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Management Insights

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CEO Ability, Pay, and Firm Performance (p. 1633)
Yuk Ying Chang, Sudipto Dasgupta, Gilles Hilary

Recent outcries over seemingly exorbitant CEO compensation in the face of poor company performance have given rise to the question: Does CEO pay accurately reflect CEO ability? If so, does the CEO make a difference to company performance? Examining CEO departures over the decade from 1992 to 2002, the authors find that CEO pay does reflect CEO ability when one considers the market for CEOs. The departing CEO's subsequent labor market success is greater if the firm's predeparture performance is better, the prior pay is higher, and the stock market's reaction is more negative on the departed company's stock price. CEOs can often earn comparably in the market with subsequent employment, but that does not imply that the CEO salary is worth the cost to the company. Do CEOs really matter to firm profitability? The authors find that the stock price reaction upon CEO departure is negatively related to the firm's prior performance and to the CEO's prior pay, indicating that the CEO really matters. Collectively, the authors' results reject the view that differences in firm performance stem entirely from non-CEO factors such as the firm's assets, other employees, or "luck," and that CEO pay is unrelated to the CEO's contribution to firm value. The insight for management: The CEO's pay is often justifiable with respect to the market for CEOs and when the CEO's influence on company performance is considered.

Predicting the Next Big Thing: Success as a Signal of Poor Judgment (p. 1653)
Jerker Denrell, Christina Fang

It's been said that it's better to be lucky than to be good. Is that the case with stock prognosticators who have correctly made a long-shot stock prediction? Certainly, successfully predicting that a stock will become a big hit seems impressive. Managers and entrepreneurs who have made successful predictions and have invested money on this basis are promoted, become rich, and may end up on the cover of business magazines. In both lab experiments and field data on professional forecasts from the *Wall Street Journal* Survey of Economic Forecasts, the authors show that an accurate prediction about such an extreme and unlikely event may in fact be an indication of poor rather than good forecasting ability. The insight for management: Pay for a sound approach, not for results. Bide your time before promoting superstar stock pickers—their performance may not be indicative of their ability and may not be sustainable.

Capacity Sizing Under Parameter Uncertainty: Safety Staffing Principles Revisited (p. 1668)
Achal Bassamboo, Ramandeep S. Randhawa, Assaf Zeevi

How many live telephone operators should be scheduled to provide high-quality service at a low cost? The long-held "square-root rule" suggests that it is best to staff for the mean call volume and duration, plus a factor of the square root of their ratio to cover for the stochastic variability of call arrival patterns and call durations. However, the square-root rule assumes that the mean call volume and duration are known; the authors consider the case in which the mean arrival rate of work is random. The authors establish a simple and intuitive relationship between the incoming load and the extent of uncertainty in arrival rates that characterizes the extent to which mean uncertainty dominates stochastic variability or vice versa. The insight for management: The "square-root rule" accommodates random variation around a known mean, but, in the case of highly uncertain mean call volume and duration projections, new rules must be adopted to achieve high-quality service at low cost.

An Experimental Test of Advice and Social Learning (p. 1687)
Boğaçhan Çelen, Shachar Kariv, Andrew Schotter

Do actions really speak louder than words? "Social learning" describes any situation in which individuals learn by observing the behavior of others. In the real world, however, individuals learn not just by observing the actions of others but also by seeking advice. The authors conduct experiments so that both pieces of information—action and advice—are equally informative. Despite the informational equivalence of advice and actions, the authors find that subjects in a laboratory social-learning situation appear to be more willing to follow the advice given to them by their predecessor than to copy their action and that the presence of advice increases subjects' welfare. The insight for management: Words of advice might carry more weight among trainees than providing a good example.

Seller Search and Market Outcomes in Online Auctions (p. 1702)
Jason Kuruzovich, Siva Viswanathan, Ritu Agarwal

It has become widely accepted that information technology (IT) has had a profound influence on market transactions, with lower search costs for buyers often considered the key to lower prices and higher consumer welfare. But is the reverse true? Sellers also use online channels to search for buyers whose product preferences and valuations match the sellers' offerings. The authors tracked thousands of experienced sellers in tens of thousands of online auctions for used vehicles. They find that the mean price and price dispersion, duration of search, and search on other websites are each associated with a higher final sale price. The insight for management: Sustained seller effort in finding the right buyer can pay off with a higher sales price.

Culture Clash: The Costs and Benefits of Homogeneity (p. 1718)
Eric Van den Steen

The merger of two dissimilar companies can result in "culture clash" and disharmonious, counterproductive behavior between the two merged firms. The author develops an economic theory of the costs and benefits of a homogeneous corporate culture in the sense of shared beliefs and values. The author's analysis confirms that harmony among merged companies can create efficiency; shared beliefs lead to more delegation, less monitoring, higher satisfaction, higher motivation, faster coordination, less time in internal negotiations, and more communication—in short, a smooth merger due to shared beliefs. However, a merger of like firms can lead to less experimentation and less information collection. In the long run this could lead to a reduced ability to evolve and change with the environment. The insight for management: Culture clash may be costly and frustrating in the short run but, carefully managed, can allow the organization to avoid the pitfalls of "group think," making it better able to critically evaluate the business environment from multiple perspectives.

The Competitive Consequences of Using a Category Captain (p. 1739)
Upender Subramanian, Jagmohan S. Raju, Sanjay K. Dhar, Yusong Wang

Should Kellogg's determine grocer shelf design and display for Post and General Mills? Many retailers designate one national brand manufacturer in each product category as a "category captain" to help manage the entire category. The authors examine when and why a retailer may engage one manufacturer exclusively to provide such service. They find that service that expands the category is more effective in increasing the category captain's sales and margin than service that shifts demand from a rival's brand. Because of this, a category captain might be motivated to provide a service that benefits all brands in the category even though doing so is more costly. In categories that are less price competitive, the authors find higher competition between manufacturers to become the category captain, and, consequently, a retailer may obtain better service by using a category captain exclusively than by engaging both manufacturers simultaneously. The insight for management: Despite concerns regarding category captain opportunism, a retailer may rely exclusively on one manufacturer with limited empirical evidence of harm to rival manufacturers.

Mechanism Design for "Free" but "No Free Disposal" Services: The Economics of Personalization Under Privacy Concerns (p. 1766)
Ramnath K. Chellappa, Shivendu Shivendu

It might seem ideal to receive a coupon for cereal on your smart phone as you walk down the cereal aisle. Or is it? It might be discomforting to a shopper that someone, somewhere, is tracking their movements. Similarly, is it helpful to receive a discount for a weight loss program just after sending an e-mail about exercise? Despite the convenience and timeliness, consumers do not always prefer more services to fewer if personalization might jeopardize their privacy. How much information is a consumer willing to provide to get augmented service? The authors examine vendor strategies in a market where consumers have mixed concerns about privacy. First, they find that a vendor offering a fixed level of personalization does not cover the market. Second, under a fixed services offering, the vendor serves the same market with or without couponing. When the vendor can offer coupons that vary according to personalization levels, when the value of that personal information is high, higher-value coupons should be offered; conversely, the vendor will not offer coupons when the value of information is low. The insight for management: Offering variable services and coupons helps to better serve consumers who opt in and will more fully serve a market of consumers with varying privacy concerns if the value of incremental information justifies the cost of the incremental discounts or service.

Investor Inattention and the Market Reaction to Merger Announcements (p. 1781)
Henock Louis, Amy Sun

Can an investor follow every earnings announcement of companies in which stock is held? No, it is well known that investors cannot reasonably keep up with every event occurring in their stock holdings. But one would think that large corporate events such as mergers and acquisitions would always attract investor attention. The authors find evidence indicating that inattention affects investors' information processing even in the context of merger announcements. They find further that the market reaction to Friday stock swap announcements is muted; there results lower abnormal trading volumes and less-pronounced abnormal stock returns. The insight for management: To encourage spikes in trading levels and price swings on the news of a merger, avoid Friday announcements; conversely, for less dramatic swings, announce on a Friday.

Expectation and Chance-Constrained Models and Algorithms for Insuring Critical Paths (p. 1794)
Siqian Shen, J. Cole Smith, Shabbir Ahmed

Managing the critical path to an on-time completion date is essential to effective project management. If the cost of failure is high and many of the uncertainties in the project are outside the planner's control, is there a cost-effective way to protect the project from this uncertainty? Which tasks should be bolstered with "insurance" resources, and how much buffering is appropriate? The authors analyze a problem in which task finishing times are uncertain but can be insured beforehand to mitigate potential delays. A decision maker must trade off costs incurred in insuring arcs with expected penalties associated with late project completion times. The authors show for a number of different late penalty functions that their optimization approach can be quickly solved. The insight for management: Optimization techniques can help determine optimal strategies for hedging against late project completion.

Capturing Consumption Flexibility in Assortment Choice from Scanner Panel Data (p. 1815)
Liang Guo

If a consumer bought blueberry yogurt last week, are they more or less likely to buy strawberry yogurt this week? The author develops and estimates a model to empirically identify consumption flexibility across similar choices in a product category and across time. The author allows for a consumer's consumption utility to be dependent on recent purchases. Moreover, consumers' purchase and consumption decisions are modeled at two distinctive and sequentially related stages, which allows for incorporating the effect of consumption flexibility. The author finds that recent purchases in the same category do affect subsequent purchase decisions. The insight for management: Effective cross-product promotions (such as coupons at checkout) should consider the complementarity and substitutability of recent purchases in the same category.

Nested Simulation in Portfolio Risk Measurement (p. 1833)
Michael B. Gordy, Sandeep Juneja

In finance, risk is assessed and purchase decisions are made. As events unfold, the portfolio assets valuations are realized and risk is reassessed for future periods. Research in this area is based on "nested simulation," but practitioners may perceive the computational burden of such nested schemes to be unacceptable and adopt a variety of second-best pricing techniques to avoid the inner simulation. The authors question whether such shortcuts are necessary. They show that a relatively small number of trials can yield accurate estimates and minimize the mean square error of the resultant risk estimate with little computational effort. The insight for management: Better risk and valuation estimates are within reach with reasonable computational effort.

Open Platform Strategies and Innovation: Granting Access vs. Devolving Control (p. 1849)
Kevin Boudreau

Whether or not to open a new technology is one of the most crucial decisions an innovator will face. One approach is to grant access to a platform and thereby open up markets for complementary components around the platform. Another approach is to give up control over the platform itself. Opening has the potential to build momentum behind a technology but could leave its creator with little control or ability to appropriate value. The author studies these two fundamentally distinct approaches to opening a technology platform and their different impacts on innovation. Based on data on 21 handheld computing systems between 1990 and 2004, the author finds that granting greater levels of access to independent hardware developer firms produces up to a fivefold acceleration in the rate of new handheld device development, but the marginal effect of relinquishing control of the platform adds only 20% to the rate of innovation. The insight for management: Open access to a technology platform has a big effect on innovation; however, relinquishing control results in a relatively small marginal increase in innovation.