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Management Insights

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Quantifying Managerial Ability: A New Measure and Validity Tests (p. 1229)

[Peter Demerjian](#), [Baruch Lev](#), [Sarah McVay](#)

How good is your manager? These authors suggest that it comes down to the ability to generate revenues. They find that revenue generation from all sources is strongly associated with the stock price movement. Stock reaction to chief executive officer (CEO) turnovers is positive when we assess the outgoing CEO as having low ability, and replacing CEOs with more able CEOs is associated with improvements in subsequent firm performance. The authors find that the negative relation between equity financing and future abnormal returns documented in prior research is mitigated by managerial ability; more able managers appear to utilize equity issuance proceeds more effectively. The insight for management: There are many possible measures of managerial talent; perhaps the most significant one is the ability to generate revenues.

Public Opinion and Executive Compensation (p. 1249)

[Camelia M. Kuhnen](#), [Alexandra Niessen](#)

Can public opinion sway boards' decisions on CEO compensation? The authors investigate whether public opinion influences the level and structure of executive compensation. During 1992–2008, the negativity of press coverage of CEO pay varied significantly, with stock options being the most criticized pay component. The authors find that, after more negative press coverage of CEO pay, firms reduce option grants and increase less contentious types of pay such as salary, although overall compensation does not change. They find that the reduction in option pay after increased press negativity is more pronounced when firms, CEOs, and boards have stronger reputation concerns. The insight for management: Public opinion matters; firms' CEO pay seems to respond to press coverage, at least in structure if not in total compensation.

On Fair Routing from Emergency Departments to Hospital Wards: QED Queues with Heterogeneous Servers (p. 1273)

[Avishai Mandelbaum](#), [Petar Momčilović](#),
[Yulia Tseytlin](#)

Although a hospital emergency room may take care of triage in record time, the interface between an emergency department and internal wards is often a hospital's bottleneck. How can this interface be better managed? The authors introduce a "randomized most-idle" (RMI) routing policy and analyze it in the quality- and efficiency-driven regime. The RMI policy results in the same fairness in work levels as the "longest-idle-first" policy, which is commonly used in call centers and is considered fair. The advantage of RMI is that it does not require detailed information on the wards that is not typically available in real time in the emergency room to be used. The insight for management: Good results with less information can be achieved with new patient routing heuristics.

Network Progeny? Prefounding Social Ties and the Success of New Entrants (p. 1292)

[Peter W. Roberts](#), [Adina D. Sterling](#)

It's who you know! These authors find that entrepreneurs who were employed by successful industry incumbents prior to founding tend to confer advantages on their new organizations. They propose and then demonstrate a "network progeny" effect rooted in the social relationships that form among entrepreneurs. Analyzing data on new entrants into the Ontario wine industry shows that prefounding friendship ties of the founders of one especially prominent entrepreneurial firm led to significantly higher ice wine prices. This attests to the promise of a network progeny extension of the parent-progeny account of new firm success. Follow-on analysis indicates that this effect is not attributable to an entrant's ability to make ice wines of superior quality or to the entrant's having access to better distribution knowledge. The insight for management: Market entrants connected

with social ties to a prominent entrepreneurial firm can enhance the valuations and prices.

Streaks in Earnings Surprises and the Cross-Section of Stock Returns (p. 1305)

Roger K. Loh, Mitch Warachka

Do investors fall in love with successful stocks? The gambler's fallacy predicts that trends bias investor expectations. Consistent with this prediction, the authors find that investors underreact to streaks of consecutive earnings surprises with the same sign. When the most recent earnings surprise extends a streak, post-earnings-announcement drift is strong and significant. In contrast, the drift is negligible after the termination of a streak. Indeed, streaks explain about half of the post-earnings-announcement drift in the data that the authors examined. The insight for management: The gambler's fallacy has empirical support; post-earnings-announcement drift has a significant time-series component.

Information Environment and Equity Risk Premium Volatility Around the World (p. 1322)

Sie Ting Lau, Lilian Ng, Bohui Zhang

How do factors such as a country's information disclosure, accounting standards, and financial transparency relate to cross-country differences in the market risk premium volatility? Using time variation in risk premiums for 41 developed and emerging markets, the authors find that countries with better information environments tend to experience a lower risk premium volatility. They analyze two major events, the 1997 Asian financial crisis and the 2008 global financial crisis, and find evidence that information environments play an important role in explaining market risk premium variability. The insight for management: Financial transparency has benefits; it allows for lower risk premium volatility.

Efficient Cost Allocation (p. 1341)

Korok Ray, Maris Goldmanis

How should a firm allocate the costs of common corporate resources such as information technology, legal services, human resource management, and executive time to its divisions? Divisions charged an "average cost" have an incentive to overconsume corporate resources. We propose a new allocation rule, the polynomial rule, which achieves efficiency and approximate budget balance. Welfare losses due to linear allocation rules increase with firm size, so polynomial allocation rules dominate linear rules for larger firms. The insight for management: Any efficient allocation rule must reflect the firm's underlying cost structure.

Product and Price Competition with Satiation Effects (p. 1357)

Felipe Caro, Victor Martínez-de-Albéniz

Hot fashions command huge profits through both high volumes as product flies off the shelves. However, demand can dry up quickly as customers become satiated. So how much volume is too much, and how can retailers like Zara avoid the satiation effect? The answers to these questions depend on the characteristics of the product and the time interval. Knowing that, consumers allocate their budgets to products that generate less satiation effects. Retailers should then choose to sell products that induce minimal satiation, but usually this is operationally more costly. The authors examine a number of different competitive situations (price only, product only, and both price and product) to determine the long-run average profit-maximizing strategy. In particular, they show that when a firm becomes more efficient at reducing satiation, its competitor may benefit if competition is on product only, but not if it is on price and product. The insight for management: When satiation effects are not managed, a firm's profit may be significantly reduced while a strategic competitor can largely benefit.

Measuring the Informative and Persuasive Roles of Detailing on Prescribing Decisions (p. 1374)

Andrew T. Ching, Masakazu Ishihara

Pharmaceutical representatives spend their days "detailing"—visiting physicians' offices sharing news, clinical results, and product samples. The sales reps often provide the doctors with pens, pads, free lunches, and much more. So how much of the detailer's work is informative, and how much is persuasive? In the pharmaceutical industry, measuring the importance of informative and persuasive roles of detailing is crucial for both drug manufacturers and policy makers. The authors split those two roles in this way: The informative component of detailing is chemical specific, and the persuasive component is brand specific. Some drug manufacturers engage in a comarketing agreement, under which two or more companies market the same chemical using their own brand names. Variation in market share for the chemical component depends on information; variation in relative market share for each brand depends on persuasion. The authors use data for angiotensin-converting enzyme inhibitor with diuretic in Canada and find that both effects are statistically significant but that the persuasive function of detailing plays a minor role in determining the demand at the chemical level—the informative role of detailing is mainly responsible for the diffusion patterns of chemicals. On the other hand, the persuasive role of detailing plays

a crucial role in determining the demand for brands that comarket the same chemical. The insight for management: The patient comes first; doctors use the drug that fits the need, but, given a choice between two identical options, they recommend the brand that bought lunch that week.

Contractual Flexibility, Rent Seeking, and Renegotiation Design: An Empirical Analysis of Information Technology Outsourcing Contracts
(p. 1388)

[Anjana Susarla](#)

How does contract renegotiation structure affect contract efficiency for outsourced information technology (IT) services? Usually, it is believed that service providers try to profit in renegotiation of the contract. The author suggests that renegotiation can improve efficiency by incorporating contingencies revealed after the contract is negotiated. Using a unique sample of 141 IT outsourcing contracts, she finds that flexibility provisions, termination for convenience rights, and contractual rights (whereby vendors are granted rights to reuse know-how) are associated with efficiency-improving amendments. The results are robust to contractual provisions when parties have

feasible foresight into those contingencies. The insight for management: IT contracts can be written more efficiently with reasonable contingencies in place instead of planned renegotiations.

The Power of Diversity over Large Solution Spaces (p. 1408)

[Marco LiCalzi, Oktay Surucu](#)

Is there power in numbers, or in diversity, or both? The authors consider a team with limited problem-solving ability facing a challenging problem with many possible solutions. The insights for management are many. First, two heads are better than one: A team of two agents will solve the problem even if neither agent alone would be able to. Second, teaming up does not guarantee success: If the agents are not sufficiently creative, even a team of arbitrary size may fail to solve the problem. Third, *defendit numerus*: When the agent's problem-solving ability is adversely affected by the complexity of the solution space, the solution of the problem requires only a mild increase in the size of the team. Fourth, groupthink impairs the power of diversity: If agents' abilities are positively correlated, a larger team is necessary to solve the problem.