Two Takes on Exec Pay

Do big executive compensation packages do more harm than good to a company's bottom line? To the economy itself? Two new studies come to different conclusions about these questions.

Incentives and Market "Shocks." The most popular executive incentive—the stock option—has led to volatile swings, or "shocks," in the market, according to researchers John Donaldson and Mark Giononi of Columbia Business School and Natalia Gershun of the Lubin School of Business at Pace University, both in New York City. When executive compensation is tied to company performance, as stock options are, CEOs may set unrealistic earnings expectations.

These expectations, rather than business fundamentals, drive business cycles, say the researchers. The consequence of this vicious circle can be economic instability—much like the instability of today's markets.

The paper, "Some Unpleasant General Equilibrium Implications of Executive Incentive Compensation Contracts," is available on the Social Science Research Network.

Incentives and Shareholder Wealth. While the study above finds the dark side of executive incentives, a study from Carnegie Mellon University's Tepper School of Business in Pittsburgh, Pennsylvania, suggests that such incentives may actually build shareholder wealth.

Tepper professors George-Levi Gayle and Robert Miller analyzed compensation and firm data for the aerospace, electronics, and chemical industries from 1944 to 1978 and 1993 to 2003. The researchers found that at those average-sized firms that maintained their size from 1944 to 2003, CEO pay increased by a factor of 2.3—approximately equal to the growth rate of per capita national income over the same period.

These findings undermine the argument that the earnings of high-ranking executives have skyrocketed compared to the general population, say the researchers. However, per capita nonwage income—such as dividends and interest income—grew more quickly than average wages, a reflection of the increasingly volatile state of earnings. CEOs who lead larger companies are taking bigger risks themselves. If such incentives were eliminated and replaced by fixed wages, the value of U.S. firms could be reduced by half in just eight years, the researchers argue.

"Properly designed incentive-based pay helps to discourage excessive risk-taking, and eliminating such compensation would undercut the critical role that it plays in ensuring the alignment of interests between shareholders and executives," says Miller. "Such a change would do serious harm to the fiscal health of corporations and the wealth of shareholders."

"Has Moral Hazard Become a More Important Factor in Managerial Compensation?" is forthcoming in the *American Economic Review.* It also is available for download at www.comlabgames.com/ramiller/AER.pdf.

Whither Economics?

Economics has long been somewhat of a chameleon on university campuses. In some institutions it's found in the business school; in others, the school of arts and sciences; in still others, the school of social sciences. But does its location affect the curricular emphasis of its doctoral program?

Shane Sanders is an assistant professor of economics in the department of finance and economics at Nicholls State University's College of Business Administration in Thibodaux, Louisiana. He examined the curriculum vitae of 661 economics PhD candidates from 76 economics departments, all entering the job

Shane Sanders

market in the spring of 2008.

Sanders found that factors such as candidates' academic specialty and gender, as well as how their PhD programs were ranked and whether they earned degrees in English-speaking countries, affected their choice of research specialty. However, the location of the economics department had no effect, writes Sanders, "on a given student's propensity to choose a general field, a field within macroeconomics or monetary economics, a field that advertises an empirical methodology, or a field related to traditional business studies."

He concludes that these findings provide "strong case evidence that administrative location of an academic department does not affect the nature of its educational output."

"Does Administrative Location of an Academic Department Affect Educational Emphasis? The Case of Economics," was published in the August 2009 issue of the *Journal of Higher Education Policy and Management.*

Do Promotions Affect Other Product Categories?

Peanut butter and jelly. Coffee and dairy creamer. Cheese and crackers. Certain products go together. The question is whether—and how much—promoting a product in one category increases sales of products in complementary categories, says Subir Bandyopadhyay, a marketing professor at Indiana University Northwest's School of Business & Economics in Gary.

To measure the effects of cross-category promotions, Bandyopadhyay and a research team studied data from The Kroger Co., a supermarket chain based in Cincinnati, Ohio. They specifically examined data involving the sale of four brands of ice cream, two brands of ice cream toppings, and three brands of frozen yogurt. They had access to scanner data for 97 consecutive weeks.

The researchers were not surprised to find that promotions of frozen yogurt did not significantly affect the sales of ice cream toppings. However, they discovered that ice cream promotions did—and that specific ice cream brands affected toppings sales in different ways.

For instance, directly after stores promoted Texas Gold brand ice cream, sales of Hershey's toppings increased by 137 units, but sales of Nestlé toppings increased by only 12 units. Similarly, a promotion of Breyer's brand ice cream led to a 10.5 percent increase in units sold of Nestlé toppings over the next eight weeks, compared to an 8.7 percent increase in units sold of Hershey's toppings.

Subir Bandyopadhyay

That indicates that Nestlé and Hershey's could do well to merchandise certain brands of ice cream within promotions of their own toppings, says Bandyopadhyay. He realizes that marketers may not be enthusiastic about promoting products from companies other than their own. But he maintains that this cross-category analysis model could help both retailers and manufacturers identify shopping patterns that could inspire more advantageous product stocking, shelf placement, and coupon combinations.

This model is not as effective for evaluating brands new to a category, says Bandyopadhyay. But when it comes to established brands, he writes, the cross-category competition model "unravels the competitive dynamics within and across categories."

"A Dynamic Model of Cross-Category Competition: Theory, Tests, and Applications" is due to be published in the November issue of the *Journal of Retailing.*

How Branded Components Are Changing the Market

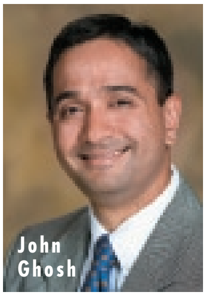
There once was a time when Dodge pickup trucks represented only the Dodge brand. Today, a Dodge pickup truck may share equal billing with the Cummins engine inside, says George John, chair of the marketing department at the University of Minnesota's Carlson School of Management in Minneapolis. "When component brands become powerful, it changes the industry," John says.

John and Mrinal Ghosh, marketing professor at the University of Arizona's Eller College of Management in Tucson, studied a number of component brands, including Intel processing chips inside Dell computers and Detroit Diesel engines inside GM vehicles. They found that on 30 percent of the industrial products in their samples, users see at least one component brand displayed in addition to the primary brand.

Once a component brand's name is on a product, the component's manufacturer benefits from a kind of insurance policy, says John. The company owning the primary brand is less likely to switch to a newer, cheaper component from a competing supplier. That means that the component maker can spend more time working on its product, and less time marketing it.

In fact, says John, the innovation that makes one product superior over another often doesn't come from the primary brand, but from the component brand.


George John


John Ghosh

The increase in visibly branded component parts is of special interest to policymakers and regulators, John adds. In the case of a failure—of an industry or of a product with a primary brand and secondary brand—those setting the rules will face difficult questions. "Who gets bailed out? Detroit Diesel or GM? Cummins or Dodge?" asks John. "The right answers must depend on a deep understanding of who offers the real value."

"When Should Original Equipment Manufacturers Use Branded Component Contracts with Suppliers?" was published in the October 2009 issue of the *Journal of Marketing Research*.

What Makes Investors Tick?

Why do some investors buy up a stock at the same time others are selling it? What makes their perceptions of the same company so different? Over the years, researchers have developed several tools to explain this diver-

STUDY BRIEFS

POWER IN THE ABSTRACT

The more powerful the leaders, the more abstract their thinking—and the more overconfident they'll be, according to a new study from New York University. Joe Magee and Frank Milliken of NYU's Stern School of Business, Robert Wagner of the Graduate School of Public Service, and NYU student Adam Lurie analyzed hundreds of public comments in the media from September 11, 2001, to September 20, 2001, regarding the 9/11 attacks. They found that individuals in positions of power in government, on Wall Street, and in the military were more likely to describe the event in abstract terms. Such abstractions contributed to these individuals' underestimates of the difficulties they would face and the time they would need to achieve their goals. The study, "Power Differences in the Construal of a Crisis," is forthcoming in the *Personality and Social Psychology Bulletin*.

STUDY OF WINE COUNTRY

Researchers from the University of North Carolina at Greensboro and North Carolina A&T State University, also in Greensboro, have collaborated to examine the growth of North Carolina's wine industry. They found that winery owners are hindered by a lack of time and capital, as well as by the state's alcohol regulations. Because most of the state's wineries are fairly young—less than ten years old on average—the study emphasized the need for more education in basic business practices and marketing. The researchers' next step is to conduct a benchmark study of the state's alcohol regulations to compare them to those of other U.S. states. The full report is available at www.uncg.edu/bae/or/WIBDC_Results_Final_Report.pdf.

MEDIA UNDER THE MICROSCOPE

A new paper by David Grayson, director of the Doughty Centre for Corporate Responsibility at the U.K.'s Cranfield School of Management, explores corporate responsibility (CR) and the media, from print and broadcast to blogs and social networking sites. Recent media behaviors—ranging from reproducing cartoons that offended Muslims to operating in China under the shadow of censorship—raise critical CR issues, Grayson says. He adds that the media must not only play a vital role in reporting on the bad behavior of businesses and society, but also do more to delve into the complexities and trade-offs that modern businesses face. Their responsibilities, he says, include gence, but to date no one had tested these tools' effectiveness.

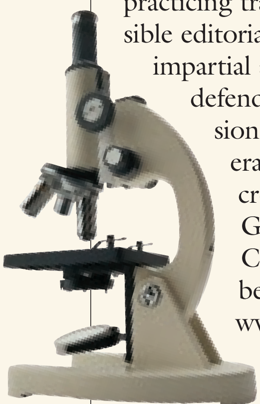
Jon Garfinkel, associate professor of finance at the University of Iowa's Tippie College of Business in Iowa City, has developed a process to indicate which of these measures is most accurate at determining the effects of this phenomenon, known as "investors' opinion divergence." Such a guide, Garfinkel explains, could help analysts predict how a particular stock will perform in the future.

After signing nondisclosure agreements, Garfinkel and his research assistant were granted access to proprietary data from the New York Stock Exchange, which they used to study limit orders placed with the NYSE during three months in 2002.

Garfinkel found that, of the currently used measures, "unexplained volume" was the most accurate in determining the effects of opinion divergence. Those using unexplained volume begin with a previous day's volume as an indicator of a stock's expected volume on any given day; then, they compare this number with actual volume. If actual volume significantly and unexpectedly exceeds expectations—and has no other obvious cause, such as an earnings report or news story—investors are most likely trading because they disagree about the stock's value.

Another frequently used measurement—analyst forecast dispersion—did not fare as well. The measure views analysts' opinions as a reflection of investors' opinions. Garfinkel found it to be a weaker indicator—most likely because analysts and investors often view the markets differently.

Garfinkel's study, "Measuring Investors' Opinion Divergence," is forthcoming in the *Journal of Accounting Research.*



practicing transparent and responsible editorial policies, generating impartial and balanced reporting, defending freedom of expression, promoting media literacy, and helping people cross the digital divide. Grayson's paper about CR and the media can be found online at www.doughtycentre.info under the "Publications" link.

UPCOMING & ONGOING

NETWORK FOR HEALTHCARE MANAGEMENT

Two centers at the University of Leeds in the United Kingdom have won €300,000 (about US $437,800) in funding from the European Cooperation in Science and Technology. The Centre for Employment Relations, Innovation and Change and the Centre for Innovation in Health Management will use the funding on a four-year project to organize the research of healthcare management in 19 countries. Leeds will coordinate the research activities of groups such as the European Health Management Association, the European Association of Hospital Managers, and the European Hospital and Healthcare Federation. The objective, says Ian Kirkpatrick, a professor at Leeds University Business School, is to determine whether reforms in health services in these countries have led to improved quality of care and greater cooperation between healthcare providers.

AWARDS FOR INNOVATION

Boston University's Institute for Technology Entrepreneurship and Commercialization has created the Boston University Clinical Innovation Awards Program. The program is supported by a grant of $150,000 from the Johnson & Johnson Corporate Office of Science and Technology to provide support for multidisciplinary research and development of new medical technologies.

'COLLABORATORY' ESTABLISHED

IBM and the Indian School of Business in New Delhi have opened a research "Collaboratory" on ISB's campus dedicated to the study of service science. The lab initially will have a team of ten full-time researchers—five each from IBM and ISB—who will focus on developing best practices for the service sciences field. Research will be multidisciplinary and include academic, government, and commercial partners. Z