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Management Insights

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Management Insights

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Analyst Recommendations, Mutual Fund Herding, and Overreaction in Stock Prices (p. 1)
Nerissa C. Brown, Kelsey D. Wei, Russ Wermers

Bandwagon or contrarian—how do mutual fund managers react to analyst recommendations? The authors find that mutual funds "herd" (trade together) into stocks with consensus sell-side analyst upgrades and herd out of stocks with consensus downgrades. This influence of analyst recommendation changes on fund herding is stronger for downgrades and among managers with greater career concerns. These findings indicate that career-concerned managers are incentivized to follow analyst information and that managers have a greater tendency to herd on negative stock information, given the greater reputational and litigation risk of holding losing stocks. Furthermore, starting in the mid-1990s (when aggregate mutual fund equity ownership is significantly higher), stocks traded by career-concerned herds of fund managers in response to analyst recommendation changes experience a significant same-quarter price impact, followed by a sharp subsequent price reversal. The insight for management: Analyst recommendation revisions induce herding by career-concerned fund managers, and this type of trading has become price destabilizing with the increasing level of mutual fund ownership of stocks.

Celebrity Endorsements, Firm Value, and Reputation Risk: Evidence from the Tiger Woods Scandal (p. 21)
Christopher R. Knittel, Victor Stango

What were the stock market effects of the Tiger Woods scandal for his sponsors and his sponsors' competitors? In the 10–15 trading days after the onset of the scandal, the full portfolio of sponsors lost more than 2% of market value, with losses concentrated among the core three sponsors: Electronic Arts, Nike, and PepsiCo (Gatorade). Sponsors' day-by-day losses correlate strongly with Google search intensity regarding the endorsement-related impact of the scandal, as well as with qualitative indicators of "endorsement-related news." At least some sponsors' losses were competitors' gains, suggesting that endorsement deals are partially a business-stealing strategy. However, competitors who were themselves celebrity endorsement intensive fared relatively worse than those who were not endorsement intensive, and that difference also correlates day by day with news/search intensity regarding the scandal. The insight for management: Scandals among endorsers negatively affect sponsor stock performance and seem to boost a sponsor's competitors but also send a negative marketwide signal about the reputation risk associated with celebrity endorsements.

The Dark Side of Competition for Status (p. 38)
Gary Charness, David Masclet, Marie Claire Villeval

Do efforts to climb the corporate ladder lead to pushing others down? The authors evaluate the role of status-seeking behavior in sabotage and cheating activities aiming at improving one's performance ranking. They find that average effort is higher when individuals are informed about their relative performance. However, ranking feedback also favors disreputable behavior. Some individuals do not hesitate to improve their rank by sabotaging others' work or by increasing artificially their own performance. The existence of sabotage opportunities has a strong detrimental effect on performance. The insight for management: Ranking incentives should be used with care; inducing group identity discourages sabotage among peers but increases in-group rivalry.

Television Advertising and Online Search (p. 56)
Mingyu Joo, Kenneth C. Wilbur, Bo Cowgill, Yi Zhu

Are television advertising and online advertising well integrated? The authors suggest that despite a 20-year trend toward integrated marketing communications, advertisers seldom coordinate television and search advertising campaigns. They find that television advertising for financial services brands increases both the number of related Google searches and searchers' tendency to use branded keywords in place of generic keywords. The elasticity of a brand's total searches with respect to its TV advertising is 0.17 and is strongest in the morning. The insight for management: Advertisers should account for cross-media effects when planning, executing, and evaluating both television and search advertising campaigns.

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Onshore and Offshore Hedge Funds: Are They Twins? (p. 74)
George Aragon, Bing Liang, Hyuna Park

How are organizational design, investment strategy, capital flows, and fund performance different for onshore and offshore hedge funds? Contrary to offshore hedge funds, U.S.-domiciled ("onshore") funds are subject to strict marketing prohibitions, accredited investor requirements, a limited number of investors, and taxable accounts. The authors find that onshore funds are associated with greater share restrictions, more liquid assets, and a reduced sensitivity of capital flows to superior past performance. They also find some evidence that onshore funds outperform offshore funds, depending on the sample period. The insight for management: A fund's investment and financial policies reflect differences in investor clienteles and the regulatory environment.

Matthew: Effect or Fable? (p. 92)
Pierre Azoulay, Toby Stuart, Yanbo Wang

The Matthew effect consists in the accruing of greater increments of recognition for particular scientific contributions to scientists of considerable repute and the withholding of such recognition from scientists who have not yet made their mark. The authors ask, "Is Matthew effect or fable?" They address this problem by examining the effect of assignment to the prestigious Howard Hughes Medical Institute (HHMI) on citations to articles the scientist published before the prize was awarded. They find evidence of a post-appointment citation boost, but the effect is small and is limited to a short window of time. The insight for management: Fame has its rewards; articles of questionable quality and from authors of low status are much more likely to be cited after fame is achieved.

Optimal Hiring and Retention Policies for Heterogeneous Workers Who Learn (p. 110)
Alessandro Arlotto, Stephen E. Chick, Noah Gans

How should management hire and retain employees who learn over time? The authors characterize the optimal hiring and retention policy. Workers can have diverse capabilities that change through time. In many settings, such as call centers and manufacturing, on-the-job learning is an important element of operational performance. Learning can take a number of forms, including decreases in the time required to complete tasks and improvements in quality. Employee turnover can similarly affect organizational performance. Workers who turn over (quit) or are terminated may be replaced by new hires who differ in both ability and experience. Different policies for hiring, monitoring, and retaining employees will influence the long-run performance of a firm. The insight for management: The value of active monitoring and screening of employees can be substantial.

Pareto Efficiency in Robust Optimization (p. 130)
Dan A. Iancu, Nikolaos Trichakis

If you expect the worst, can you hope for the best? What the best portfolio, inventory level, or project plan depends on how it is viewed; is it the best possible, or is it the safest? Historically, best outcomes have been characterized by Pareto optimality, or the best outcome. Relatively new robust optimization (RO) deals with decision-making problems where there is uncertainty, and in a risk-averse manner maximizes the worst-case outcome. Because RO focuses solely on the worst-case scenario, the authors argue that the classical RO paradigm may not produce solutions that are Pareto optimal. They demonstrate solution approaches that achieve both Pareto optimality and robustness by extending the RO framework. They propose methods that verify Pareto optimality of robust solutions with limited extra computational costs, generating Pareto robustly optimal (PRO) solutions. The insight for management: New approaches allow for significant potential upside while still insuring against worst-case outcomes.

Sale of Price Information by Exchanges: Does It Promote Price Discovery? (p. 148)
Giovanni Cespa, Thierry Foucault

Does sale of price information by exchanges promote price discovery? Exchanges sell both trading services and price information. The authors study how the joint pricing of these products affects price discovery and the distribution of gains from trade in an asset market. A wider dissemination of price information reduces pricing errors and the transfer from liquidity traders to speculators. This effect reduces the fee that speculators are willing to pay for trading. Therefore, to raise its revenue from trading, a for-profit exchange optimally charges a high fee for price information so that only a fraction of speculators buy this information. The insight for management: Due to the profit motive of exchanges, price discovery is not as efficient as it would be with free price information.

Governance Institutions and Adaptation Costs: Evidence from the Fall of the Berlin Wall (p. 166)
Douglas H. Frank

How does the involvement of institutions that govern the employment relationship influence firms' adaptation to environmental changes? After the Berlin Wall fell, migration from the former East Germany accounted for an abrupt increase in the supply of labor in the West. The author studies responses to this disruption among firms in the machinery and

equipment industry. The author suggests that western firms adapted to migration by increasing employment unless they were affiliated with a works council, an institution that limits the firm's autonomy in managing its workforce. The author finds evidence of institution-contingent responses to migration in two areas of firm strategy: vertical boundaries and the focus on exploration versus exploitation. The insight for management: "Hybrid" (i.e., less hierarchical) governance institutions increase adaptation costs, which have implications for multiple aspects of firm decision making that are nominally beyond the scope of those governance institutions.

Consumer Favorites and the Design of News (p. 188)
Yi Xiang, David Soberman

In an average day, U.S. consumers have access to more than 100 news reports from prime-time TV news programs, only some of which are of interest to an individual viewer. For example, a consumer watching CNN might be interested in only the news about French economy and not the news about Syria or the election in Kenya. Given this, how should a competitive news provider design and deliver news programs? Should firms adopt designs that facilitate the delivery of more information in their news programs? Does the decision of firms to implement such strategies depend on the number of news stories covered in the news product? How do such strategies influence competition? The insight for management: Firms may or may not benefit from providing better-designed news; the complexity of the news product and the intensity of competition between news providers directly affect incentives for improved design.

Uncertainty, Risk, and Incentives: Theory and Evidence (p. 206)
Zhiguo He, Si Li, Bin Wei, Jianfeng Yu

How do uncertainty and risk affect incentives? Uncertainty has qualitatively different implications than risk in studying executive incentives. The authors study the interplay between profitability uncertainty and moral hazard, where profitability is multiplicative with managerial effort. Investors who face greater uncertainty desire faster learning and consequently offer higher managerial incentives to induce more effort from the manager. The insight for management: In contrast to the standard negative risk-incentive trade-off, this "learning-by-doing" effect generates a positive relation between profitability uncertainty and incentives.

Understanding the Effect of Advertising on Stock Returns and Firm Value: Theory and Evidence from a Structural Model (p. 227)
Maria Ana Vitorino

What is the effect of advertising on stock returns and firm value? The author develops a method to estimate the impact of advertising expenditures on stock returns and firm value by interpreting advertising expenditures as an investment in brand capital. The author matches the pattern of average stock returns and firm values of portfolios sorted on advertising expenditures. The insight for management: Brand equity accounts for a substantial fraction of firm market value (approximately 23%), though this value varies substantially across industries.

Corporate Risk Management: Integrating Liquidity, Hedging, and Operating Policies (p. 246)
Andrea Gamba, Alexander J. Triantis

What is the role of liquidity in corporate risk management? The authors analyze the value created by a dynamic integrated risk management strategy involving liquidity management, derivatives hedging, and operating flexibility. They show that liquidity serves a critical and distinct role in risk management, justifying high levels of cash. They find that the marginal value associated with derivatives hedging is likely to be low. The insight for management: The complex interactions between operating flexibility and financial risk management are affected by operating leverage, the nature of operating flexibility, and the effectiveness of the hedging instrument.

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