valuations by the Management Group and KKR. The primary objective of the case is to estimate the value of company under different operating strategies. Whereas the Management group's strategy was to sell the company's food businesses and retain its tobacco business, KKR's strategy was to retain the tobacco business as well a many of the food businesses.

The student group presents an overview of RJR Nabisco, discusses the reasons that the company is a good LBO candidates (low debt, potential reductions in overhead expenses, and sale of assets) and its valuations of the company under the different operating strategies. I also ask the group to bring the class up-to-date with what has happened to the company in the years subsequent to the LBO. The latter update provides student with insight into the risks associated with LBOs and how the buyout of RJR Nabisco turned out for KKR's investors and the other stakeholders of the company.

### **Barbarians at the Gate: The Fall of RJR Nabisco**

An excellent history of RJR Nabisco that culminates with the takeover battle for the company is the best selling book Barbarians at the Gate: The Fall of RJR Nabisco by Wall Street Journal reporters Bryan Burrough and John Helyar. Reading like a novel, the book chronicles the events, personalities, greed and egos of the executives, lawyers and investment bankers who were drawn into the takeover battle.

At the beginning of the course, students are asked to read the book and write a reaction paper on any related topic they like. Over the years, the papers have covered a wide spectrum topics, often quite introspective. Students are fascinated with the lavish lifestyle, fraternal mentality, and motivation of F. Ross Johnson, RJR Nabisco's CEO, and the shrewdness and motivation of KKR's Henry Kravis. Their reactions to Johnson and Kravis range from repulsion to attraction. For some students, the book reinforces their desire to pursue careers in investment banking. For others, the book causes them to second guess their career plans and goals.

Some of the more memorable quotes from their papers in recent years provide insight into their topics and reactions to the events and personalities colorfully described in the book:

“After I finished reading this book, I was appalled that so many high-powered members of large corporations and Wall Street businessmen sacrificed honor and integrity by letting their greed and large egos dominate their decision-making process. I came away with the feeling that in order to achieve their level of success, an individual needs to act selfishly, focusing on strategies that only benefit them, while simultaneously attempting to hurt competitors.”

“I think Barbarians at the Gate is one of the most interesting and fascinating books I have ever read. Even though the world of corporate finance is filled with unethical and immoral executives, I look forward to being a part of that world after I graduate for a number of other reasons. I enjoyed reading about the competitive workplace, the ambitions of individuals, and the lavish lifestyles some of the characters lived. One of the least appealing aspects of the book and of that world is the presence of greed and ostentatious egos. I believe that these two things drove the LBO of RJR Nabisco and the eventual termination of Ross Johnson and his cronies. Almost every individual involved in this deal lost in the end. Ross Johnson was out of the job he loved and all the amenities that came with it, and Henry Kravis had a company with too much debt for which he paid too much to get. These two individuals allowed minor disputes to sour what could have been a sweet deal for the both of them and the shareholders of the company. They let their egos cloud their business acumen, which caused bad results for almost everyone involved.”

“The Wall Street ‘masters of the universe’ allowed their greed and egos to prevent any real winner from emerging from the transaction.”

“Competitive businessmen spent months vying for a company they did not understand, and they did not know its future cash flows. The frenzy of all night meetings and valuations seemed to boil down to who wins. The story was not who gets the most money. The story was who receives the power.”

“As a woman on the brink of entering the corporate world, I was both disheartened and motivated after reading Barbarians at the Gate. The banking industry is a historically male-dominated one in which women in the past have struggled to climb the corporate hierarchy and earn senior executive positions. After all, to survive in such a competitive, fast-paced environment, demanding environment, one must have the stamina, ego, and competitive drive that only men have -- right? I can envision Ross Johnson explaining to his wife Laurie in an unintentionally condescending tone that she just wouldn't be interested in pursuing this type of work. While I believe it does require a certain cluster of characteristics to become successful in the corporate world, I do not think that those traits are inherent strictly to males. However, the book portrays aspects of both the business and social life of Ross Johnson that imply that the corporate world is nothing but one great big fraternity.”

“The unending thirst for power makes Wall Street an incredibly unappealing place to work. Even when successful bankers have more money than they know what to do with, their greed will not allow them to quit because they are constantly compared with their peers. Money simply becomes a way to keep score, just like Monopoly. What strikes me about Barbarians the Gate is – are any of them happy? I do not know. I know I would be miserable. Living on little sleep and teetering personal relationships is a high price to pay for the Wall Street prestige.”

“The book has all of the characteristics of a great movie – dynamic characters, intense rivalries, greed, and a gut-wrenching scene in which characters race through midtown Manhattan to turn in a proposal.”

“Though Johnson was a master at navigating this minefield of corporate politics and manipulating situations in his favor, he cost a lot of people their jobs in the process. At the end of the day, he got rich, but his leadership style raises many ethical questions. He was undeniably an effective leader, but I would argue that he was not a ‘good’ leader because he did not look after the best interest of his employees or the stakeholders of his company. Though many of them profited in the end, it was largely a coincidence, because Johnson’s priority was looking after himself.”

“Throughout the deal, the men’s egos played a crucial role. The raising of bids, the leaking of information to the press, and the partnering with other firms were all influenced by egos. The bids were fueled by

egos and the desire to win the bidding process. Valuation models seemed to be irrelevant as competing investment groups were forced to raise their bids to stay in the competition.”

“While society has come a long way, there remains a clear difference between what is acceptable work behavior of men and that of women. As a female, I cannot be a Ross Johnson. A female version of Ross Johnson would be considered an alcoholic bitch who never would have shared his success. It is inappropriate for females to take co-workers out drinking all night or to describe executives’ presentations as ‘a blinding glimpse of the obvious.’” A woman resembling Ross Johnson would be disliked by all and most likely stripped of the chance to climb the corporate ladder, especially in the male-dominated world of finance. While we have evolved and women are encouraged to join the workforce, a new challenge has arisen. If a man reaches success by running a company like it is a fraternity and creating a ‘boys town,’ and this is unacceptable for women, just how are women supposed to match that success? Where is the line between aggressive confident women and a complete bitch? How are women supposed to assertively make their abilities known without coming across as terrible people that are hard to work with?”

As reflected in these comments, Barbarians at the Gate: The Fall of RJR Nabisco provides an opportunity for students to gain insights into mergers and acquisitions, investment banking, business ethics, and corporate responsibility that goes beyond theories, models, spreadsheets and numbers.

On the day the papers are due, I ask each student to spend a few minutes summarizing their papers and reaction to the book. The informal discussion that ensues is quite interesting and often rather lively.

### **The Movie**

At the end of the course, we watch the movie, *Barbarians at the Gate*. Prior to the movie, I assign a variety of thought-provoking readings prior to the movie, including commentaries on LBO’s and the takeover battle for RJR Nabisco (“Leveraged Rip-off,” “Barbarians at the Trough,” “Ski Lift Tiff,” “The Mystery of the Disappearing Employees,” and “Mr. Wall Street Goes to Washington”) written by Michael Lewis in his book The Money Culture, excerpts from George Anders’ book Merchants of Debt: KKR and the Mortgaging of American Business, and Elizabeth Lesly’s (1995) epilogue to the takeover battle (“Barbarians Revisited”).

The movie, produced by HBO, stars James Garner as F. Ross Johnson, Jonathan Pryce as Henry Kravis, Fred Thompson as James Robinson, CEO of American Express, and Peter Riegert as Peter Cohen, CEO of Shearson Lehman Hutton. Available on DVD, the movie provides an entertaining depiction of the takeover battle for the company. Nofsinger (1995) and Peterson and Philpot (1997) have described how *Barbarians at the Gate* can be effectively used to prompt discussions of issues related to valuation, ethics, agency theory, and social responsibility.

One might ask whether Hollywood movies are an appropriate use of class time in

a finance course (a question even posed by my own department head!). It can be argued that students, especially undergraduate students, do not have the experience and organizational context within which to place much of what is learned in the classroom. This would especially seem to be the case when studying the events, negotiations, egos, and greed surrounding corporate takeovers. As pointed out by Serey (1992), movies can bring situations and people to life in ways that cases, text books and lectures cannot. Whether fictional (such as *Wall Street*, *Boiler Room*, *Other People's Money*, and *Trading Places*) or based upon actual events (such as *Barbarians at the Gate*, *Rogue Trader*, and *Enron: The Smartest Guy in the Room*), movies capture students' attention, provoke thought, and stimulate discussion. The use of the movie *Wall Street* as an excellent "live case" and springboard for classroom discussion of legal and ethical issues in finance has been described by Dyl (1991) and Beldon (1992). Similarly, Hatfield and Buchko (2008) discuss how the academy-award winning documentary, *Enron: The Smartest Guys in the Room*, can be used to enhance discussions of financial and ethical issues related to this well known story of fraud and bankruptcy. Chan, Weber and Johnson (1995) and Graham and Kocher (1995) describe how *Other People's Money* can be used effectively as case study in corporate restructuring, business ethics, social responsibilities of the firm, free enterprise, and gender stereotypes. In fact, *Other People's Money* is also shown the Cases in Corporate Finance course at W&L as part of a sequence of classes on business ethics. After the movie is shown, a discussion focusing upon the "post movie" questions suggested by Graham and Kocher (1995) is led by a guest speaker who also teaches W&L's Business Ethics course.

The use of *Barbarians at the Gate* to bring the takeover battle of RJR Nabisco alive is appreciated by students and an entertaining way to end the course. They have invested a significant amount of time and effort preparing the RJR Nabisco case, reading *Barbarians at the Gate: The Fall of RJR Nabisco*, and writing, presenting and discussing their reaction papers. The movie nicely brings to life the personalities and events in a memorable and visual way and in my view is an excellent use of class time in an otherwise intensive case course in corporate finance.

## STUDENT EVALUATION

To evaluate the students' perceptions the RJR Nabisco case study and related book, movies and readings, I ask them to complete a questionnaire similar to the ones used by Nofsinger (1995) and Belden (1992). In the questionnaire, students are asked to indicate their level of agreement with nine closed-end statements based upon a five-point scale ranging from 1 for strongly disagree to 5 for strongly agree. Table 1 contains summary statistics of the responses to the closed-end statements (identified later by "S") of the 20 students who took the course and completed the questionnaire during Fall 2007.

Students thought the time spent reading and writing the reaction paper (S1, rating of 4.55) and discussing the book was well spent (S2, rating of 4.65). They also thought that watching the movie was time well spent (S3, rating of 4.53), a rating that was similar to the 4.45 based on the same question and scale reported by Nofsinger (1995). They also agreed that the book (S4, rating of 4.65) and other readings (S5, rating of 4.40) provided valuable background. They disagreed with the statement that Hollywood movies are not an effective use of class time (S9, rating of 1.50) and the statement that

the film and readings failed to bring the financial issues into a real world setting (S6, rating of 1.35). The latter result is similar to the rating of 1.60 reported for the same question by Nofsinger (1995).

Although one student strongly disagreed with (or misread) S7, the students strongly agreed that it is appropriate to discuss ethical issues in business (rating of 4.70). This rating is similar to the 4.55 reported by Nofsinger (1995) and 4.37 reported by Belden (1992).

Overall, students agreed that the time spent on the book, other readings, and film were helpful in learning the topics of the course (S8, rating of 4.60). This conclusion is reinforced by the comments students made on the questionnaire, which are listed in the Appendix.

## **SUMMARY**

This paper has described how the wide variety of a teaching materials, including a Harvard Business School case, best-selling book, full length motion picture, and articles in the popular press related to the takeover battle for RJR Nabisco is integrated into a upper level case course in corporate finance to provide students with a multidisciplinary perspective on one of the largest leveraged buyouts in history. Based upon my experience, the buyout of RJR Nabisco provides an excellent opportunity to go beyond the numbers and spreadsheets to consider the wide variety of questions and issues related to mergers and acquisitions, investment banking, and corporate responsibility. Over the years, student feedback regarding these teaching materials and learning experiences has been quite positive -- leading me to write this paper.

## **ENDNOTES**

<sup>1</sup> A copy of the course syllabus for Cases in Courses in Finance is available upon request.

<sup>2</sup> See Kester (1989) for a more detailed discussion of the benefits and limitations of this group project approach to teaching cases.

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**Table 1. Student Responses to Questionnaire**

	<u>Number of Responses</u>					<u>Average</u>
	Strongly Disagree				Strongly Agree	
	1	2	3	4	5	
1. The time you spent reading and writing your reaction paper to <u>Barbarians at the Gate</u> was well spent.	0	0	1	7	12	4.55
2. Class time discussing the book <u>Barbarians at the Gate</u> was well spent.	0	0	0	7	13	4.65
3. Class time watching the film was well spent.*	0	1	1	4	13	4.53
4. The book provided valuable background information for the group presentation of the RJR Nabisco case.	0	0	1	5	14	4.65
5. The other readings provided valuable background information and insights.	0	0	2	8	10	4.40
6. The film and readings failed to bring financial issues into a real world setting.	13	7	0	0	0	1.35
7. It is appropriate to discuss ethical issues in business.	1	0	0	2	17	4.70
8. The time you spent on the book, other readings and film were helpful in learning the topics of this course.	0	0	1	6	13	4.60
9. Hollywood movies are not an effective use of class time in an upper-level finance course.	12	7	1	0	0	1.50

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\* One student did not attend the class during which the movie was shown.

## Appendix. Student Comments on Questionnaire

“Great book, movie and discussions. I think it is still relevant (what happened in Barbarians) because recent companies have demonstrated the same greed.”

“I thought the case really brought home the real-life consequences of financial and business decisions, especially their effect on the employees and communities that interact with a company as well as its shareholders.”

“The film does a good job of allowing you to visualize what you have read in the book. Both are relevant to understanding how big business works.”

“Reading the book is learning history, which is never a bad thing.”

“The movie was a good way to tie all of the materials together at the end of the course.”

“The movie put faces to names and events. It was an interesting way to end the class and a nice reward.”

“Loved tying in the movie with the book and discussion.”

“I thoroughly enjoyed the reading materials and movie that focused on the RJR Nabisco deal. Definitely brought the topics of the course into a real-world perspective.”

“Really enjoyed the topic, especially the book.”

“Reading the book and watching the movie were both informative and interesting.”

“I enjoyed the book and the movie. I found it interesting how F. Ross Johnson was portrayed in each. I found him much more likeable in the film than in the book. Also, the film portrayed Henry Kravis as somewhat an evil figure. Whether this is fair or not is up to the viewer/reader. Overall, great book, it helped me understand LBO's better and what goes into them. I wish it had focused a little more on the negative consequences of LBO's, such as layoffs.”

“I think Barbarians at Gate puts this course into perspective. Next year, many of us will be working for banks, so I believe that it is important to examine financial issues from an ethical standpoint.”

“Great learning experience. The book provides useful and interesting insights into the world of Wall Street and corporate takeovers. I think studying the RJR Nabisco takeover is a great way to bring the real world into the classroom.”

“I found the supplemental readings especially helpful. It was good to see what happened after the deal. Allowed students to get an entire framework for an LBO. Wall Street is a

very different world than academic [finance] and students need to understand that, especially those thinking about careers in finance.”

“Barbarians helped explain a lot about how competing firms act during their competition for different transactions. Also, it explains the whole financial world in general, which is great for individuals who are interested in going into finance.”

“I enjoyed the time spent on Barbarians the most. This class in general was exceptional.”

“Great course and topics. I learned a lot more than I realized the end. RJR Nabisco was a good way to bring together the entire course.”