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Management Insights

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Management Insights

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Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach (p. 2549) Caroline Flammer

Does corporate social responsibility lead to superior financial performance? The author focuses on shareholder proposals related to corporate social responsibility (CSR) that pass or fail by a small margin of votes to evaluate the effect of such proposals on financial performance. The author finds that the adoption of close-call CSR proposals leads to positive announcement returns and superior accounting performance, implying that these proposals are value enhancing. The author finds that labor productivity and sales growth increase after the vote. The insight for management: Although the results imply that adopting close-call CSR proposals is beneficial to companies, they do not necessarily imply that CSR proposals are beneficial in general.

Can Noise Create the Size and Value Effects? (p. 2569)

Robert D. Arnott, Jason C. Hsu, Jun Liu, Harry Markowitz

Can noise create the size and value effects? If the price of a stock differs from its intrinsic value by a random noise, then value stocks are more likely to have negative noise; they are thus more likely undervalued and have higher expected return than justified by risk. The authors develop a parsimonious model that defines the value premium and size premium using only four parameters: mean of stock return, volatility of stock return, volatility of the price-to-dividend ratio, and noise volatility. They emphasize that only a moderate volatility of price noise is needed to generate the observed value premium. The insight for management: Random noise is usually negative and can create an above-average return relative to its risk; this value and size can be predicted with a relatively small model.

Financing Investment: The Choice Between Bonds and Bank Loans (p. 2580)

Erwan Morellec, Philip Valta, Alexei Zhdanov

How to finance an investment: bonds or bank loans? The authors show that firms with more growth options, with higher bargaining power in default, operating in

more competitive product markets, or facing lower credit supply are more likely to issue bonds. They also demonstrate that, by changing the cost of financing, these characteristics affect the timing of investment. A statistical test from a sample of U.S. firms supports their theory. The insight for management: The preferability of bank loan or bond funding depends on various attributes of the company.

Aging and Financial Decision Making (p. 2603) Keith Jacks Gamble, Patricia A. Boyle, Lei Yu, David A. Bennett

How does aging affect financial decision making? The authors study how cognitive changes associated with aging impact the financial decision-making capability of older Americans. They find that a decrease in cognition is associated with a decrease in financial literacy. Decreases in episodic memory and visuospatial ability are associated with a decrease in numeracy, and a decrease in semantic memory is associated with a decrease in financial knowledge. A decrease in cognition also predicts a drop in self-confidence in general, but, importantly, it is not associated with a drop in confidence in managing one's own finances. Participants experiencing decreases in cognition do show an increased likelihood of getting help with financial decisions; however, many participants experiencing significant drops in cognition still do not get help. The insight for management: Grandpa needs help managing his finances, whether he realizes it or not; aging reduces financial ability but not a consummate reduction in recognition of that reduced ability.

Performance Information, Production Uncertainty, and Subjective Entitlements in Bargaining (p. 2611) Emin Karagözoğlu, Arno Riedl

Do performance information and details of the production process affect entitlements and thus bargaining behavior? The authors experimentally explore the effect of performance information and production uncertainties on subjective entitlements derived from the production process and bargaining over the jointly produced surplus. Without performance information, subjective entitlements are mostly mutually consistent, and bargaining mainly ends with an equal split. In stark contrast, negotiators derive strong, mutually

inconsistent, subjective entitlements when there is performance information. These subjective entitlements affect opening proposals, concessions, and bargaining duration and lead to asymmetric agreements. Moreover, given performance information, endogenous variations in entitlements influence bargaining, which suggests an independent role of subjective entitlements. Production uncertainties influence bargaining, especially when performance information is present, but do not substantially mitigate the effect of entitlements. The insight for management: Production and information uncertainties directly affect entitlement expectations and bargaining approach.

Legitimacy, Communication, and Leadership in the Turnaround Game (p. 2627)

Jordi Brandts, David J. Cooper, Roberto A. Weber

How do key attributes of elected leaders affect corporate turnaround efforts? The authors study the effectiveness of leaders for inducing coordinated organizational turnaround. They compare communication from leaders to incentive increases and also compare the effectiveness of randomly selected and elected leaders. They find that communication from leaders has a greater effect than incentives. Moreover, leaders who are elected by followers are significantly better at improving their group's outcome than randomly selected leaders. A combination of factors including incentive increases and communication from elected leaders yields near-universal turnarounds to full efficiency. The insight for management: The way in which leaders are selected affects their legitimacy and the degree to which they influence followers.

Expectations as Reference Points: Field Evidence from Professional Soccer (p. 2646)

Björn Bartling, Leif Brandes, Daniel Schunk

Do soccer players and coaches approach the game differently when they are losing? The authors suggest that the answer is yes. They examine more than 8,200 matches from 12 seasons of the German Bundesliga and 12 seasons of the English Premier League. The authors show that, on a minute-by-minute basis, players breach the rules of the game—as measured by the referee's assignment of cards—significantly more often if their teams are behind in the expected match outcome. The authors also show that coaches implement significantly more offensive substitutions if their teams are behind expectations. Both types of behaviors actually reduce the probability of ultimate match outcome of the team, which shows that the behaviors are not necessarily rational. The insight for management: Sometimes emotion gets in the way; changing behavior in soccer matches when a team is lagging often does not improve the odds of winning.

On the Effectiveness of Patenting Strategies in Innovation Races (p. 2662)

Jürgen Mihm, Fabian J. Sting, Tan Wang

Which, if any, of a firm's inventions should it patent? Should it patent at all? Many companies engaged in an innovation race seek a patenting strategy that balances protection of their intellectual property against the knowledge spillovers resulting from disclosure requirements. Not much is known about factors that determine the patenting strategy best able to resolve this trade-off. The authors develop an inventory of real-life patenting strategies and characterize the optimal patenting choices for different environmental and firm-level contingencies while capturing the dynamics between competing firms. The insight for management: The firm's research and development strategy is the most salient determinant of its optimal patenting strategy.

Evaluating Venture Technical Competence in Venture Capitalist Investment Decisions (p. 2685)

Rohit Aggarwal, David Kryscynski, Harpreet Singh

Why are some venture capitalists (VCs) better at assessing the technical competence of ventures than others? The authors gathered unique and proprietary data from 33 VCs and 308 ventures that sought funding from those VCs. They show that VC assessment of ventures predicts VC investment, and venture technical competence predicts subsequent venture failure. This means that VCs that over-assess ventures are more likely to invest in firms that are more likely to fail. The authors also show that higher VC technical competence leads to lower errors in assessment but that greater similarity between the VC and venture in technical competence leads to higher assessments, *ceteris paribus*. The insight for management: VC competence enhances the accuracy of VC assessments, but similarity in technical competence between VCs and ventures may lead to positive assessment bias.

Standardization and the Effectiveness of Online Advertising (p. 2707)

Avi Goldfarb, Catherine E. Tucker

Standardization of online advertising has improved automation and efficiency, but what has it done to memorability? The technological transformation and automation of digital content delivery have revolutionized the media industry, but increased reliance on automation has also led to requirements for standardization of content-delivery formats. The authors examine how the memorability of banner advertising changed with the introduction of new standards regularizing its format. The insight for management: For most ads, effectiveness falls as the use of standard formats rises.

An Interproduct Competition Model Incorporating Branding Hierarchy and Product Similarities Using Store-Level Data (p. 2720)

Sudhir Voleti, Praveen K. Kopalle, Pulak Ghosh

How does advertising for Budweiser affect sales for Coors and Heineken? Is the effect the same on both? The authors model demand under interproduct competition and assess the respective contributions of brand hierarchy and interproduct similarity to explaining and predicting demand. They test their model using aggregate beer category sales data from a midsize U.S. retail chain. They find that the model partitions the 15 brands in the data into four brand clusters and the 96 SKUs into 25 SKU clusters conditional on brand cluster membership. The insight for management: Bud affects Coors' sales more than Heineken's; SKU competition is more local than global in that only subsets of products compete within groups of comparable products.

Service Quality Variability and Termination Behavior (p. 2739)

S. Sriram, Pradeep K. Chintagunta, Puneet Manchanda

How important are the level and variability in quality in driving customer retention for a new service? The authors find that though high average quality helps in retaining customers, high variability leads to higher termination rates. Failing to consider variability in quality while inferring the impact of improvements to average quality leads to an 18%–64% overestimation of quality improvement elasticities. The insight for management: It is better for the firm to focus quality-improvement efforts on customers experiencing low variability; increasing average quality by 1% lowers termination by 1.1% for low-variability customers but only by 0.41% for high-variability households.

Colocation Still Matters: Conformance Quality and the Interdependence of R&D and Manufacturing in the Pharmaceutical Industry (p. 2760)

John V. Gray, Enno Siemsen, Gurneeta Vasudeva

Given the ubiquitous availability and low cost of information technology and long distance communication, does colocation still matter? An analysis of a data set of U.S.-based pharmaceutical plants over a 13-year period reveals that colocation of manufacturing and R&D relates to better conformance quality. The authors find that these benefits of colocation persist throughout the time period they studied (1994–2007), which is surprising given the rapid development of information and communication technologies during that time. These benefits are particularly enhanced for manufacturing plants operating with processes that involve a high

level of tacit process knowledge and that belong to large firms. Their findings highlight the importance of matching organizational design with process and firm characteristics in settings involving knowledge interdependence. They also highlight the continued value of physical proximity through geographical colocation between manufacturing and R&D activities to achieve desired quality outcomes. The insight for management: Proximity matters; colocation enhances the R&D process.

Propagation of Financial Shocks: The Case of Venture Capital (p. 2782)

Richard R. Townsend

How do financial stocks propagate via propensities to invest venture capital, even for unrelated stocks? The author investigates how venture-backed companies are affected when others sharing the same investor suffer a negative shock. The author estimates the impact of the collapse of the technology bubble on non-information-technology (non-IT) companies that were held alongside Internet companies in venture portfolios. The bubble was associated with a significantly larger decline in the probability of raising continuation financing for these non-IT companies in comparison to others. The insight for management: The halo effect has a vicious component; investors with greater Internet exposure were significantly less likely to continue to participate in follow-on rounds, even for non-IT companies.

Information Sharing in Supply Chains: An Empirical and Theoretical Valuation (p. 2803)

Ruomeng Cui, Gad Allon, Achal Bassamboo, Jan A. Van Mieghem

What is the value of information sharing across the supply chain? The value of downstream sales information to the upstream firm stems from improving upstream order fulfillment forecast accuracy. Such an improvement can lead to lower safety stock and better service, but this information sharing can be costly. The authors show that, if the company includes the downstream sales data to forecast orders, the improvement in the mean squared forecast error ranges from 7.1% to 81.1% across all studied products in a consumer packaged-goods company. Theoretically, the information sharing should be zero for many products, but by allowing orders to deviate, accounting for private information held by the decision maker but not to statistical models, information sharing is preferred. The insight for management: Knowing the downstream replenishment policy improves forecasts when decision makers deviate from statistical models based on that information.