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Management Insights

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Fighting City Hall: Entry Deterrence and Technology Upgrades in Cable TV Markets (p. 461)
Robert C. Seamans

How does government bailout of automotive and financial companies affect competition? Economists have long studied competition between profit maximizing firms. The author investigates how private firms respond to potential entry from public firms. Based on a data set of more than 3,000 U.S. cable TV systems, the author presents evidence consistent with the idea that cable firms actively try to deter entrance by municipal electricity utilities that may be considering offering cable services. Interestingly, the author points to evidence that incumbent cable TV firms upgrade faster when located in markets with a potential municipal entrant. However, it isn't necessarily for the good of its customers; the same systems are then slower to offer new products enabled by the upgrade. Incumbent cable systems also upgrade faster in response to municipal entry threats than to the threat of a private company entering the market. The insight for management: A private firm's response to potential entry from a public firm differs from its response to a threat from a private firm; government participation may spark a quicker and more defensive stance from incumbents.

Constant Proportion Debt Obligations: A Postmortem Analysis of Rating Models (p. 476)
Michael B. Gordy, Søren Willemann

A complex financial instrument called the constant proportion debt obligation (CPDO) might be viewed as the poster child for the excesses of financial engineering in the credit market. For example, one of the first CPDOs, ABN AMRO's Surf, was rated AAA by Standard and Poor's (S&P) and earned considerable attention in the financial press and industry awards such as *Risk* magazine's "Deal of the Year" in February 2007. However, when credit markets came under stress in 2007, CPDOs were among the first to unravel. The authors examine the CPDO as a case study in model risk in the rating of complex structured products. They show that the volatility of CPDOs was itself volatile and that it was common for risk models to underestimate the probability of extreme spread changes. The insight for management: Traditional risk models' estimates of high spread levels were biased downward, which in turn biased the rating upward.

Cutting in Line: Social Norms in Queues (p. 493)
Gad Allon, Eran Hanany

"May I go in front of you?" is a request often made in a bank or grocery line, followed by "I am in a huge hurry and will only take a second." How do you respond? The authors explore both the decision to request to "cut" and the decision whether to grant or reject the request. They find that when no "authority" (e.g., bank manager) is involved, in some cases the answer is yes, in others, no. As it turns out, the eyes boring into the back of the "cutter" might be the best enforcement mechanism to reduce cutting. The insight for management: Your customers might "cut" only in certain situations; social policing may be an alternative to authority policing of customer behavior.

Calendar Cycles, Infrequent Decisions, and the Cross Section of Stock Returns (p. 507)
Ravi Jagannathan, Srikant Marakani, Hitoshi Takehara, Yong Wang

Have you checked your portfolio lately? The prevailing "consumption-based capital asset pricing model" (CCAPM) suggests that the risk premium that investors require to invest in a financial asset is proportional to the covariance of its return with the growth rate in aggregate per capita consumption, the measure of the security's systematic risk. The authors suggest that this model holds only at those points in time when all investors review their plans. They find more support for this theory at the end of the tax year in both Japan and the United Kingdom, when people are more likely to reevaluate their investment and

consumption decisions. The insight for management: The assumption of full information is important for the CCAPM to hold.

Is Leasing Greener Than Selling? (p. 523)
Vishal V. Agrawal, Mark Ferguson, L. Beril Toktay, Valerie M. Thomas

Is leasing greener than selling? Based on the proposition that leasing is environmentally superior to selling, some firms have adopted a leasing strategy and others promote their existing leasing programs as environmentally superior to "green" their image. The argument is that because a leasing firm retains ownership of the off-lease units, it has an incentive to remarket them or invest in designing a more durable product, resulting in a lower volume of new production and disposal. However, leasing might be environmentally inferior because of the direct control the firm has over the off-lease products, which may prompt the firm to remove them from the market to avoid cannibalizing the demand for new products. The authors find that leasing can be environmentally worse despite remarketing all off-lease products and greener than selling despite the mid-life removal of off-lease products. They show that imposing disposal fees or encouraging remanufacturing, under some conditions, can actually lead to higher environmental impact. They also identify when educating consumers to be more environmentally conscious can improve the relative environmental performance of leasing. The insight for management: Leasing might sound green, but other alternatives might be more effective.

Density Forecasting of Intraday Call Center Arrivals Using Models Based on Exponential Smoothing (p. 534)
James W. Taylor

How many operators are needed to adequately staff a call center? The key input to the call center staffing decision is a forecast for the number of calls arriving. Typically, density forecasts that are inputs to analytical call center simulation models assume Poisson arrivals with a stochastic arrival rate. Often, Holt–Winters exponential smoothing forecasts adapted for modeling the intraday and intraweek cycles has been used. The author proposes a Poisson count model with a gamma distributed arrival rate forecasting method and tests his forecasting methodology using data from three organizations. The author evaluates forecast accuracy up to two weeks ahead and finds that the proposed models improve prediction beyond two days ahead. The insight for management: Improved forecasting methodologies can improve call center simulations to support staffing decisions.

Sequential Sampling with Economics of Selection Procedures (p. 550)
Stephen E. Chick, Peter Frazier

Stop or shop? Say a manager is investigating a location for a new retail outlet or distribution center, for example. How does he know when to stop or to continue searching when there is great uncertainty of how each location will perform? How can a manager select "best" alternatives in an environment of future uncertainty of how the alternatives will perform? The authors suggest that "economics of selection" procedures help a manager facing a sequential sampling problem in which sampling is used to infer the unknown performance of several alternatives before one is selected as best. The manager compares a known standard with one alternative whose unknown reward is inferred with sampling. The insight for management: Sequential decision heuristics based on economics may account for the expected benefit of alternatives and may allow for adaptive stopping policies, saving time and effort.

Bayesian Dynamic Pricing Policies: Learning and Earning Under a Binary Prior Distribution (p. 570)
J. Michael Harrison, N. Bora Keskin, Assaf Zeevi

Imagine that a bank makes loan decisions to consumers who call in sequentially, observing either success or failure in each sales attempt. Initially, the bank may not know the underlying willingness to pay, so each price decision involves a trade-off between learning (failed sale) and earning (successful sale, but potentially underpriced). Because learning is passive (that is, learning takes place only as a by-product of actions that have a different purpose), incomplete learning and poor long-run profit performance can result. The authors find that, in some cases, a myopic policy can work out. The insight for management: A rather myopic policy under this uncertainty has a bounded performance gap relative to that of perfect information as the number of sales attempts becomes large.

Chasing a Moving Target: Exploitation and Exploration in Dynamic Environments (p. 587)
Hart E. Posen, Daniel A. Levinthal

It has been said that an organization must evolve or die. In fact, a common justification for organizational change is that the circumstances in which the organization finds itself have changed, thereby eroding the value of utilizing existing knowledge. On the surface, the claim that organizations should adapt by

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generating new knowledge seems obvious and compelling. However, this standard wisdom overlooks the possibility that the benefit of learning may itself be eroded if change is an ongoing property of the environment. Any collected information has costs—but no benefits—as the information becomes obsolete. The insight for management: Under some conditions the appropriate response to environmental change is a renewed focus on exploiting existing knowledge and opportunities rather than a costly pursuit of new information that may itself be obsolete.

Multiattribute One-Switch Utility (p. 602)
Ilia Tsetlin, Robert L. Winkler

The "one-switch" property states that the preference between any two lotteries switches at most once as wealth increases. The authors extend the one-switch notion to the multiattribute case and identify the families of multiattribute utility functions that are also one-switch. The insight for management: The one-switch property, when appropriate, can simplify the assessment of multiattribute utility.

Managing Delegated Search Over Design Spaces (p. 606)
Sanjiv Erat, Vish Krishnan

Recently, the Swiss-based nongovernmental organization Mabawa posed the Rwanda Rural Electrification Challenge in "tournament" fashion, with the top three solutions splitting $2,500. Would you participate? Such an unstructured problem is costly to specify, poses credibility issues for the focal firm, and requires finely tuned awards for meeting the firm's needs. The firm must go through extensive efforts in these regards to attract participants and useful solutions. The authors suggest how a firm should effectively manage such open-ended design contests by examining the relationship among problem specification, award structure, and breadth of solution space searched by outside agents. The authors explain an interesting phenomenon observed in design contests: clustering of searchers in specific regions of the solution space. Although the breadth of search increases with the number of searchers, the growth of the solution space is slower than the growth of participants. The insight for management: Unstructured contests can be made more effective by carefully choosing how many and what size awards should be offered, as well as the extent to which problems are specified.

Pricing Kernels with Stochastic Skewness and Volatility Risk (p. 624)
Fousseni Chabi-Yo

How are investor utility and stock prices affected by price volatility, and vice versa? A pricing kernel can be interpreted as a scaled marginal utility. The author shows that market volatility risk is not exogenous to investor preferences; it is in fact restricted by the investor's risk aversion and skewness preferences. The author shows that the pricing kernel decreases in the market index return and increases in market volatility. The insight for management: Although often investor utility is considered a function of volatility, in fact market volatility and skewness themselves can be affected by investor preference.

Optimal Compensation and Pay-Performance Sensitivity in a Continuous-Time Principal-Agent Model (p. 641)
Nengjiu Ju, Xuhu Wan

How should compensation be structured between diversified, risk-neutral shareholders and a risk-averse manager? The authors show several interesting results. First, the optimal compensation is increasing but concave in output value if the manager is more risk averse than a log-utility manager; optimally, there is diminishing payout for performance. Second, when the manager has a specific preference form, linear contract is optimal without lower bound on payment, but an option contract is optimal when there is an explicit lower bound. Third, optimal effort of the manager depends on the situation he or she is placed in. The insight for management: Pay schemes should be well designed to invoke the appropriate incentives and returns for both investors and managers.