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Management Insights

Michael F. Gorman

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Management Insights

Michael F. Gorman
School of Business Administration, University of Dayton, Dayton, Ohio 45469,
michael.gorman@udayton.edu

Forward-Looking MD&A Disclosures and the Information Environment (p. 931)
Volkan Muslu, Suresh Radhakrishnan, K. R. Subramanyam, Dongkuk Lim

What are the informational properties of forward-looking disclosures in the management discussion and analysis (MD&A) sections of 10-K filings made with the Securities and Exchange Commission? The authors find that firms make more forward-looking MD&A disclosures when their stock prices have lower informational efficiency, for example, when their stock prices poorly reflect future earnings information. The greater levels of forward-looking MD&A disclosures help improve yet are unable to completely mitigate the lower informational efficiency of stock prices for such firms. These findings are stronger for operations-related forward-looking disclosures, disclosures that were made prior to 2000, and disclosures made by loss firms. The insight for management: 10-K filings tend to be more forthcoming when stock prices are not indicative of future performance.

The Hidden Cost of Accommodating Crowdfunder Privacy Preferences: A Randomized Field Experiment (p. 949)
Gordon Burtch, Anindya Ghose, Sunil Wattal

How does crowdfunding information affect investor activity during funding? Online crowdfunding has received a great deal of attention as a promising avenue to fostering entrepreneurship and innovation. Because online settings bring increased visibility and traceability of transactions, many crowdfunding platforms provide mechanisms that enable a campaign contributor to conceal his or her identity or contribution amount from peers. The authors study the impact of these information (privacy) control mechanisms on crowdfunder behavior. They find evidence of both positive (e.g., comfort) and negative (e.g., privacy priming) causal effects. They find that reducing access to information controls induces a net increase in fundraising but that this outcome results from two competing influences. Treatment increases willingness to engage with the platform (a 4.9% increase in the probability of contribution) and simultaneously decreases the average contribution (a $5.81 decline). This decline derives from a publicity effect, wherein contributors respond to a lack of privacy by tempering extreme contributions. The insight for management: More public information on investment activity can hinder participation rates and amounts.

A Comparison of Milestone-Based and Buyout Options Contracts for Coordinating R&D Partnerships (p. 963)
Shantanu Bhattacharya, Vibha Gaba, Sameer Hasija

How should contracts in a bilateral research and development (R&D) partnership between early-stage researchers and late-stage producers be formed? The authors capture the inherent incentive alignment problems of double-sided moral hazard, risk aversion, and holdup. They compare the efficacy of milestone-based options contracts and buyout options contracts from the client's perspective and identify conditions under which they attain the first-best outcome for the client. The insight for management: Milestone-based options contracts always attain the first-best outcome for the client when the provider has some bargaining power in renegotiation and identifies their applicability to different R&D partnerships.

Does a Procurement Service Provider Generate Value for the Buyer Through Information About Supply Risks? (p. 979)
Zhibin (Ben) Yang, Volodymyr Babich

In a setting where suppliers are subject to disruptions and whose likelihoods of disruption are their private information, does the buyer benefit from engaging the services of a better-informed procurement service provider (PSP) compared with procuring directly from the suppliers? Intuition might suggest that hiring a PSP is always the right choice because the PSP's knowledge of the supply base improves supplier selection and management. On the other hand, earlier studies prove that using a PSP purely for its superior knowledge about supply costs is always worse for a buyer than contracting with the suppliers directly. Contrary to the findings of earlier studies, the authors find that the buyer may benefit from using a PSP. The benefits of using a PSP are derived when one supplier is of high reliability and the other is of low reliability, from a reduction of informational costs due to implicit supplier collusion facilitated by the PSP and an improvement of supply availability. The costs of using a PSP are derived when both suppliers are of low reliability, from the loss of direct control over the supplier's production actions, which leads to reduced supply availability and increased informational costs, and from the PSP facilitating implicit supplier collusion. The insight for management: Using the PSP is valuable only if the buyer diversifies with some supplier-type combinations but not others, and hiring a PSP is not a solution to the problem of an unreliable supply base.

Interdiction Games on Markovian PERT Networks (p. 999)
Eli Gutin, Daniel Kuhn, Wolfram Wiesemann

Since its inception in 1968 a total of 190 states have joined the Treaty on the Non-Proliferation of Nuclear Weapons, whose objective is to prevent the spread of nuclear weapons, to promote nuclear disarmament, and to regulate the peaceful use of nuclear technology for energy production. How should those who continue to covertly build nuclear weapons (proliferators) be approached by those who would like it stopped (interdictors)? In an interdiction game a proliferator aims to minimize the expected duration of a nuclear weapons development project, and an interdictor endeavors to maximize the project duration by delaying some of the project tasks. The authors formulate static and dynamic versions of the interdictor's decision problem where the interdiction plan either is precommitted or adapts to new information revealed over time, respectively. They prove that the static model reduces to a mixed-integer linear program, whereas the dynamic model reduces to a finite Markov decision process in discrete time that can be solved via efficient value iteration. The insight for management: New game-theoretic approaches and simplified formulations can help solve nuclear proliferation problems.

The Impact of Advice on Women's and Men's Selection into Competition (p. 1018)
Jordi Brandts, Valeska Groenert, Christina Rott

How does advice by a more experienced and better-informed person affect an individual's entry into a real-effort tournament and the gender gap? The authors' work is motivated by the concerns raised by approaching the gender gap through affirmative action policies. Overall, advice improves the entry decision of subjects, in that forgone earnings due to wrong entry decisions decrease significantly. The improvements are mainly driven by increased entry of strong-performing women, who also become more confident, and reduced entry of weak-performing men. The authors find that the overall gender gap persists even though it disappears among low and strong performers. The persistence is due to an emerging gender gap among intermediate performers driven by women following more the advice to stay out of the tournament and men following more the advice to enter The insight for management: Listen to sage advice; the decision to enter a competition can be improved by listening to more informed individuals.

An Experimental Investigation of Auctions and Bargaining in Procurement (p. 1036)
Jason Shachat, Lijia Tan

In reverse auctions, buyers often retain the right to bargain further concessions from the winners. The optimal form of such procurement is an English auction followed by an auctioneer's option to engage in ultimatum bargaining with the winners. In an experiment, the authors find that sellers closely follow the equilibrium strategy of exiting the auction at their costs and then accepting strictly profitable offers. Buyers generally exercise their option to bargain according to their equilibrium strategy, but their take-it-or-leave-it offers vary positively with auction prices when they should be invariant. The insight for management: In reverse auctions, buyers and sellers behave differently; sellers behave as predicted, and buyers tend to stray from theoretical predictions.

Global Sourcing and Foreign Knowledge Seeking (p. 1052)
Heather Berry, Aseem Kaul

What are the antecedents of offshore integration from those of offshore outsourcing in firm global sourcing decisions? The authors analyze cross-border product transfers by U.S. manufacturing multinational corporations from 1989 to 2004 to evaluate global sourcing strategies. Although traditional theories of global sourcing focus on lowering costs, the authors argue that as high-performing firms seek to develop new capabilities by tapping into foreign knowledge, they will increasingly turn to offshore integration to reap colocation benefits and overcome expropriation challenges. By contrast, offshore outsourcing will be preferred by less-profitable firms seeking to tap into low-cost inputs, especially as investments in information technology lower monitoring costs. The insight for management: The increasing reliance on offshore integration in technology-intensive industries is driven by foreign knowledge seeking.

The Reaction of Stock Returns to News About Fundamentals (p. 1072)
Tolga Cenesizoglu

Why is it that in good times, stock prices react negatively to good news and positively to bad news, whereas in bad times, they react positively to good news and negatively to bad news? To account for this stylized fact, the author considers an asset pricing model where the dividend growth rate switches between different values depending on the underlying state of the economy. The insight for management: The differing precision of external signals across different states of the economy can change the sign of the market reaction to news from external signals in good and bad times.

Real Options and American Derivatives: The Double Continuation Region (p. 1094)
Anna Battauz, Marzia De Donno, Alessandro Sbuelz

What is the optimal exercise policy for American derivatives? The authors study the nonstandard optimal exercise policy associated with relevant capital investment options and with the prepayment option of widespread collateralized-borrowing contracts like the gold loan. Option exercise is optimally postponed not only when moneyness is insufficient, but also when it is excessive. The authors extend the classical optimal exercise properties for American options. Early exercise of an American call with a negative underlying payout rate can occur if the option is moderately in the money. The authors fully characterize the existence, the monotonicity, the continuity, the limits, and the asymptotic behavior at maturity of the double free boundary that separates the exercise region from the double continuation region. The insight for management: The finite-maturity nonstandard policy conspicuously differs from the infinite-maturity one.

Contractual vs. Actual Separation Pay Following CEO Turnover (p. 1108)
Eitan Moshe Goldman, Peggy Peiju Huang

Is there a difference between contractual and actual separation pay after CEO turnover? The authors document the details of the ex ante severance contracts and the ex post separation pay given to S&P 500 chief executive officers (CEOs) upon departing from their companies. They analyze what determines whether or not a CEO receives separation pay in excess of the amount specified in the severance contract. The authors find that discretionary separation pay is given to approximately 40% of departing CEOs and is, on average, \$8 million, which amounts to close to 242% of a CEO's annual compensation. They investigate the determinants of discretionary separation pay and find, for example, that discretionary separation pay positively correlates with weak internal governance in cases of voluntary CEO turnover but not when the CEO is forced out. The authors also find that discretionary pay is higher when the CEO has a noncompete clause in her ex ante severance contract. The insight for management: There is a complex role of discretionary separation pay in the bargaining game between boards and departing executives.

Sticking with What (Barely) Worked: A Test of Outcome Bias (p. 1121)
Lars Lefgren, Brennan Platt, Joseph Price

How influenced are we by the successful outcomes from bad decisions—or the bad outcomes of good decisions? Outcome bias occurs when an evaluator considers ex post outcomes when judging whether a choice was correct ex ante. To test this, the authors examine strategy changes made by professional basketball coaches and find that the coaches are more likely to revise their strategy after a loss than a win—even for narrow losses, which are uninformative about team effectiveness. The insight for management: Don't overemphasize near losses or wins; they are often the result not of the decision but of factors outside the control of the decision maker.

Bang for the Buck: Gain-Loss Ratio as a Driver of Judgment and Choice (p. 1137)
Bart de Langhe, Stefano Puntoni

How should we account for gains and losses from a decision? The authors suggest that individuals seek to maximize the rate of exchange between positive and negative outcomes and thus combine gains and losses in a multiplicative way rather than an additive way. This sensitivity to gain-loss ratio provides an alternative account for several existing findings and implies a number of novel predictions. It implies greater sensitivity to losses and risk aversion when expected value is positive, but greater sensitivity to gains and risk seeking when expected value is negative. It also implies more extreme preferences when expected value is positive than when expected value is negative. The insight for management: Bang-for-the-buck approaches for evaluating gains and losses give insight to behaviors.

Aggregate Impact of Different Brand Development Strategies (p. 1164)
Vijay Ganesh Hariharan, Ram Bezawada, Debabrata Talukdar

How does branding cause spillover effects when there are product extensions? The authors evaluate the aggregate market impact of these effects across different brand development strategies while accounting for the strategic decision to introduce the extension. It is important to examine the above given the significant investments and the high failure rates associated with the introduction of new product extensions. The authors use a data set that covers 155 extensions introduced across 20 U.S. geographic markets. Their results show that spillover effects are higher for brand extensions, whereas line extensions benefit through larger extension effects. They find that vertically differentiating a line extension in terms of increased quality mitigates its negative spillover effects. The addition of a new brand name (i.e., sub-branding) lowers spillover effects for line extensions, whereas it increases the market performance for brand extensions. The insight for management: For manufacturers to successfully introduce and manage product extensions, they must understand the subtleties of spillover effects.

Digital Content Provision and Optimal Copyright Protection (p. 1183)
Liang Guo, Xiangyi Meng

What is the best copyright protection for digital materials? Advances in digital technologies have led to an increasing concern about piracy for providers of digital content (e.g., e-books, games, music, software, videos). Yet controversies exist over the influence of copyright protection on firm profitability. The authors provide an alternative rationale for the growing anti-protection trend and investigate optimal copyright enforcement and quality provision in a monopoly setting. They propose an economic mechanism that centers on the influence of copyright protection on consumer search when consumers can get to know the firm's actions (e.g., price, quality) only after costly search. The authors show that more stringent copyright protection can induce the consumers to rationally expect lower consumer surplus after the purchase, thus exerting a negative strategic effect on the consumers' willingness to search. The long-term effect may outweigh the relative attractiveness of the authorized versus the pirated product, which can hence explain the optimality of incomplete and even zero copyright protection policies in markets where consumer prepurchase search is important (e.g., information goods, digital products). It is also because of this strategic effect that the firm may provide lower quality as copyright enforcement increases. Interestingly, the authors note that quality unobservability can moderate this strategic effect and thus lead to an increasing incentive for copyright protection. The insight for management: Strict copyright enforcement may be counterproductive to long-term profitability.