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## Management Insights

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# Management Insights

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## Will the Global Village Fracture Into Tribes? Recommender Systems and Their Effects on Consumer Fragmentation (p. 805)

[Kartik Hosanagar](#), [Daniel Fleder](#), [Dokyun Lee](#),  
[Andreas Buja](#)

Personalization is becoming ubiquitous on the World Wide Web. Personalized systems use statistical techniques to infer a customer's preferences and recommend content best suited to him (e.g., "Customers who liked this also liked . . ."). A debate has emerged as to whether personalization has drawbacks. By making the Web hyperspecific to our interests, does it fragment Internet users, reducing shared experiences and narrowing media consumption? The authors study whether personalization is in fact fragmenting the online population, and, surprisingly, they find that it does not appear to be the case. Personalization seems to be a tool that helps users to widen their interests, which in turn creates commonality with others. This increase in commonality occurs for two reasons, which the authors term volume and product-mix effects. The volume effect is that consumers simply consume more after personalized recommendations, increasing the chance of having more items in common. The product-mix effect is that, conditional on volume, consumers buy a more similar mix of products after recommendations. The insight for management: Personalization both builds communities and grows revenue in online environments.

## Who Lives in the C-Suite? Organizational Structure and the Division of Labor in Top Management (p. 824)

[Maria Guadalupe](#), [Hongyi Li](#), [Julie Wulf](#)

Who Lives in the C-Suite? Top management structures in large U.S. firms have changed significantly since the mid-1980s. The size of the executive team—the group of managers reporting directly to the CEO—doubled during this period. This growth was driven primarily by an increase in functional managers rather than general managers, a phenomenon that the authors term "functional centralization." The

authors show that changes in the structure of the executive team are tightly linked to changes in firm diversification and information technology investments. These relationships depend crucially on the function involved; those closer to the product ("product" functions, e.g., marketing and R&D) behave differently from functions further from the product ("administrative" functions, e.g., finance, law, and human resources). The authors argue that this distinction is driven by differences in the information-processing activities associated with each function, and they apply this insight to refine and extend existing theories of centralization. The insight for management: Expanding executive suites are largely the result of growing corporate diversification and technology complexity.

## From the Horse's Mouth: Economic Conditions and Investor Expectations of Risk and Return (p. 845)

[Gene Amromin](#), [Steven A. Sharpe](#)

How do investor expectations affect returns in the stock market? The authors show that the key variables found to be positive predictors of actual stock returns in the asset-pricing literature are also highly correlated with investors' subjective expected returns, but with the opposite sign. The authors use data obtained from monthly Gallup/UBS surveys from 1998 to 2007 and from a special supplement to the Michigan Surveys of Consumer Attitudes and Behavior, run in 22 monthly surveys between 2000 and 2005, to analyze stock market beliefs and portfolio choices of household investors. They find that subjective expectations of both risk and returns on stocks are strongly influenced by perceptions of economic conditions. In particular, when investors believe that macroeconomic conditions are more expansionary, they tend to expect both higher returns and lower volatility. Finally, the relevance of these investors' subjective expectations is supported by the finding of a significant link between their expectations and portfolio choices. The insight for management: Portfolio equity positions tend to be higher for those respondents that anticipate higher expected returns or lower uncertainty.

### **Entrepreneurial Exits and Innovation** (p. 867)

Vikas A. Aggarwal, David H. Hsu

How do initial public offerings (IPOs) and acquisitions affect entrepreneurial innovation? The authors address this question through tracking patent counts and forward patent citations after an acquisition or IPO. They constructed a firm-year panel data set of all venture capital-backed biotechnology firms founded between 1980 and 2000. They find that innovation quality is highest under private ownership and lowest under public ownership, with acquisition intermediate between the two. The insight for management: Entity ownership directly affects innovation as measured by patents.

### **Do Private Equity Returns Result from Wealth Transfers and Short-Termism? Evidence from a Comprehensive Sample of Large Buyouts** (p. 888)

Jarrad Harford, Adam Kolasinski

The authors test whether the well-documented high returns of private equity sponsors result from wealth transfers from other financial claimants and counterparties and from a focus on short-term profits at the expense of long-term value. Debt investors who finance buyouts, as well as buyers of private equity portfolio companies, represent the two potential sources of wealth transfers. However, the authors find that, on average, public companies benefit when they buy financial sponsors' portfolio companies, experiencing positive abnormal returns upon the announcement of the acquisition and long-run post-transaction abnormal returns indistinguishable from zero. They further find that large portfolio company payouts to private equity on average have no relation to future portfolio company distress, suggesting that debt investors are not suffering systematic wealth losses either. However, they find some evidence of wealth transfers from both strategic buyers and debt investors in some special situations. The insight for management: Portfolio companies invest no differently than similar public control firms, which is inconsistent with short-termism.

### **Dynamics of Consumer Adoption of Financial Innovation: The Case of ATM Cards** (p. 903)

Botao Yang, Andrew T. Ching

What drives consumers' adoption and usage decisions surrounding financial innovation? The authors investigate consumers' adoption decisions surrounding ATM cards. The authors capture the heterogeneity of consumers over their life cycle to estimate adoption costs more accurately. They evaluate Italian consumers' adoption decisions for ATM cards and their cash withdrawal patterns before and after adoption to estimate adoption costs. They find that one could significantly overestimate adoption costs for the elderly

when ignoring their shorter life span. They find that a sign-up bonus targeted to the elderly could be much more effective if implemented as a limited-time offer rather than a permanent offer. Interestingly, if the sign-up bonus is permanent, younger consumers may strategically postpone adoption. The insight for management: Promotional programs for financial tools like ATM cards should consider the age of the consumer; adoption decisions are directly affected by age of the consumer.

### **Fast or Rational? A Response-Times Study of Bayesian Updating** (p. 923)

Anja Achtziger, Carlos Alós-Ferrer

When should you "trust your gut"? A long-standing discussion in management science concerns the value of intuitive decision making for day-to-day and business decisions. Arguments in favor of intuitive decision-making styles are often colorfully illustrated with examples where well-known chief executive officers "went with their gut." On the other hand, well constructed and complete analytical models usually can consider more information, more completely than a human decision maker. What if the gut and the model disagree? The authors show that, in the case of conflict between the two approaches, correct responses are associated with more careful decision making, but, if both approaches agree, errors are slower. Finally, decision response times in the case of conflict are longer than in the case of alignment. The insight for management: Man and the machine coexist; a careful blend of rational thinking and going with your gut is typically employed in decisions.

### **Do Individuals Have Preferences Used in Macro-Finance Models? An Experimental Investigation** (p. 939)

Alexander L. Brown, Hwagyun Kim

Do people prefer early resolution of uncertainty? Recent financial studies often assume that agents have preferences that require agents to care about when uncertainty is resolved. Under this framework, the preference for uncertainty resolution is determined entirely by an agent's preferences for risk and intertemporal substitution. The authors perform an experiment designed to elicit subject preferences on risk, time, intertemporal substitution, and uncertainty resolution. Their results reveal that most subjects prefer early resolution of uncertainty and have relative risk aversion greater than the reciprocal of the elasticity of intertemporal substitution. Subjects are classified in a finite mixture model by their risk, time, and intertemporal-substitution parameters. The insight for management: The desire for fast uncertainty resolution affects preferences in financial decision making.

**Can Analysts Analyze Mergers?** (p. 959)

Hassan Tehranian, Mengxing Zhao, Julie L. Zhu

After the completion of a merger and acquisition (M&A) transaction, the target firm is delisted, but some analysts who covered it retain coverage of the merged firm. The authors hypothesize that this decision is based on two factors: the analyst's ability to cover the merged firm and his or her assessment of the M&A deal. They find that the remaining target analysts provide more accurate earnings forecasts and more optimistic stock recommendations and growth forecasts for the merged firms than do the remaining acquirer analysts. They also find that a higher percentage of target analysts choosing to cover the merged firm is associated with better operating and long-term stock performance of that firm, but they do not find this relation with acquirer analysts. The insight for management: Target analysts' coverage decisions reveal valuable information about a merged firm's future performance.

**How Do Firms Become Different?****A Dynamic Model** (p. 980)

Matthew Selove

How do nearly identical firms become different? The author considers hypothetical firms that are initially identical but develop assets that are specialized to different market segments. The author assumes that there are increasing returns to investment in a segment, for example, as a result of word-of-mouth or learning curve effects. The author makes three key conclusions. First, under certain conditions there is a unique equilibrium in which firms that are only slightly different focus all of their investment in different segments, causing small random differences to expand into large permanent differences. Second, on the other hand, sufficiently large random shocks are possible; firms over time repeatedly change their strategies, switching focus from one segment to another. Third, a firm might want to reduce its own assets in the smaller segment in order to entice its competitor to shift focus to this segment. The insight for management: Market specialization can be a natural outcome of otherwise similar firms.

**Should Sellers Prefer Auctions? A Laboratory Comparison of Auctions and Sequential Mechanisms** (p. 990)Andrew M. Davis, Elena Katok,  
Anthony M. Kwasnica

When bidders incur a cost to learn their valuations, bidder entry can impact auction performance. Two common selling mechanisms in this environment are an English auction and a sequential bidding process. Theoretically, sellers should prefer the auction because it generates higher expected revenues,

whereas bidders should prefer the sequential mechanism because it generates higher expected bidder profits. In a controlled laboratory environment, the authors find that, contrary to the theoretical predictions, average seller revenues tend to be higher under the sequential mechanism, whereas average bidder profits are approximately the same. The authors identify three systematic behavioral deviations from the theoretical model. First, in the auction, bidders do not enter 100% of the time. Second, in the sequential mechanism, bidders do not set preemptive bids according to the predicted threshold strategy. Third, subsequent bidders tend to overenter in response to preemptive bids by first bidders. The insight for management: The benefits of different auction types may not affect buyers and sellers as once thought.

**A Branch and Bound Algorithm for a Class of Biobjective Mixed Integer Programs** (p. 1009)Thomas Stidsen, Kim Allan Andersen,  
Bernd Dammann

How can challenging real-world multiobjective problems be solved more quickly? Most real-world optimization problems are multiobjective by nature, involving noncomparable objectives. Many of these problems can be formulated in terms of a set of linear objective functions that should be simultaneously optimized over a class of linear constraints. Often there is the complicating factor that some of the variables are required to be integral. Solving these kinds of optimization problems exactly requires a method that can generate the whole set of nondominated points, known as the Pareto-optimal front. The authors propose a new branch and bound method for solving a type of these problems where only two objectives are allowed, the integer variables are binary, and one of the two objectives has only integer variables. The authors find that their "biobjective branch and bound method" performs better than previous methods in most cases. The insight for management: New branching methods speed solution times for difficult multiobjective problems.

**Analysis of Product Rollover Strategies in the Presence of Strategic Customers** (p. 1033)

Chao Liang, Metin Çakanyıldırım, Suresh P. Sethi

Is it better to phase out an old product when introducing a new product to avoid cannibalization or to continue selling it in the market for additional revenue? Frequent product introductions emphasize the importance of product rollover strategies. For example, Spanish retailer Zara has reduced its design-to-market cycle time from a few months to a few weeks and therefore has more frequent new clothing style introductions. With single rollover, when a new product is introduced, the old product is phased out from the market. With dual rollover, the old product

remains in the market along with the new product. Anticipating the introduction of the new product and the potential markdown of the old product, strategic customers may delay their purchases. The authors study the interaction between product rollover strategies and strategic customer purchasing behavior and find that single rollover is more valuable when the new product's innovation is low and the number of strategic customers is high. Interestingly, and counter to intuition, the firm may have to charge a lower price for the old product as well as receive a lower profit with a higher value disposal (outside) option for the old product under single rollover. The insight for management: Whether to phase out old models depends directly on the level of sophistication of customers.

**Prospect Theory and the Newsvendor Problem** (p. 1057)

[Mahesh Nagarajan](#), [Steven Shechter](#)

The newsvendor problem is a classic example of decision of how much inventory to stock in the face of uncertain demand for a good whose value lasts for a short time (such as a newspaper). Prospect theory describes decision making under uncertainty and the distaste for incurring a loss. These two disparate theories are combined in this research. The insight for management: Prospect theory cannot explain the

findings of this fundamental operations management problem.

**Integrating Problem Solvers from Analogous Markets in New Product Ideation** (p. 1063)

[Nikolaus Franke](#), [Marion K. Poetz](#), [Martin Schreier](#)

When people seek a novel solution to a complicated problem and lack the skill to solve it themselves, they might consider consulting a person with more expertise. But whom? Conventional wisdom appears to suggest that target market expertise is indispensable, which is why most managers searching for new ideas tend to stay within their own market context even when they do search outside their firms' boundaries. However, the authors find evidence for the opposite: Although solutions provided by problem solvers from analogous markets show lower potential for immediate use, they demonstrate substantially higher levels of novelty. This effect is further amplified when the analogous distance between the markets increases. Finally, the analogous market effect is particularly strong in the upper tail of the novelty distribution; thus, exploring related markets can result in more extensive innovation. The insight for management: It might pay to systematically search across firm-external sources of innovation that were formerly out of scope for most managers.