The impact of economic prosperity on CEO ethics

Prior research suggests that economic booms are associated with overconfidence and risk-taking. In a new paper, Emily Bianchi, assistant professor of organization & management, and coauthor Aharon Mohliver (London Business School) build on that research by showing that prosperous times are also associated with more ethical lapses. The authors examined whether CEOs were more likely to backdate their stock options during prosperous economic times. Backdating stock options was relatively common during the late 1990s to early 2000s. It was also unethical. A backdating CEO would receive a stock option grant on one day but report that the options were assigned on an earlier date when the stock price was lower. This would allow the CEO to realize greater gains when he or she sold the stock. Also, it required lying to the SEC and came at the expense of company profits. To test their theory, Bianchi and Mohliver looked at the backdating patterns of 2,139 CEOs of US publically traded companies between 1996 and 2005. They found that CEOs were more likely to backdate in good economic times. They also found that “CEOs who began their careers in prosperous times were more likely to backdate stock option grants later in their careers.” The findings indicate that economic prosperity influences the likelihood of corporate misconduct. Organization Science (2016)

Dubious loan origination and the housing collapse

Gonzalo Maturana, assistant professor of finance, and coauthor John M. Griffin (U of Texas) argue that securitization was not the only factor in the recent housing crisis. Their new research indicates that questionable mortgage origination practices played a significant role in the distortions in the 2003 to 2012 real estate boom and bust. Specifically, the underreporting of the true risk profiles of borrowers, including the misreporting of second-liens, helped to drive housing demand and, ultimately, contributed to the crisis. They note, “The process of underreporting key loan attributes can have the by-product of facilitating credit to borrowers who have little ability to repay.” The researchers tested their theory by using county deed records, securitized loan information, house price statistics, and home loan application data from a number of reliable sources to detail the 2003 to 2006 run-up of housing prices and its subsequent 2007 to 2012 collapse. After controlling for securitization, they determined that “originator malfeasance” in certain areas also served to raise the credit supply. Maturana and Griffin concluded that dubious origination practices helped to cause house prices in certain zip codes to increase relative to other areas and eventually led to larger price crashes. Review of Financial Studies (2016)

Markdown management and shopping behavior

Consumers face the trade-off of immediately paying tag price for an item or waiting for a time when it might be marked down but out of stock. In new research, Nikolay Osadchiy, assistant professor of information systems & operations management, Manel Baucells (U of Virginia), and Anton Ovchinnikov (Queen’s U) argue that retailers can better optimize markdowns by paying more attention to this particular type of consumer behavior. The researchers approach the consumer wait-or-buy decision as a “multidimensional trade-off between the delay in getting an item, the likelihood of getting it, and the magnitude of the price discount.” Those dimensions need not be independent; for example, the consumer patience (or sensitivity to delay) could depend on the magnitude of markdown. By optimizing the model, they find that retailers can substantially increase revenues by offering larger markdowns than the current state of the art suggests. In the experiments involving business school students as well as Amazon Mturk participants, which is an on-demand, scalable workforce, the trio found that the expected revenue gains are between 1.5% and 2%. Operations Research (2016)

The role of behavior in managing mergers

Despite corporate interest in M&As as a growth strategy, research indicates that financial returns on such deals often fall short of expectations. Corporate leaders spend considerable time looking at the financial and quantitative aspects of mergers and acquisitions; however, Sandy Jap, Sarah Beth Brown Professor of Marketing; A. Noel Gould (Texas State U); and Annie H. Liu (Texas State U) argue that factoring in people should also be a major consideration when it comes to a proposed deal. Their research indicates that better employee and customer management is especially critical to an organization’s M&A strategy and implementation success. The trio analyzed ANZ New Zealand’s horizontal merger with the National Bank of New Zealand to better understand the impact of employee and customer behavior on the deal. They contend that this brand and technology merger succeeded due to ANZ’s commitment to ensuring customer satisfaction and addressing employee concerns about the merger. ANZ New Zealand also focused on business efficiencies and rebranding efforts. Jap, Gould, and Liu note that collaboration became a big key to the success of the merger with ANZ’s financial, IT, marketing, and communications personnel working closely together to retain customers. Business Horizons (2017)
Financial covenant violations and private debt contracts

In new research, Edward Owens, assistant professor of accounting, and Peter R. Demerjian (U of Washington) offer an improved methodology for predicting financial covenant violations in private debt contracts. A financial covenant is a condition on a commercial loan that requires a borrower to maintain certain financial ratios, and there are many covenants that exist in any one loan. Covenant violations often reflect the borrower’s riskiness or the degree of conflict between lender and borrower. Prior research has struggled to measure the probability of covenant violations. Although the preeminent database used in debt contracting research, Thomson Reuters’ DealScan, provides details about which financial covenants exist on a given loan, it does not provide specific measurement definitions of individual covenants. Owens and Demerjian use a subset of loans for which covenant definitions are available to determine standard covenant definitions that researchers can apply to broader loan samples. Further, Owens and Demerjian propose an intuitive, comprehensive measure of the probability of loan covenant violation that is more accurate than previously considered measures, which should open up additional avenues for researchers in the field of debt contracting. Journal of Accounting and Economics (2016)

Luxury retailers, customer experience, and brand desire

Consumers often complain that sales staff at luxury retailers ignore or reject average customers. Employees in the industry confirm that sales staff at luxury retailers do sometimes size up customers, choosing who to help and who to avoid based on what they wear. Conventional wisdom would suggest that the rejected consumer would choose not to buy the specific brand. Morgan Ward, assistant professor of marketing, and coauthor Darren W. Dahl (U of British Columbia) challenge this idea “by exploring how negative customer service experiences can, in some instances, facilitate more positive attitudes and customers’ desire for the brand.” The pair tested their theory by providing study participants with a variety of shopping scenarios involving being rejected versus receiving a neutral response from the salesperson while in a luxury retailer. Ward and Dahl discover that shoppers who “relate their self-concept to an aspirational brand” become more motivated to buy that luxury brand after a salesperson’s rejection, in order to be accepted by what they perceive as the in-crowd. Journal of Consumer Research (2014)

Social media mentions of television advertising

Television advertising is an expensive proposition, so media planners and advertisers are devoting considerable attention to social media mentions of their advertising and the real-time feedback it can provide. David A. Schweidel, associate professor of marketing, and coauthor Beth L. Fossen 16PhD (Indiana U) study this trend by using data from actual television advertising on the broadcast networks and brand and program mentions of those same ads on Twitter. The pair found that television advertising does impact the volume of online word-of-mouth for the advertised brand and the program showing the ad. Ad and brand characteristics played a huge role in creating social media “chatter.” For instance, movie advertisements generated the largest increase in online word-of-mouth. Ads for phones, computers, notebooks, and tablets also created substantial increases in social media mentions. In contrast, apparel, dental care, nonprofit ads, and PSAs benefited the least in terms of online brand chatter. Higher rated programs resulted in more online chatter for the ads shown, likely due to the fact that these programs draw larger viewing audiences. Marketing Science (2017)

Managers’ performance measures and their work behavior

Management accounting literature devotes considerable attention to the “controllability principle.” This principle stipulates that managers should only be held responsible for the results they directly control through their actions. The literature argues that the use of less controllable performance measures reduces managerial motivation and causes stress. However, Karl Schuhmacher, assistant professor of accounting; Michael Burkert (U Fribourg); Franz Fischer (independent researcher); and Florian Hoos (HC Paris) argue that there can also be positive effects associated with a lack of controllability. The researchers conducted a survey with 432 business managers, asking questions related to the measures used for their performance evaluations. They concluded that less controllable measures do create stress but also induce proactive work behaviors. In fact, the lack of controllability stimulates managers to cope with stress by interpreting their roles more flexibly and cooperating with peers to seek solutions for organizational problems they cannot control individually. The authors suggest further research to determine how organizations modulate between the positive and negative effects of disregarding the controllability principle. Accounting and Business Research (2017)