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Management Insights

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Asymmetric Effects of Informed Trading on the Cost of Equity Capital (p. 2460)

Michael J. Brennan, Sahn-Wook Huh,
Avanidhar Subrahmanyam

How does informed trading affect the cost of equity capital? There are two types of information related to stock prices: good news and bad news. Investors who take long positions will be more concerned about informed selling than about informed buying since the former depresses the sale price whereas the latter raises it, so, there is likely to be an asymmetry in the pricing of private information. The authors provide new evidence that informed trading around earnings announcements predict both positive and negative earnings surprises. The insight for management: The effect of bad news on the cost of equity capital is large and highly significant, whereas the effect of good news is small and statistically insignificant.

Is IT Enough? Evidence from a Natural Experiment in India's Agriculture Markets (p. 2481)

Chris Parker, Kamalini Ramdas, Nicos Savva

Is information technology enough? Access to information and communication technologies (ICTs) such as mobile phone networks is widely known to improve market efficiency. The authors examine whether access to timely and accurate information provided through ICT applications has any additional impact. Using a detailed data from a text message service in India that provides daily price information to market participants, the authors find that this information reduces the geographic price dispersion of crops in rural communities by an average of 12%, over and above access to mobile phone technology and other means of communication. Bulk text messages were banned unexpectedly across India for 12 days in 2010, which allowed the authors to evaluate the effect of their absence. The insight for management: Besides reducing geographic price dispersion, bulk texting

also increases the rate at which prices converge across India over time. The authors discuss the implications of this for development organizations and information providers.

Cash-Flow News and the Investment Effect in the Cross Section of Stock Returns (p. 2504)

Mike Qinghao Mao, K. C. John Wei

Can cash-flow news quantitatively explain the investment effect in the cross section of stock returns? The negative return predictability of asset growth, investment growth, and accruals is evident only through the cash-flow news component of returns. The cash-flow news returns associated with investment-sorted portfolios exhibit a reversal from the preformation period to the postformation period. The insight for management: The return reversal is in line with reversals in firm fundamentals and becomes stronger for stocks with higher information uncertainty.

The Financial Implications of Supply Chain Changes (p. 2520)

Joel F. Houston, Chen Lin, Zhongyan Zhu

What are the financial implications of supply chain changes? A firm's bankruptcy affects the bank financing costs of its key suppliers. The authors look at data that captures the supply chain relationships of bankrupt firms over the time period 1990–2009. They compare the average borrowing cost of suppliers in the two years prior to the bankruptcy of a key customer to the average cost in the two years following the announced bankruptcy. The authors find a significant effect, and these effects are even stronger if the bankrupt firm is operating within a distressed industry or when there is a strong supplier–customer relationship. They also find that the structure of lending agreements significantly changes in the aftermath of a client bankruptcy. The insight for management: Average loan spreads increase by roughly 20% following the customer's announced bankruptcy.

Attention Allocation in Information-Rich Environments: The Case of News Aggregators

(p. 2543)

Chrysanthos Dellarocas, Juliana Sutanto, Mihai Calin, Elia Palme

News aggregators have emerged as an important component of digital content ecosystems, attracting traffic by hosting curated collections of links to third-party content, but also inciting conflict with content producers. Aggregators provide titles and short summaries (snippets) of articles they link to. Content producers claim that their presence deprives them of traffic that would otherwise flow to their sites. How do readers allocate their attention between a news aggregator and the original articles it links to? The authors examine how key design parameters, such as the length of the text snippet that an aggregator displays about articles, the presence of associated images, and the number of related articles on the same story, affect a reader's propensity to visit the content producer's site and read the full article. The insight for management: The presence of a substitution relationship between the amount of information that aggregators offer about articles and the probability that readers will opt to read the full articles at the content producer sites. Interestingly, however, when several related article outlines compete for user attention, a longer snippet and the inclusion of an image increase the probability that an article will be chosen over its competitors.

Culling the Herd: Using Real-World Randomized Experiments to Measure Social Bias with Known Costly Goods

(p. 2563)

Miguel Godinho de Matos, Pedro Ferreira, Michael D. Smith, Rahul Telang

Peer ratings have become increasingly important sources of product information, particularly in markets for information goods. What is the impact of peer ratings on consumers transacting in "real-world" marketplaces? The authors examine peer reviews of video-on-demand for a major telecommunications company, and find that peer ratings influence consumer behavior independently from underlying product quality. However, they also find that there is little evidence of long-term bias as a result of herding effects. Specifically, when movies are artificially promoted or demoted in peer rating lists, subsequent reviews cause them to return to their true quality position relatively quickly. The insight for management: In real-world marketplaces where consumers have sufficient access to outside information about true product quality, peer ratings may be more robust to herding effects and thus provide more reliable signals of true product quality than previously thought.

Disproportional Control Rights and the Governance Role of Debt

(p. 2581)

Aiysha Dey, Valeri Nikolaev, Xue Wang

Does the use of debt alleviate the conflict between shareholder classes by balancing the power of controlling insiders? The authors examine the governance role of debt in the context of U.S.-based dual class ownership structures. They suggest that dual class firms have higher leverage and a greater propensity to issue private debt; they also more frequently use cash sweeps and performance-based covenants. Dual class firms with greater agency conflicts and a greater need to access the capital market appear to rely more extensively on debt. This could be due to controlling insiders bonding against the agency costs associated with dual class ownership. The governance role of debt is further corroborated by the valuation effect of debt for dual class companies. Private debt issuances trigger greater positive market reactions to the inferior dual class stock in relation to both the superior dual class stock and a matched sample of single class firms. The insight for management: Dual class firms use debt as a complementary governance mechanism.

Market Design and Moral Behavior

(p. 2615)

Michael Kirchner, Jürgen Huber, Matthias Stefan, Matthias Sutter

How might different interventions have an influence on the degree of moral behavior when subjects make decisions? Sometimes, those decisions can generate negative externalities on uninvolved parties. In the authors' experiments, subjects can either take money for themselves or donate it to UNICEF for measles vaccines. The insight for management: The threat of monetary punishment promotes moral behavior; only the removal of anonymity, thus making subjects identifiable, gives perceptions of responsibility.

The Flipside of Comparative Payment Schemes

(p. 2626)

Thomas Buser, Anna Dreber

Can performance-based bonuses be detrimental to performance? "Comparative payment schemes" are pervasive in the workplace. Raises are based on performance; only one person can get the promotion. The authors examine whether such competitive compensation schemes have a negative impact on people's willingness to cooperate. The insight for management: Compared with a simple piece-rate scheme, individuals in a competitive environment, winner-takes-all competition, or luck-based lottery are significantly less cooperative in the public goods game; the result is substantial losses in the realized social surplus from the public good while having no significant impact on performance.

When $3 + 1 > 4$: Gift Structure and Reciprocity in the Field (p. 2639)

Duncan S. Gilchrist, Michael Luca, Deepak Malhotra

Do higher wages elicit reciprocity and lead to increased productivity? The insight for management: Paying higher wages, per se, does not have a discernible effect on productivity in a context with no future employment opportunities; however, structuring a portion of the wage as a clear and unexpected gift—by offering an unconditional raise after the employee has accepted the contract—leads to higher productivity for the duration of the job.

Intrinsic Variability in Group and Individual Decision Making (p. 2651)

Tigran Melkonyan, Zvi Safra

Can the inherent variability of preferences in managerial and individual decision making be explained? There are two models differentiated by the structure of core preferences: expected utility and betweenness-like preferences. Because there might exist violations of transitivity of preferences in these models, variability is important to understand in such decision-making environments. The insight for management: There are implications for variability in group and individual decision making for managerial decision making and for majority rule voting.

Opening Up Intellectual Property Strategy: Implications for Open Source Software Entry by Start-up Firms (p. 2668)

Wen Wen, Marco Ceccagnoli, Chris Forman

Does a firm's intellectual property (IP) strategy in support of the open source software (OSS) community stimulate new OSS product entry by start-up software firms? The authors analyze the impact of strategic decisions taken by IBM around the mid-2000s, such as its announcement that it will not assert its patents against the OSS community and its creation of a patent commons. These decisions formed a coherent IP strategy in support of OSS. The insight for management: IBM's actions stimulated new OSS product introductions by entrepreneurial firms and their impact is increasing in the cumulativeness of innovation in the market and the extent to which patent ownership in the market is concentrated.

How Does Adoption of the Outlet Channel Impact Customers' Spending in the Retail Stores: Conflict or Synergy? (p. 2692)

Gonca Soysal, Lakshman Krishnamurthi

How does adoption of the outlet channel impact customers' spending in the retail stores: conflict or synergy? The authors investigate how adoption of a retailer's factory outlet channel impacts customers'

spending in the retailer's traditional retail store channel. In recent years, many retailers have added exclusively sourced factory outlet stores into their channel mix to achieve market expansion and customer segmentation. However, the impact of adoption of this lower-quality, lower-price alternative channel on spending at the retailer's higher-quality, higher-price retail store channel is not clear. Customers adopting the outlet channel might increase their spending in the retail store channel because of the opportunity to become familiar with the brand at a lower price point or transfer of positive associations formed through patronage of the outlet channel to the store channel. Customers adopting the lower-quality channel might also decrease their spending in the retail store channel because of brand dilution or cannibalization. The authors use data from a specialty apparel retailer from a period during which the retailer opened many factory outlet stores to study how purchase behavior changes after customers adopt the outlet channel. Although customers who adopt the outlet channel spend less with the retailer compared to store-only customers, the difference cannot be attributed to the impact of adoption of the outlet channel. The authors uncover a positive spillover to the retail store channel from adoption of the outlet channel. The insight for management: Customers who adopt the outlet channel not only make incremental purchases at the outlet channel, but also increase their spending in the retail store channel after adoption. The increase in spending is due to more frequent retail store purchases and not to larger per-purchase expenditure.

Behavior-Based Pricing: An Analysis of the Impact of Peer-Induced Fairness (p. 2705)

Krista J. Li, Sanjay Jain

Are perceptions of the "fairness" of price discrimination an important consideration for firms? Firms tracking consumer purchase information often use behavior-based pricing (BBP), i.e., price discriminate between consumers based on preferences revealed from purchase histories. Research has shown that such pricing practices can lead to perceptions of unfairness when consumers are charged a higher price than other consumers for the same product. The authors study the impact of consumers' fairness concerns on firms' behavior-based pricing strategy, profits, consumer surplus, and social welfare. It had been shown that BBP often yields lower profits than profits without customer recognition or behavior-based price discrimination. The authors find that firms' profits from conducting BBP increase with consumers' fairness concerns. The insight for management: When fairness concerns are sufficiently strong, practicing BBP is more profitable than without customer recognition. However, consumers' fairness

concerns decrease consumer surplus. In addition, when consumers' fairness concerns are sufficiently strong, they reduce inefficient switching and improve social welfare.

Responsible Sourcing in Supply Chains (p. 2722)
Ruixue Guo, Hau L. Lee, Robert Swinney

What is the best sourcing strategy given the sometimes conflicting objectives of cost savings and environmental responsibility? The authors analyze the sourcing decision of a buyer choosing between two supplier types: responsible suppliers are costly but adhere to strict social and environmental responsibility standards, whereas risky suppliers are less expensive but may experience responsibility violations. Some socially conscious consumers are willing to pay a higher price for a product sourced from a responsible supplier and may not purchase in the event of a responsibility violation from a risky supplier. There are four possible sourcing strategies that a buyer might employ: (1) low cost sourcing (sourcing from the risky supplier), (2) dual sourcing, (3) responsible niche sourcing (sourcing from a responsible supplier and selling only to socially conscious consumers), and (4) responsible mass market sourcing (sourcing responsibly and selling to all consumers). The authors determine when each strategy is optimal and show that efforts to improve supply chain responsibility that focus on consumers (by increasing their willingness to pay for responsibility or increasing the

number of consumers that are socially conscious) or increasing supply chain transparency may lead to unintended consequences, such as an increase in risky sourcing. The insight for management: Enforcement and penalization of the buyer lead to more responsible sourcing and less risky sourcing.

The Sum and Its Parts: Judgmental Hierarchical Forecasting (p. 2745)

Mirko Kremer, Enno Siemsen, Douglas J. Thomas

Top down or bottom up, what is the best way to build a forecast, given subjective elements of developing projections? Firms require demand forecasts at different levels of aggregation to support a variety of resource allocation decisions. For example, a retailer needs store-level forecasts to manage inventory at the store, but also requires a regionally aggregated forecast for managing inventory at a distribution center. In generating an aggregate forecast, a firm can choose to make the forecast directly based on the aggregated data or indirectly by summing lower-level forecasts (i.e., bottom up). The authors find two judgment biases that affect the relative performance of direct and indirect forecasting approaches: a propensity for random judgment errors and a failure to benefit from the informational value that is embedded in the correlation structure between lower-level demands. The insight for management: There are demand environments where one hierarchical process results in more accurate forecasts than the other.