



## Valuing Assets When the Bottom Drops Out

In their paper “Liquidity and Valuation in an Uncertain World,” Maureen O’Hara and David Easley look closely at the financial crisis—and more specifically, at how to value assets accurately when a market essentially stops in its tracks.

O’Hara, professor of management at Cornell University’s Johnson Graduate School of Management in Ithaca, New York, worked with Easley, professor of economics in Cornell’s department of economics, to develop a model that tracks and explains the behaviors and decision making of individuals during a financial meltdown. When market turmoil goes beyond the norm, rules of prob-

ability no longer apply. And when market participants can no longer predict likely scenarios or calculate risk, they stop buying and selling assets regardless of bid or ask prices.

But even in such an economic environment, regulatory bodies still require firms to price their assets. So, the question remains: How is asset value calculated in a market where no one’s buying? The typical approach of using ask or bid prices to set values is faulty, say O’Hara and Easley. In uncertain markets, these prices are often in freefall because markets are frozen, not because the actual value of the company has changed.

Instead, the researchers recommend averaging the bid and ask prices—essentially looking at the best- and worst-case scenarios and

meeting in the middle. While this approach might not be perfect, it offers a best estimate until markets stabilize, says O’Hara.

Ironically, the two researchers were working on this approach long before the banking collapse of September 2008. They point out that their new model recognizes that firms still need a way to calculate value logically, even when economic forces stop making sense.

Their study recently received the Western Finance Association’s award for best paper in asset pricing. It is available as abstract No. 1282106 on [www.ssrn.com](http://www.ssrn.com).

## White-Collar Crime: A Slippery Slope

White-collar crime might begin with a single malefactor, but it is enabled by many otherwise good individuals, say three Canadian researchers. These people are simply caught up in a corporate culture governed by power plays and bad behavior.

For example, the collapse of 233-year-old Barings Bank in the United Kingdom might have seemed to be caused by a single person. After all, the bad trades of chief trader Nick Leeson cost the bank \$1.4 billion—and its very existence. But for years, Barings Bank executives allowed Leeson to both trade and settle deals, actions usually completed by two people to avoid conflicts of interest and corruption.

Likewise, three executives might share the brunt of the blame for Enron’s collapse, but their actions were enabled by a pervasive culture of misrepresentation and secrecy.

Ruth McKay, an associate professor at Carleton University’s Sprott School of Business in Ontario, Cana-

da, worked with psychologists Carey Stevens and Jae Fratzl to examine the making of a white-collar criminal. They identified a 12-step process that can lead an individual, a team, or an entire organization from legal to illegal activity.

Four initial steps set the stage to create the likes of Enron and Barings Bank. First, someone of questionable morals must be hired into a position of power. Next, this individual must be driven more by achievement and self-advancement than by the needs of others. Third, those in power must be willing to turn a blind eye to his questionable behavior. Fourth, he must hire people under him who are passive and “too new to raise questions.” These staff members will likely suffer from “low self-esteem, or circumstances that lead them to be more vulnerable,” the researchers write.

Illegal activity begins only once these first four factors are in place. In the next six steps, staff members begin to question their leader’s behavior, only to be reassured that all is well. If that doesn’t work, the leader begins to bully and threaten them. Soon, they’ve silently witnessed or even contributed to so many misdeeds that they feel trapped and fear discovery.

Then, for some, the cognitive dissonance between their values and their behavior is too much to bear. They become whistleblowers. In the final step, the truth is revealed, and the perpetrator either denies any



wrongdoing or portrays himself as simply misunderstood.

McKay, Stevens, and Fratzl plan a follow-up study that will explore the aftermath of white-collar crime to determine how an organization can best react and survive if unethical behavior is discovered among its ranks. “It’s a unique crisis situation,” says McKay.

It’s important for all companies to understand that white-collar crime is the result of a network of interpersonal relationships—of a culture that condones bullying and misuse of power, says McKay. Only then can they take steps to change before a crisis occurs.

Their paper, “A 12-step process of white collar crime,” is forthcoming in the *International Journal of Business Governance and Ethics*.

## ■ Making Economic Stimulus Work

**After a three-month study, researchers** from two Colorado business schools are recommending a plan to make sure the U.S. stimulus package results in economic growth.

The research was conducted by Ron Rizzuto, professor of finance at the Daniels College of Business at the University of Denver; Brian Lewandowski, research analyst with the Business Research Division (BRD) at the Leeds School of Business at the University of Colorado-Boulder; and Gary Horvath, managing director of BRD. The trio focused on a proposal made by John Sie, founder and former CEO of cable movie channel Starz, in a commentary in the *Denver Post*. Calling his proposal the “Incentivize Success Plan,” or IS!, Sie recommended that stimulus money

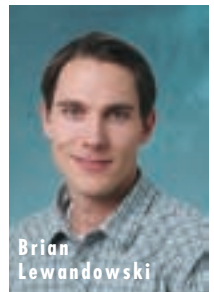
be used to offer low-interest, government-guaranteed loans; a tax credit for retraining U.S. workers; and a 1 percent rate discount on borrowing rates.

Sie’s proposal, now called the “Incentivize Successful Small Businesses” (ISSB) Plan, is part of a bill being drafted in the U.S. Congress.

Horvath, Lewandowski, and Rizzuto studied whether such a plan would make sense at a time when nearly every economic indicator has declined and small businesses find it increasingly difficult to obtain loans. ISSB would increase lending and help businesses grow capital.

Their financial models showed that ISSB would be profitable in its second year, because of the increased tax revenue generated by economic growth. If the plan were supported by \$15 billion in funding, the researchers posit, it would result in 978,196 jobs, a \$595.4 billion increase in GDP over five years, and a positive ROI for taxpayers.

There are three keys to making ISSB a success, says Horvath. First, it must be easy to understand and implement. Second, it must find a home within a current government agency, such as the Small Business Administration. Finally, it must have a high level of participation among successful companies that have been unable to secure loans. If too many



Brian  
Lewandowski



Gary Horvath



Ron Rizzuto

high-risk companies were to be accepted, he says, the plan would be hindered by a higher-than-anticipated default rate.

In the second phase of their research, Lewandowski, Horvath, and Rizzuto will focus on determining the optimal size, design, and administration of such a program. Their goal is to provide policymakers with a plan for economic growth that's both effective and ready to implement.

The "IS! Phase I Final Report" is available under the "Research" link at [leads.colorado.edu/BRD](http://leads.colorado.edu/BRD). The authors also welcome comments on Lewandowski's blog entry on the plan at [www.cuboulderblogs.com/brd/](http://www.cuboulderblogs.com/brd/).

## ■ Don't Be Too Certain

**Two scholars in the Stanford Graduate School of Business in California** have come to a surprising conclusion: Experts might lose credibility when they express *too much* certainty in their own points of view.

Zakary Tormala, associate professor of marketing, and doctoral candidate Uma Karmarkar presented consumers with two favorable reviews of a fictitious restaurant. One review gave the restaurant four out of five stars unequivocally. The other offered the same rating, but offered its endorsement more tentatively, noting that the reviewer had visited the restaurant only once.

In one experiment, study participants were told that the high-certainty reviewer was a prominent food critic and the low-certainty reviewer was a local community college administrator who wrote a food-related blog. In another, they were told the opposite.

## STUDY BRIEFS

### ■ BENEFITS OF DIGITAL RECORDS

A study from the University of Rochester's Simon Graduate School of Business in New York supports the use of medical information tracking technologies. Abraham Seidmann, a professor of computer and information systems and operations management, completed the study with doctoral student Atanu Lahiri. They found that when hospitals use radiology information systems, they improve clinical information gathering, speed up interpretation times, increase physicians' productivity, and enhance patient service. The study was published in the October *Journal of the American College of Radiology*.

### ■ "SIN" STOCKS PAY OFF

Virtue may be its own reward, but vice wins out when it comes to stocks. Marcin Kacperczyk, assistant professor of finance at New York University's Stern School of Business, and Harrison Hong, an economics professor from Princeton University in New Jersey, examined stock performance from 1926 to 2006. They discovered that those who invest in companies in the alcohol, tobacco, and gaming industries gain 2.5 percent higher returns, on a risk-adjusted basis,

than those who invest in comparable, more family-friendly industries such as beverage, food, and entertainment. "The Price of Sin: The Effects of Social Norms on Markets" has been accepted for publication with the *Journal of Financial Economics*. It is available online at [pages.stern.nyu.edu/~sternfin/mkacperc/public\\_html/sin.pdf](http://pages.stern.nyu.edu/~sternfin/mkacperc/public_html/sin.pdf).

### ■ ENFORCE OR DESIST

Badly enforced laws for insider trading are worse than no laws at all, according to Utpal Bhattacharya, an associate professor of finance at Indiana University's Kelley School of Business in Bloomington, and Hazem Daouk, an economics professor at Cornell University in Ithaca, New York. The two analyzed monthly stock indices from 22 developed markets and 33 emerging markets through Morgan Stanley Capital Market International. When laws aren't well-enforced, firms find capital more expensive to obtain, honest investors are at a disadvantage, and national economies suffer. The researchers' message to policymakers: Either enforce the laws or don't pass them at all to keep everyone on equal footing. The study, "When No Law is Better Than a Good Law," was published online on November 1 by the *Review of Finance*.

Tormala and Karmarkar found that the consumers took the reviews in the second scenario—from the high-certainty novice and the low-certainty expert—more seriously than they took those in the first. "We find that when the regular, everyday person is extremely certain, that's surprising to readers,"

Tormala says in a report in *Stanford-Knowledgebase*. "Conversely, when the expert is not so certain, that's surprising. In both cases, surprise increases readers' interest in and involvement with the review."

Tormala adds that no opinion will have much impact if it is not strongly presented. But well-crafted



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expert opinions that are qualified by a dose of doubt could be the most persuasive of all.

Tormala and Karmarkar's study, "Believe Me, I Have No Idea What I'm Talking About: The Effects of Source Certainty on Consumer Involvement and Persuasion," is forthcoming in the *Journal of Consumer Research*.

### Nonprofits, Partner Carefully

Now that many corporations want to boost their corporate social responsibility initiatives, nonprofits are themselves seeking more support from public-sector firms. But nonprofits should be cautious when they create these alliances, say Stacy Landreth Grau, associate professor of marketing at the Neeley School of Business at Texas Christian University in Fort Worth, and Amanda Bower, marketing professor at Washington and Lee University's Williams School of Commerce, Economics, and Politics in Lexington, Virginia. If a cause pairs its name with the wrong firm,

it could send the wrong message and possibly damage its brand.

For their study, Grau and Bower created a fictional childhood learning company. They then developed various print ads for that company that indicated several levels of connection to two fictional nonprofits. Some ads included only the nonprofits' logos (a licensing agreement); others linked a consumer purchase to a donation to the nonprofits (cause-related marketing); and others featured the nonprofits' stated endorsement of the company.

When the researchers surveyed participant reaction to the ads, they found that most participants paid no attention to the level of nonprofit engagement in the ads—in many cases, consumers assumed the logo alone represented a seal of approval. For that reason, the licensing agreement, with only the logo appearing in the ad, could be the riskiest type of partnership for a nonprofit.

"Our results suggest that some

## RESEARCH RECOGNITIONS

■ The National Association of Economic Educators has awarded its 2009 Henry H. Villard Research Award to **KimMarie McGoldrick**, a professor of economics at the University of Richmond's Robins School of Business in Virginia. The award recognizes McGoldrick's research on economics education.

■ Two educators from the University of Guam have received the Allied Academies Distinguished Research Award. **Anita Borja-Enriquez**, dean of the UOG School of Business and Public Administration, and economics professor **Claret Ruane** received the award for their paper, "The Making of the Pacific Tiger: Lessons from the Celtic Tiger," which will be published in the *Journal of Economics and Economic Education Research*.

■ Three California researchers have received the 2009 Moskowitz Prize for Socially Responsible Investing from the Haas School of Business' Center for Responsible Business at the University of California, Berkeley. **David Baron** of the Stanford Graduate School of Business, **Maretno Harjoto** of Pepperdine University's Graziadio School of Business and Management in Los Angeles, and **Hoje Jo** of Santa Clara University's Leavey School of Business won for their paper, "The Economics and Politics of Corporate Social Performance." The three analyzed 3,000 firms during the last four years of the Clinton Administration. One of their findings is that companies that face pressure from activists also tend to suffer from lackluster financial performance.

CSR initiatives may produce consumer inferences that are wrong but desirable for the company," says Grau. "These inferences can have potentially negative consequences for the nonprofit."

"Explicit Donations and Inferred Endorsements: Do Corporate Social Responsibility Initiatives Suggest a Nonprofit Organization Endorsement?" appeared in the Fall 2009 *Journal of Advertising*.

## ■ Diversity and Foreign Investment

**When an emerging market attracts foreign direct investment (FDI) from firms representing diverse national origins, its own economy is more likely to flourish, according to a new study. The research was conducted by professors Yan Anthea Zhang and Haiyang Li of Rice University's Jones Graduate School of Business in Houston, Texas; Yu Li of the University of International Business and Economics in Beijing, China; and Li-An Zhou of Peking University's Guanghua School of Management in Beijing.**

The researchers focused their study on China, examining data on Chinese firms across 509 manufacturing industries, from 1998 to 2003. They found that diverse FDI has helped Chinese companies grow tremendously. Some firms—such as Lenovo and Haier—have become multinational corporations themselves. Much of that growth, say the researchers, can be attributed to the broad base of technological knowledge and management skills that foreign firms brought with them. Exposure to that knowledge helped Chinese managers learn more and learn it faster, says Li.



Moreover, as more foreign firms enter a market, they must compete with each other more aggressively, says Zhang. That competition places Chinese firms on even stronger footing.

The researchers stress that these findings can apply to any nation, including the U.S. "Firms from emerging markets have not been widely viewed as knowledge sources from which American firms can learn," says Zhang. She adds that strategically encouraging more FDI from a variety of countries can be a "win-win" situation.

The study, "FDI Spillovers in an Emerging Market: The Role of Foreign Firms' Country of Origin Diversity and Domestic Firms' Absorptive Capacity," is forthcoming in the *Strategic Management Journal*.

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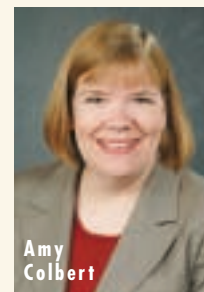
## UPCOMING & ONGOING

### ■ THE VALUE OF AN EMBA

Studies examining the return on investment of a full-time MBA degree have found that MBAs are better able to attain promotions, enjoy expanded career responsibilities, and earn higher salaries. But what about those who earn executive MBAs? Two professors at the University of Iowa's Tippie College of Business in Iowa City are conducting research to determine how much—and whether—an EMBA pays off for graduates and employers.

In a longitudinal study, Amy Colbert, assistant professor of management, and Greg Stewart, professor of management and organizations, have begun collecting career data from current Tippie EMBA students. In two years, they will follow up with students at graduation; several years later, they'll measure the long-term impact of the EMBA on these students' careers.

Measuring the ROI of an EMBA might be a bit tricky, the researchers note. Full-time MBA students put their careers on hold for two years, making it easy to compare their status and salaries before and after their programs. But EMBA students continue to hold their full-time jobs during their programs, so the effects of the degree might not be as clear-cut. It's difficult to determine whether a raise or promotion they receive after graduation happens because of the degree or because of normal career progression.



Amy Colbert



Greg Stewart

So far, Colbert and Stewart are working only with Tippie EMBA students, but they hope to expand their study to students from other schools.

Salary and career data in the study include students' self-assessments and reports from their supervisors and co-workers. Companies have been particularly forthcoming with information because they often cover the cost of an employee's EMBA program, says Stewart. "They want to know if they're getting a return on their investment." 