A few years ago, a radical idea began circulating in the world of primary-care management. Rather than scheduling a medical practice in the traditional manner—booking a doctor's appointments well in advance, while perhaps keeping a few open slots for emergencies—advocates of an approach known as “advanced access” called for offering all patients a same-day appointment, regardless of the severity of their ailment. That way, patients wouldn’t experience frustrating waits of weeks or longer (and potentially suffer the medical consequences of a delay in care). Meanwhile, doctors and their staffs wouldn’t waste capacity by holding appointments open or attempting to triage patients by phone. There would be fewer cancellations and no-shows, and everyone would be happier.

Much to the surprise of skeptical doctors and nurses, researchers have found the approach works. Empirical studies have shown that managed-care and fee-for-service practices that follow advanced access can significantly reduce patient backlogs, and even make more money, by adhering to the approach’s unofficial motto: Do All of Today’s Work Today.

However, the lack of specific implementation guidelines held back doctors who might otherwise have given advanced access a try. Professors Linda Green and Sergei Savin, working with physician Mark Murray, designed a mathematical model that allows doctors to apply the approach to their practices. The researchers' elegant solution, in the form of a simple-to-use Excel spreadsheet, allows doctors to predict how many patients they can accommodate.

“A lot of physicians are trying to implement the idea of advanced access,” says Green. “But they need to find the right balance between patients and capacity.”

Many studies have investigated why the traditional scheduling method makes this balance difficult to achieve. One conclusion is that the longer patients are forced to wait for an appointment, the greater the chance they will cancel.
Often, the practice isn’t able to fill in the suddenly available slot, so the doctor’s time is wasted. “The irony is that physicians may have three or four weeks’ of patients waiting for an appointment, but they’re spending only 70 percent of the day seeing patients,” Green says. “With advanced access, the number of no-shows goes down to almost zero. If patients get an appointment for the same day, chances are they’re going to show up.”

Green says. “So they try to get nurses to sort out who needs the physician more urgently. They wind up with more administrative overhead. With this system, they’re not wasting time, and they can bring in more revenue.”

This possibility of greater efficiency and profitability has already won over some doctors. Green and Savin have received requests for their model from several large practices, including the St. Francis Hospital and Medical Center at the University of Connecticut and the Carle Clinic Association, which has more than 300 doctors, in central Illinois.

The researchers are distributing the spreadsheet to any doctor who requests it. “From my personal contact with the healthcare system and talking to physicians, I realized this was an area that needed a lot of help,” says Green, who has spent much of her career designing ways for healthcare services to run more smoothly, from increasing the efficient use of MRI machines to preventing emergency room overcrowding. “Healthcare is the biggest sector of the U.S. economy and affects all of our lives. The more I educated myself, the more I realized that problems in healthcare systems really needed an analytical approach.”

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Linda Green is the Armand G. Erpf Professor of the Modern Corporation at Columbia Business School and a founder and codirector of the Columbia Alliance for Healthcare Management. Sergei Savin is associate professor of decision, risk and operations at Columbia Business School.

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COLUMBIA BUSINESS SCHOOL
THE IDEA: A retailer that encourages its customers to shop online rather than in its stores may see its overall sales decline.

THE RESEARCH
Consumers often have the choice of purchasing a retailer’s products from its stores, catalog or Web site. Many strategists advise retailers to encourage their existing customers to “switch channels” and move to the Web, since Internet sales are thought to be more cost-efficient.

Asim Ansari, Carl Mela and Scott Neslin developed a model of customer channel migration and used it to analyze the experience of a major, multichannel retailer from 1998 to 2001. In this case, the researchers found that migration to the Web had the unwanted effect of lowering overall demand. The researchers theorized that customers receive less personal service when they shop online, and these online purchases therefore do not inspire the same loyalty as shopping in a company’s stores or ordering a product by phone. The researchers also argue that once customers start shopping online, they find it easier to compare products among retailers and therefore are more likely to defect.

The researchers also studied the strategy of sending frequent e-mails to customers. Because e-mail is a virtually cost-free marketing tool, some retailers e-mail their customers as often as possible, even on a daily basis. The data suggest that increasing the number of e-mails offsets a portion of lost sales due to Internet migration; however, this strategy appears to have diminishing returns, with each communication generating a smaller payoff.

PRACTICAL APPLICATIONS
Strategists and marketers
Before embarking on marketing campaign to migrate customers to your firm’s Web site, you should analyze your customer base. While you may lower costs by selling products online, you increase the chance that you will lose customers to competitors.

Still, as the researchers note, customer migration to the Web doesn’t necessarily degrade loyalty. To lessen the chance that your customers will defect once they start shopping online, you may want to design your site in a way that personalizes the shopping experience or builds dependence. For example, some grocery sites require customers to set up an online shopping list, which entails an initially time-consuming effort that makes future purchases easier. Even such simple steps as remembering a customer’s credit card number and shipping address tie the customer more closely to your site.

Read More

Asim Ansari is professor of marketing at Columbia Business School.
Taking a Global Look at Environmental Disclosures

Do laws or the marketplace motivate firms to release information about their behavior?

According to last year’s *Global Competitiveness Report* of the World Economic Forum, the United States produces the most wealth in the world. Even on a per capita basis, the United States ranks third, just behind finance-centric Luxembourg and oil-rich Norway. Yet this same study, based on a survey of business leaders in 125 countries, shows that when it comes to the stringency of environmental laws, the United States ranks 21st—far below what many would expect (or desire) for a country of its enormous wealth. Perhaps not surprisingly, the surveyed business leaders view the United States as a place where companies can easily avoid having to disclose information about their environmental activities and impacts.

Policymakers, economists and activists have long debated the connection between a country’s wealth and its environmental regulations. Some say richer countries can afford to take care of the environment and therefore enact more laws to limit emissions. Many argue that these laws are necessary, since left on their own, firms wouldn’t volunteer potentially negative information. Others counter that with incentives to increase transparency—such as cultivating a good public image, or even responding to consumer or investor pressure—firms would readily do so.

Prior research on the effects of government regulations on company disclosures focused on the firm level, often comparing corporate behavior within two or three countries (particularly rich countries, where the data were most accessible). Professor Bjorn Jorgensen, working with Naomi Soderstrom of the University of Colorado at Boulder, wanted to take the broadest possible look to determine what kinds of firms disclose information about their emissions. “We wanted to know if it is really true that companies in wealthy countries disclose more,” says Jorgensen. “And if so, we wanted to get an empirical sense of these firms’ motivations. Do they disclose more because they have to or because the marketplace gives them incentives to do so?”

The researchers’ global comparison found that companies in rich countries do, in fact, disclose more and that these countries also have more stringent regulations. To investigate the firms’ motivations, the researchers compared regulations and behavior on a country-by-country level from an accounting perspective.

“In Europe, there are rules that force firms to issue a lot of information about the environment in ‘green accounts’ or ‘green reports,’ often as part of their annual reports,” Jorgensen says. “The environment has become an element in their accounting system. In the United States, there is very little required disclosure of environmental activities and impacts. Most of the disclosures are completely voluntary.”

Previous studies by environmental economists have shown that requiring firms to disclose information will change the firms’ behavior: for example, a company might manage its releases of toxins to be right below a threshold so that it can avoid the PR fallout. “Many people have argued that disclosure in itself is worthless, since it doesn’t attempt to change the underlying cause but just lets people know what’s already happening,” Jorgensen says. “The counterargument is that you should care about how much firms disclose, because we know that in some settings disclosure affects firms’ decisions about how much to pollute. Disclosure may shame firms, in a way. It makes firms think about ways to change their production so that their image won’t be impaired.”

Comparative data, however, suggest that firms will not disclose this information voluntarily, no matter how wealthy the country and how much it could conceivably spend to limit emissions, Jorgensen says. And market pressure can’t function on its own; a certain degree of transparency from firms is required. “Although some industries, like oil and gas, have voluntary disclosures, governments can change company behavior and also consumer and investor behavior by requiring more disclosure,” he says. “By forcing a company to release this information, consumers and investors can make choices about whether they want to buy its products and shares, and thereby influence the firm.”

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Bjorn Jorgensen is the Gary Winnick and Martin Granoff Associate Professor of Business in the Accounting Division at Columbia Business School.
THE IDEA: Cutting back on a marketing budget to temporarily inflate earnings will come back to haunt a firm’s stock market performance in the long run.

THE RESEARCH
When managers of a firm plan a seasoned equity offering (SEO)—the sale of additional shares by a publicly traded company—they sometimes give in to the temptation to inflate current-term earnings. Because investors rely on current-term figures to predict future profits, inflating earnings can give a temporary boost to a company stock’s price and allow the firm to raise more capital through its offering. One way to inflate earnings is to temporarily cut back on marketing expenditures.

Natalie Mizik, working with Robert Jacobson, studied this pattern of “myopic marketing management.” They found that at the time of an SEO many firms report lower than normal spending on marketing and higher than normal earnings. Investors are aware that some firms artificially enhance current-term earnings. But because investors are not able to immediately identify these firms, they cannot accurately anticipate the firms’ future performance.

In the long run, however, the market catches on. Firms that inflate their current-term profits by temporarily cutting back on marketing are subsequently devalued, Mizik and her coresearcher found. These myopic spending cuts disrupt the normal business process, erode intangible marketing assets and destroy shareholder value.

PRACTICAL APPLICATIONS
Managers
You may see advantages in cutting back on marketing expenditures in the short term, but any temporary lift in equity prices will be outweighed by the longer-term devaluation. Marketing spending should not be treated as discretionary. Even a temporary cut in marketing spending for the purpose of earnings inflation has significant negative consequences.

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Natalie Mizik is assistant professor of marketing at Columbia Business School.
What Really Happens at Mixers?

An innovative experiment shows how we try—with varying degrees of success—to meet new people.

Networking parties hold so much promise. A mixer hosted by a large firm, a professional association or a business district is an opportunity to gain social capital, which has come to be seen as a critical factor in success. Many people devote significant money and time to these events with the simple goal of making new contacts.

But there has been little research about how people interact at mixers. Lessons from social science are discouraging: researchers have found that a person's past contacts tend to limit future contacts. Furthermore, a phenomenon known as homophily—the tendency of people to bond with others similar to themselves, in terms of sex, race, education and career—suggests that guests at mixers won't mingle in diverse groups.

To learn whether mixers are effective, Professors Paul Ingram and Michael Morris conducted an unusual experiment. They arranged for the School’s Executive MBA Programs to hold an after-work event, similar to dozens EMBA hosts every year, for four classes. Early on a Friday evening, about 100 guests—managers, entrepreneurs, consultants and bankers—gathered in a reception room in Warren Hall, where they mingled over hors d’oeuvres, wine and beer. To get a precise record of whom each executive met during the night, and the duration of these interactions, each wore a small electronic device called an nTag that tracked their encounters. (For more about how the nTags worked, see “More Than a Name Tag.”)

Before the mixer, the executives had used an electronic facebook to register which of the guests they already knew. On average, the executives were on friendly terms with about one-third of the others; the rest were unknown to one another. When asked why they

MORE THAN A NAME TAG

To get a second-by-second record of the interactions at the EMBA mixer, Ingram and Morris had all the guests wear nTags: four-inch by six-inch electronic devices that look like fancy name tags. The nTags registered each time they faced another nTag at a distance of less than eight feet (a limit chosen through testing). A “meeting” was defined as two nTags staying in contact with each other repeatedly over the course of at least one minute. (This avoided recording such momentary encounters as two people simply crossing each other’s path.) When two individuals met, their tags would display a two-line greeting, such as “Hello, Elizabeth. This is Jay.” In that way, the nTags functioned as an icebreaker—not unlike similar gimmicks used at many mixers to help people introduce themselves to each other.
were attending the event, 95 percent of the guests said they wanted to meet new people.

“Overwhelmingly, people come to these types of events with an important purpose in mind,” says Ingram, “and that is to make new connections that may help with their careers.” Given the ratio of friends to strangers at the mixer, it seemed the guests wouldn’t have much trouble. But the nTags showed that the average guest had 14 encounters during the night and that friends accounted for a disproportionate half of these encounters.

The reason, the researchers say, is comfort. “It’s challenging to make new connections,” says Morris. “If you stay with your friends, there’s no risk they won’t get your jokes or that they won’t accept you. And comfort is not to be derided—these are social events, after all.”

Ingram and Morris point out that people manage to make some new contacts at mixers; they just don’t maximize their opportunities. The researchers advise those who really want to meet new people to show up alone: “Don’t go with a cluster of your friends, or you’ll end up spending a lot of time with them,” says Ingram. “Or you’ll be introduced to people who are already acquainted with your friends and who are not necessarily broadening your network in the best way.”

Ingram and Morris discovered some distinct patterns through their analysis of the event. Early in the evening, there were more encounters between people of the same gender, whereas later there were more between people of opposite genders. This is because people do what is easiest and most comfortable—meeting others like themselves—at the beginning of an event but gradually break out of their comfort zone. There’s also a “part of the party” effect that establishes a feeling of comfort, says Ingram. “Over the course of a mixer, people establish a social bond that extends to everyone in the room,” he says. “The party takes on a life of its own, and demographic categories matter less.”

The study also offers a bit of reassurance to anyone who has ever attended a mixer and spent the whole time chatting with friends and acquaintances. Though many of the executives who attended the EMBA event made fewer new contacts than they’d intended, they said they valued the opportunity to strengthen their existing relationships. “Relationships have to be maintained,” Morris explains. “We can turn acquaintances into true friends by having more personal conversations than we’ve had before. Mixers turn out to be very good for that.”

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Paul Ingram is the Kravis Professor of Business and Michael Morris is the Chavkin-Chang Professor of Leadership in the Management Division at Columbia Business School.
Listen and Learn

Do investors learn more from advice or by observing the actions of others?

When economists explain the concept of social learning, they often use the example of two neighboring restaurants. If one is crowded and the other is empty, potential diners who aren’t familiar with either place typically opt for the crowded restaurant, reasoning that it must be the better place.

In essence, these deliberating diners are learning by observing the actions of others. But people also learn from one another more directly by seeking advice. Professor Boğaçhan Çelen, working with Shachar Kariv of University of California, Berkeley, and Andrew Schotter of New York University, wanted to compare the results of these two ways of gaining information, particularly in investment decisions.

“In everyday life, we get information from talking to many people who are experts and many who are not,” says Çelen. “People who are considering buying a mutual fund might ask their friends or family members or coworkers for advice. At the same time, by watching the news and following the markets, they get information by observing the behavior of other investors, and this too can influence their decisions.”

To compare the effectiveness of learning by observation and learning from advice, the researchers designed an experiment in which the same information was conveyed through both methods. Moreover, to ensure that the subjects received well-intentioned advice, the advisers were paid for giving correct information—simulating the real-world experience of getting information from a trusted or expert source, such as a family member or a financial adviser.

The researchers found that the participants were far more likely to act on advice and, furthermore, that those who learned through advice had a clearer understanding of the information. “The findings showed that people tend to take advice more seriously than simply watching others,” Çelen says. “The nature of asking for advice makes people pay closer attention, and they therefore learn faster.”

Learning from advice is also a better option for investors, who are vulnerable to herd behavior in the markets. Although mass behavior can be rational, the markets occasionally give rise to misguided or panicked herds—as they did during the Internet bubble of the late 1990s. Or take the case of the competing restaurants.

The first few customers may have selected one at random, yet they inspire others to make the same choice. Those who do so might have gotten a better meal next door.

Advice poses less of a risk of creating a wrongheaded herd, Çelen explains, and more of a chance of creating one that behaves rationally. “When we’re faced with an unknown problem—whether it’s choosing a retirement plan or buying a stock—many of us are driven to seek advice from others,” he says. “It turns out that’s a good instinct to follow.”

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Boğaçhan Çelen is assistant professor of finance and economics at Columbia Business School.
THE IDEA: Changes in investor expectations of future cash flows drive stock-price volatility.

THE RESEARCH
Asset prices, by definition, are discounted cash flows. Therefore, prices should change only if investors change their expectations about dividends or returns. Studies have shown that changes in expectations about dividends, or cash flows, do not have a significant effect on prices and that expectations about returns are largely responsible for stock market volatility.

In two recent papers, Gil Sadka set out to examine the relationship between aggregate stock-price volatility and cash flows. Unlike previous studies, Sadka used accounting earnings instead of actual cash flows as a proxy for expected cash flows. Sadka also found that there is a negative correlation between expected cash flows and expected returns, which adds to the volatility of the market. For example, during a time of recession, investors tend to avoid risky securities and demand a high risk-premium in exchange for purchasing a risky stock. Therefore, the rate of return on such stocks is relatively high. However, because economic growth during a recession is negative, profitability is expected to be low. Since the cash-flow and return components of prices have opposing directional effects on price, the negative correlation between cash flow and return increases price volatility.

Previous studies by other researchers suggested that changes in expected cash flows would not affect investors, since investors could avoid this effect by diversifying. However, Sadka, working with Ray Ball and Ronnie Sadka, found that investors can’t diversify away this effect.

PRACTICAL APPLICATIONS
Investors and fund managers
You can invest in firms with higher sensitivity to aggregate cash-flow news and earn higher expected returns. However, you should be aware that you face cash-flow risk when purchasing shares in these firms. For example, firms with high book-to-market ratios have better returns than those with lower ratios, but the former also have greater cash-flow risk.

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Gil Sadka is assistant professor of accounting at Columbia Business School.
You’re an expert in the management of organizations. But in A Perfect Mess: The Hidden Benefits of Disorder, you argue that we should worry less about having an organized office, keeping a schedule or following plans. Maintaining order and carrying out a plan whatever the consequences speaks of a certain rigidity. That might be fine in a stable world, but in our world you need to be able to drop plans and pick up new ones, and this is true of both individuals and organizations. Sometimes strategic plans put blinders on people, and they are so busy trying to execute their plans that they don’t see that something important has emerged—like automakers that are so busy putting out gas-guzzlers that they completely miss fuel-efficient cars.

People talk a lot about the benefits of organization and tidiness, but they very infrequently think about the costs. Businesses and individuals hire professional organizers, who can run from $3,000 to $10,000 for a session, and it’s not clear this has any lasting effect. There’s a financial cost in setting up and maintaining an organizational system.

There’s also an opportunity cost to all of this neatness. Say you have a burning project to finish. Your time becomes very valuable, and you shouldn’t sacrifice it for organizing your desk—but many of us have the urge to do exactly that. Two-thirds of the respondents to one of our surveys said they were embarrassed about their level of messiness. But to what extent is that warranted? It pays when you have a rush of work to let the mess go.

If there are costs to organization, are there benefits to disorder? It may seem contradictory, but a degree of messiness can improve efficiency. If you’ve let 10 things pile up on your desk, chances are that the most important items have found their way to the top. And by juxtaposing things that would have been separated in an orderly system, messiness can inspire creativity. When you’re working on a report, and you keep a number of papers scattered over your desk, you’ll be able to see all of the relationships between them and new ways of combining them.

This applies to businesses, too. Firms that put individuals who work in different capacities on the same floor, rather than keeping every person who serves the same function together, get much more interaction and innovation. Think of New York City—it’s a place that brings people of many nationalities and ethnicities together, and this jumble is a tremendous source of creativity.

There’s also a power benefit of mess, a less savory aspect but one that some individuals have clearly mastered. If you create considerable disorder in your office, you’re the only one who knows where everything is and you are therefore indispensable to your organization. This, of course, benefits you, not necessarily your firm. This relationship between mess and power is also true for organizations. Al-Qaeda, for instance, is such a challenge because it is a messy organization, not a traditional hierarchy where eliminating the top ranks would leave it headless.

That’s one extreme. Looking at disorder from a purely aesthetic standpoint, we should recognize that it can be a source of beauty. Think of a Jackson Pollock painting or a Frank Gehry building that appears haphazard but is extremely beautiful. A set of rowhouses might be perfectly orderly but devoid of feeling or meaning. A person’s home can be too neat and lack personality.

Who are your favorite mess-makers in history? Albert Einstein is the poster child for messiness. As he once said, “If a cluttered desk is a sign of a cluttered
mind, of what then is an empty desk? Then there’s Arnold Schwarzenegger, who refused to keep a schedule when he was running for governor of California. He was able to spend as little or as much time with people as he needed because he kept flexibility in his day.

Scientists talk about the “principle of limited sloppiness.” A lot of big discoveries have happened when one entity has slipped into a controlled condition and created something unexpected. Penicillin is the most famous example: if Alexander Fleming’s laboratory been completely clean, mold wouldn’t have gotten in and penicillin wouldn’t have been discovered. Too much sloppiness, and you won’t know what caused the discovery. But a little bit of sloppiness can make systems more responsive to their environments, and you discover something that you didn’t even think of discovering.

It sounds like there’s a strong link between scientists and messiness. Have researchers come up with a theory for why there are advantages to messiness?
It’s amazing that there are tons of papers on the consequences of order, but we know very little about consequences of disorder or messiness. There’s definitely a need for more research on how disorder affects systems, whether the system is a desk, an organization or a government. We live in a capitalist economy that generates a tremendous amount of stuff and things to do with your time. And we’re all very much overwhelmed by the amount of stuff, cognitive and physical, that assaults us.

In my research, I’ve done a series of computer simulations of messiness. In the simulations, you work, and this generates mess, which slows you down. You can either stop working and clean up or keep working and generate more mess. A simple simulation like that shows that the fastest way to complete the task is not perfect order but a moderate level of messiness.

How’s the state of your office these days?
I have a cyclical mess. When I’m teaching or working on a paper, my office can get very messy. There are stacks of paper and books on every surface, and the books that are on bookshelves aren’t organized to type A standards. It’s been a while since I’ve cleaned my whiteboard. And I have a two-foot-tall can of Tang in the corner, which I’ve had since I worked for a company on a project 12 years ago. I’d say I’m optimally messy. When things slow down, I’ll tidy up. But I’m in no hurry.

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Eric Abrahamson is professor of management and a faculty leader of the Sanford C. Bernstein & Co. Center for Leadership and Ethics at Columbia Business School.
When Engineers and Marketers Come Together

A way to meld insights from two very different perspectives.

In the early 1990s, product designers at General Motors found they could get a fairly accurate picture of what customers wanted by using a marketing tool called conjoint analysis. The technique, the subject of extensive academic and industry research during the preceding decade, allowed marketers to assess the relative importance of a product’s features to different groups of customers—in the case of a new car, such features as gas mileage, legroom and styling.

While this method helped marketers come up with a vision of the ideal sedan, product designers didn’t have a way of applying this information within the technical and cost constraints of car manufacturing. Working with a team of GM researchers, including Jim Christian, GM’s technical director of global product research, Professors Rajeev Kohli and Hitendra Wadhwa proposed a process for trading off the demands of market- ers and engineers when designing new products.

This may seem simple at the conceptual level, but in practice it can be difficult to integrate wish lists for two groups with little common ground.

“Marketers are focused on understanding customer needs,” says Wadhwa. “They don’t have a good grasp of the technological limits or financial implications of many product features. Meanwhile, engineers often don’t understand the market or customer demands. You need to build understanding between these two groups in order to come up with a product that is feasible and will be received well in the marketplace.”

The researchers’ methodology allows product designers to predict customer responses to specific changes in a car’s design—like switching from a four- to a six-cylinder engine—and how these changes would affect the logistics of producing it. “For a company like GM that designs a portfolio of 50 or more car models a year, these problems can quickly become very complex,” says Wadhwa. “This gives designers a way to look at the big picture analytically.”

The process includes four key steps: representation, linking, constraining and costing. In representation, product designers depict the product in ways that are meaningful to both consumers and engineers. In the linking stage, the engineering attributes of the product are mapped onto the composite picture of what customers want. Through constraining, designs are limited to those that are technically feasible. And in costing, designers determine the fixed and variable costs of manufacturing the product using modular design.

The process relies on a modular approach to product design, which is used to manufacture products ranging from airplanes to wristwatches. The benefits of modular design include greater product variety at a lower cost and customization for international markets, crucial to a global carmaker like GM. A new car from GM can be the composite of dozens of modules, from its transmission to the style of its taillights, with several options for each module. “A lot of engineering today involves modular design, but the choices can be almost limitless for particularly complicated products,” says Kohli. “Using this process, designers maximize some type of return, such as market share or profit.”

The methodology described by Kohli, Wadhwa and Christian shows how to select the best options for each module and the best choices for the composite product, whether it be a compact car or a fully loaded SUV. GM first used these methods in 1993 to redesign its fleet of midsize cars and has since adopted the process widely throughout the company.

Though the researchers developed their process within the context of car manufacturing, it can be used to develop almost any product for which integrating the needs of marketers and engineers is critical. “The intersection of engineering, marketing and computing is central to the design of so many products today,” says Kohli. “And by coming up with an optimal design, you can change the way an entire industry operates.”

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Rajeev Kohli is professor of marketing at Columbia Business School. Hitendra Wadhwa is associate professor of professional practice in marketing at Columbia Business School.
Why Your Branding Efforts May Be Your Most Important Investment

Don Sexton explains the complex yet measurable relationship between a company’s branding efforts and its shareholder value.

If you work in finance or marketing, you have probably gotten tangled at some point in a debate about how much to spend on branding. A firm’s brand is likely its most valuable single asset. But for many managers this “value” is an abstract notion, often ignored when budget decisions are being made for branding efforts.

These managers might be surprised to learn that many studies have established the significant value of brands in monetary terms, for both B2C and B2B brands. Jim Gregory, founder and CEO of CoreBrand, tracks the brands of more than a thousand companies. He estimates that corporate brands account for an average of 11.6 percent of the market capitalization for companies in the aerospace industry, 4.5 percent in chemicals, 8.3 percent in computers, 10.3 percent in foods, 16.1 percent in home appliances, 10.7 percent in hotels and entertainment and 14.4 percent in motor vehicles. Estimated company brand equity values include $69.0 billion for General Electric, $53.3 billion for Microsoft, $42.1 billion for Toyota and $36.6 billion for Johnson & Johnson.

These are huge amounts of money. If you think about it, that brands are highly valuable assets makes perfect financial sense. Brands affect demand, which affects cash flow, which affects shareholder value. Unfortunately, this cause-and-effect relationship is not always understood, because it involves ideas from several disciplines: marketing, statistics, economics, accounting and finance. Because of this lack of understanding, managers often don’t invest sufficiently in branding efforts. In the end, the firm’s shareholders pay the price.

Let’s take a closer look at how brands affect shareholder value. The starting point is a marketing concept known as perceived value, or the maximum a customer will pay for your product or service—the ceiling on your price.

Perceived value is central to marketing and marketing strategy. I don’t define marketing in terms of the well-known four Ps—product, price, place and promotion—which these days is a confining and misleading characterization. I define marketing as “managing perceived value.” Everything that marketers do—targeting, positioning, advertising, pricing, selling, customer service and public relations—affects perceived value.

Perceived value can be measured in concrete, monetary terms. There are statistical techniques, collectively known as constrained choice models, that allow you to estimate the perceived value of any product or service. Companies such as DuPont, Gillette and Marriott employ these techniques to make marketing decisions.

From statistical analyses, we know that brands represent an appreciable part of perceived value. The percentage varies by product type—from less than 10 percent for semiconductors to close to 100 percent for fragrances, which explains why brand equity as a percentage of market capitalization varies by industry and company (and also why the marketing approaches of producers of semiconductors and fragrances are rather different).

Companies that sell products or services that have a high perceived value can charge a higher price or sell more units or both. A strong brand leads to higher revenue, which in turn typically leads to higher contribution, a significant component of cash flow. Shareholder value depends on the anticipated cash flows from a company. A company that can be expected to manage its brands well should be rewarded with higher stock prices.

All of these connections can be measured. However, studies show that relatively few companies do such research. The consequence is often irritation to or underinvestment in branding efforts, both in product improvements and in communications with customers.

If the products or services under a brand’s umbrella are not improved, or if improvements are not communicated, the brand may die. I call this process “hollowing out” a brand. It sometimes occurs when a senior manager wishes to improve short-term financial numbers by cutting investment in innovation and in customer communications.

The scary aspect of hollowing out a brand is that it can work in the short term. Brands benefit from inertia; customers will show loyalty to a strong brand even when it is being hollowed out. However, at some point those customers will realize that the brands they once knew no longer exist.

Brands are assets—extremely valuable assets—that need to be nurtured and developed like any other asset. Managers who recognize this will weigh an expenditure on branding with the same deliberation and long-term view that they apply to any investment decision. After all, the numbers are available to ensure that these brand investment decisions are sound.

Don Sexton is professor of marketing at Columbia Business School.
The healthcare industry, now the largest sector of the U.S. economy, has long provided enormous opportunities for ambitious and talented business professionals. And for many years, the route to success was rather simple: an MBA student with an interest in healthcare might manage the finances for a hospital, become a star marketer for the latest pharmaceutical offering, work on the deal side of a healthcare merger or provide consulting services.

Those opportunities still exist. But healthcare jobs for MBAs have changed because of the complexity of the industry today. The industry comprises an array of interconnected parties that provide care (physicians, hospitals and other institutional providers), pay for care (government, insurers, employers and consumers) and receive care (patients). In such an environment, there’s far less of a need for managers who want to operate only in functional silos like R&D, finance or law.

The healthcare industry needs business professionals with sophisticated, multidisciplinary skills. For example, it needs pharmaceutical and medical technology executives who can maneuver through an often-hostile regulatory and political environment, while ensuring that customers can afford their products. It needs hospital managers who can create operational efficiencies, while improving care and advancing a community mission. And it needs corporate benefit managers who can structure creative benefit plans that curb costs, while rewarding innovation and wellness initiatives.

Healthcare’s complexity is in part the result of the industry’s advances and growth. Pharmaceutical companies and manufacturers of healthcare devices have poured funds into creating technology-based tools that prevent and treat disease, illness and physical abnormalities. Innovations have been hugely successful in both extending life and improving the quality of life.

However, this new technology—together with an aging population and system inefficiencies—is costly: from 1970 to 2005, U.S. healthcare spending as a percentage of GDP jumped from 7 percent to 16 percent. These soaring costs threaten our ability to continue to invest in, and afford, much-desired innovation.

The challenges confronting healthcare extend beyond such escalating costs, as the industry continues to be plagued by a system that remains fragmented and inefficient, with misaligned incentives and uneven quality of patient care. The key challenges facing leaders and managers of healthcare enterprises are to continue to drive innovation—developing breakthrough drugs and new medical and information technologies—while addressing the growing problems of affordability, inefficiency and gaps in quality.

To be effective in meeting these challenges, healthcare leaders and managers need knowledge of and training in areas like organizational effectiveness, leadership, product and technology development, capital formation, finance, supply chain management, risk assessment, intellectual property, mergers and acquisitions, entrepreneurship and public policy. That may sound like a lot. But because the industry has become so complex, each decision by a healthcare manager (or a healthcare investor) involves virtually all of these disciplines.

Recognizing this, last year Columbia Business School established the Program in Healthcare and Pharmaceutical Management. The program builds on the School’s core business curriculum to provide the knowledge and practical training to develop effective leaders, managers and investors of existing and new healthcare enterprises. Students take pragmatic, insightful courses not just in healthcare management but in strategy and competition, marketing, entrepreneurial finance and economics. Most important, these students learn a new way of thinking: visualizing the effect of each decision on the multiple constituents that provide, pay for and receive healthcare products and services.

With so many practitioners and other experts acknowledging that much of the current healthcare system is broken, there is a greater openness than ever to business professionals with the training and skills to repair it. The healthcare industry has changed, and so does the way we have to educate future healthcare leaders.

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New York City’s Trans Fat Ban: The Costs and Benefits of Regulating Behavior

Nachum Sicherman, who has researched cost-benefit analysis in medical decision making, delves into the economic angles of the city’s controversial public health regulation.

On December 4, New York City banned the use of all but trace amounts of trans fats in restaurant cooking. My first reaction was one of joy—one thing less to worry about when I go out to eat, knowing how guilty I’ll feel later for ordering greasy and delicious french fries rather than sensible but tasteless steamed vegetables.

But restaurant owners, including chefs at some of the city’s high-end restaurants, have warned New Yorkers not to rejoice. Without trans fats, they argue, it will be impossible to create the flavor and texture of many of our guilty pleasures. They also say the prices of many foods will rise, since the alternatives to trans fats are more expensive. All empirical evidence, however, suggests the opposite. The almost total ban of trans fats in Denmark had virtually no effect on the cost, availability or quality of food. Perhaps more worrisome is the risk that many restaurants will go back to saturated fats, which pose health risks of their own.

Unfortunately, being an economist means that almost no question—down to what oil to use when cooking fries—has a simple answer. First, one has to examine the costs and benefits. Trans fats are chemically modified fats that are often used in fast foods, baked goods, salad dressings and many other food products. Restaurant owners and chefs love them because they are cheaper and have a longer shelf life than butter, lard and some vegetable-based alternatives. Medical researchers hate them (and we should too) because trans fats increase cholesterol levels, thus raising the risk of coronary heart disease significantly more than alternative oils do.

Because of this health risk, some fast-food and packaged-food companies have already backed away from trans fats. Wendy’s now uses cooking oil made from soy and corn in its restaurants, and even our beloved Girl Scout Thin Mints are trans-fat free.

Given the industry reaction, one has to question the wisdom of a ban when increasing public awareness may achieve the same goal. Some proponents of New York’s ban have argued it is a logical next step after the success of the city’s ban on smoking in public places. But secondhand smoke—what economists call a “negative externality”—was a major argument in justifying the smoking ban. This argument doesn’t hold here. The only victims of trans fats are those consuming the food, unless one wants to consider the increased costs to the public health system as a negative externality.

In fact, the trans fat ban has more in common with seatbelt regulations, which seek to protect individuals from being victimized by their own bad choices. But if consumers are being victimized by their eating habits, why not ban the sale of countless other potentially harmful foods, like cholesterol-laden foie gras?

At a certain point, the costs of regulating behavior outweigh the benefits. In the case of banning a particular food, the costs depend on the availability of substitutes. While there seem to be good substitutes for trans fats, there are none for foie gras. Therefore, there is a good argument for banning trans fats but not foie gras—even if the foie gras is more hazardous to your health.

Why don’t governments let consumers decide if they want to eat themselves to death (provided they have been made aware of the risk)? One answer is paternalism. It might be reasonable to conclude, at least for some of us, that the government is better than we are at making choices about what is good for us. Even individuals who understand the risks of particular foods must master a level of self-control that may be out of reach.

There’s another potential outcome of the trans fat ban that has gotten very little attention, and this is the so-called compensation effect: sometimes, people engage in riskier behavior when they believe they are protected. For example, there is evidence that drivers who usually don’t use seat belts drive more recklessly if they buckle up. Personally, I have tried very hard, though not always successfully, to order a baked potato instead of fries with my meals. Once I know trans fats are no longer in fries, I might give up this struggle and always order fries, which even without trans fats are not the healthier option.

The likely effect of the trans fat ban on public health is far from clear, since we don’t know how the public will “compensate” by changing its consumption of certain foods. Before other cities go ahead with bans of their own (Chicago is already considering one), we need more objective research, not hasty conclusions from restaurant lobbyists or politicians.

After all, it wasn’t long ago that public health experts told us that fat-free foods could help make us thin and that carbs were good, not evil. Ordering dinner seemed so much simpler then.

Nachum Sicherman is professor of finance and economics at Columbia Business School.
IN THIS ISSUE . . .

Do investors learn more from advice or by observing others? Should retailers encourage customers to shop online rather than in their stores? Are firms motivated by laws or market pressures to disclose information about emissions? In this issue, Boğaçhan Çelen, Asim Ansari and Bjorn Jorgensen answer these questions and explain how their findings relate to your world. Rajeev Kohli and Hitendra Wadhwa describe how to integrate the insights of marketers and engineers when designing new products. Linda Green and Sergei Savin show doctors how to offer every patient a same-day appointment. And in his new book, Eric Abrahamson lambastes our obsession with order and explains the hidden benefits of a good mess.

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