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In a new book, E. Tory Higgins shares the keys to understanding what motivates people—and how to unlock success and influence others.

Q&A: Competitive Advantage’s End

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Why Are There So Few Women in Corporate Leadership?

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New research reveals severe weather’s toll on manufacturing.

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A Better Standard for Credit Risk

A new metric uses publicly disclosed bank information to better predict credit losses from loans.

Hedge Fund Activists’ Real Returns

New research shows that stock-price jumps following hedge-fund activism are the result of genuine productivity gains, not mere financial engineering.

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It’s Good to Be the King

Research suggests that status influences performance and the ability to cope with stress.

In a hierarchical office environment, who are better at handling stress: those who occupy a low rung on the ladder or those at the top? Entry-level workers might face status-induced stresses such as lack of control, fear of layoffs, and the daunting prospect of trying to earn a promotion or raise. However, managers and executives face other stresses, including time pressures, demanding jobs, and the necessity of having others depend on them.

While some animal studies have suggested that high status confers benefits when dealing with stress, there have been few human studies that show a causal connection between status and health. Professor Modupe Akinola, working with coresearcher Wendy Berry Mendes of the University of California, San Francisco, examined this relationship in a recent study on the psychological, physiological, and behavioral effects of having high status. “Most organizations have some sort of hierarchy,” she says. “But not much is known about the effects of these hierarchies, in terms of performance and health.”

The researchers focused the first part of their study on male police officers. First, they had officers rate their status relative to their colleagues and to other people in the United States. Then they exposed the officers to stress. Each officer participated in a stressful role-play exercise in which the officer had to placate a disgruntled citizen, played by an actor, who claimed that another officer had verbally and physically abused him. The officers were made aware that this type of role-play exercise is used by many police departments to help decide which officers should be promoted.

Akinola and her coresearcher measured each officer’s physiological responses to the stressful role-play, including their heart rates, the efficiency of their blood circulation, and their testosterone levels. These measures allowed them to assess whether officers exhibited a thriving, adaptive stress response during the role-play.

Read the Research

The findings showed a significant relationship between the officers’ perceptions of their social status and whether they exhibited a healthy, thriving stress response. “The higher the self-perceived status, the more likely they were to have an adaptive stress response,” Akinola said. “High-status officers dealt with stress much more easily.”

Next, the researchers delved further into the relationship between status and adaptive stress responses by conducting a second study using a non-officer population. In this study, they used male undergraduate participants, and rather than asking subjects about their perceptions of their status, as they did in the first study, the researchers placed the participants in either high- or low-status roles in an effort to examine the causal relationship between status and physiological responses to stress. “In an organizational environment, this is something that we do all the time. We ask individuals to work together and tell them who is going to lead the project and who will play a supporting role, but the questions remain—who is more stressed in these contexts and who will perform better? The person who is told he will lead the project or the person who is supporting the project?”

Akinola says, “Based on our results from the first study, we wanted to see what would happen to the performance and physiological reactivity in this context.”

In this study, participants played a complicated, fast-paced video game with a partner. The researchers measured participants’ cardiovascular responses and testosterone levels during the task. They found that those participants who were placed in the leader role exhibited more adaptive hormonal and cardiovascular reactions during this stressful task. In addition, they performed better and faster and were more generous, both in allocating resources to their partners and in having positive perceptions of them. “The finding that leaders had more favorable perceptions of their supporter partners than supporters did of their leader partners is some parallels with the 360-degree evaluations used in many organizations,” Akinola says. “When you’re the leader, you may want to say nice things about the people who support you and decide that you want to work with them again. You may be more generous, which is driven by your status position.” The researchers found that the opposite was true of the participants placed in the supporter role, who were less generous, had less adaptive responses, and did not perform as well on the task.

This research has significant practical implications for managers, Akinola says. “When people are told they are leaders, they want to work hard and do a good job, and this research also shows that they may perform well and thrive physiologically,” she says. “But managers should consider how they should interact with workers who must take a supporting role.” To avoid negative responses and behaviors, managers may want to indicate that lower status workers will have the opportunity to move up. “Managers could discuss how performance on a task might influence mobility,” she said. “When people know that they can move from being a supporter to a leader, they may be more likely to perform optimally.”

When people are told they are leaders, they want to work hard and do a good job.”

Power Rewards

The mere act of writing about a past experience of power can lead us to appear more confident and powerful to others.

Professor Adam Galinsky is power hungry. For more than a decade, he has studied the role of power as a psychological force, both its behavioral effects and the practical implications of having power and feeling powerful.

“Power is the central regulator of human interaction, so in most interactions we want to come across as someone on the higher rungs of the hierarchy,” Galinsky says. “It is such an effective regulator of social relationships because it creates patterns of deference, reduces conflict, creates division of labor—all things that make our species successful.”

Power is so deeply ingrained in human beings that we are surprisingly easy to power prime—that is, to coax ourselves into feeling more or less powerful than we typically feel. In new research, Galinsky, working with David Dubois of INSEAD, Joris Lammers of Tilburg University, and Derek Rucker of Northwestern University, shows just how effective power priming can be when we face some of life’s most challenging and stressful experiences.

The research was inspired in part by the story of one now-Ivy League professor who was making the rounds for an academic position that required her to present her research to sizable audiences of academics. In her two previous times interviewing, she secured interviews at Harvard and Wharton but no offers. In subsequent interviews, though, just before she gave each talk, she wrote out a power prime, a method Galinsky and his colleagues had developed to make people feel powerful. Hundreds of studies

READ THE RESEARCH
have shown that simply recalling a time in which one had power produces the same effects as having power. Power buffers people from stress (for example, it reduces cortisol, a stress hormone) and helps them feel and express more confidence.

Armed with a power prime, the academic ended up getting offers from four top-tier universities, including Harvard and Wharton. Galinsky decided to test more formally whether power-primed people would not only feel less stressed under pressure but would express the necessary confidence to get the job.

The researchers conducted two experiments designed to test these questions. In one experiment, students were asked to write about a time when they either had power or lacked power (the students believed themselves to be participating in a warm-up task). They were then asked to write a hypothetical application letter for a real job advertised in a well-known newspaper. The researchers then had a different group of students read the essays and evaluate if they would hire the person for the job. The student judges deemed the power-primed application letters as more confident, and they were much more likely to rate the power-primed applicants as people they would want to hire.

Would judges who saw power-primed candidates in the flesh—rather than merely reading letters—react similarly? Galinsky and colleagues conducted another experiment, this time in a face-to-face setting, and found similar results. Graduate business school candidates who wrote about an experience of personal power prior to participating in a mock job interview saw their odds of acceptance shoot up: they were accepted 68 percent of the time, compared with a normal acceptance rate of 47 percent. And people who wrote about a time in which they lacked power plummeted in effectiveness, with only 26 percent getting selected by the judges. The judges—in this case, the interviewers—rated power-primed applicants as much more persuasive than the powerless-primed candidates.

In short, Galinsky says, “There is something about how power-primed people presented themselves that others picked up on. They expressed themselves with more confidence and more persuasiveness and that led them to better outcomes.”

A large body of management research suggests that soft skills—those related to managing interpersonal interactions—are often more critical in leadership roles than more readily defined hard skills, such as financial analysis or other technical talents. Galinsky’s work here offers one more tool for shoring up those soft-skill portfolios.

“Anytime you need to present yourself in a confident and persuasive way this technique can be effective,” Galinsky says. “It could be a job interview, a date, an important presentation at the office—anytime that you want a little bit of swagger—recalling an experience of power can be really effective.”

### A Power Primer

**Make it interpersonal.**
Recall an interpersonal situation in which you had a good deal of power.

**Write it down.**
Simply thinking about being powerful may not be enough. Take a little time to write it out. Five minutes is all it takes.

**This is the real you.**
Power priming is not about faking it, says Galinsky. Using a power prime, he says, “allows your anxieties to melt away so that you are left with the confident, persuasive part of yourself.”

**For best results, use in moderation.**
“Anything that is overused becomes less effective over time,” Galinsky says. “To retain the potency of power primes, use them judiciously—in those situations where it really matters and where anxiety is most likely to curtail you.”
received greater concessions and secured better final settlements than round offer-makers. In fact, in some cases they found that a negotiator making a round offer ($50.00) fared better when she conceded on price and opened with a slightly less extreme but precise offer (for example, $49.75 if she was a seller; $50.25 if she was a buyer).

Although their research highlights the potential downsides of round first offers, the researchers acknowledge the possible risks in being precise. Just as overly extreme first offers lead to higher rates of avoidable impasses, overly precise first offers might signal inflexibility and prompt recipients to walk away from mutually beneficial deals.

THE APPLICATION

Negotiators

These findings are relevant to almost any negotiation over a quantity (for example, a price, a time, etc.). A babysitter who is negotiating with a parent and hopes to be paid $9 an hour may be better off making an initial offer of $9.75 than of $10; likewise, a project manager negotiating the date of a key deliverable is better off asking for 14 days rather than two weeks.

Being precise signals that you have researched the subject and put thought into your offer before expressing it. It’s not just about the numbers; it’s about what your price proposal implies about your knowledge. It’s therefore important for precise offer-makers to be prepared to offer a rationale for the price they suggest.
**Why did you write this book, Shaping Jazz?**

The initial question that set off the project was why the biggest record companies in the late 1910s and early 1920s, the market leaders, often avoided producing certain styles of jazz. Despite the success of jazz, musically and financially, these firms started to pull away from it and produce a type of jazz that was more symphonic but less profitable and less likely to make it into the jazz canon.

On the face of it, that fails Strategy 101. You are the pioneer. You introduce a new product. The product is successful. You are supposed to then take one of many actions designed to take advantage of that success. But with jazz it was different, and I didn’t know why. In the 1920s firms were dealing with a cultural market where jazz, because of both the way the music was played and the race of many jazz musicians, had a stigma attached to it and it wasn’t highly thought of by the era’s cultural elite. The stigma was especially acute for the large firms, who were better known for producing classical music. But why would firms care about this if they were making so much money?

I dug through archives, worked with colleagues and jazz collectors, culled print media from the period, and compiled data from the discography of the time—not just the songs, but which musicians played which instruments, where a song was recorded—which gave me close to one million data points to use in my quantitative analysis.

**And what did you learn?**

It turns out that the people who were running these major labels were also friends or business partners with a lot of the same people who were against the original form of jazz, which today would be recognized as New Orleans and Dixieland styles. As a consequence, the major labels ended up producing a lot of jazz that had no longevity. A great many of the songs those major labels released in the early 1920s have been forgotten about in the history of jazz.

And in most cases, record companies were trying to define the market in a way that was consistent with what they were already good at. The big companies shifted to a more symphonic style of jazz in part because they were already good at producing classical music. They knew highly trained and talented classical musicians. You could put a sheet of music in front of these people and they’d just play. The big companies’ infrastructure and distribution was set up to replicate something close to what they were already capable of doing versus a style that customers might like more but that record companies would find more difficult to produce. At the same time, the decisions that those record companies made early on made it possible for someone like Duke Ellington to become popular.

We rarely talk about these kinds of firm behaviors in a typical strategy course. And these things are timeless. You see it a lot today in cultural markets and technology markets. We haven’t studied them a lot and we don’t have a lot of answers as to why this happens. There has been some of this with rap music. Time Warner in the 1990s was associated with some gangster rap artists and got a lot of pushback. There were even protests at stockholder meetings.

Part of the purpose of the book is to begin this discussion, to point out that these are normal ways that markets operate and the types of pressures that affect decisions.

**Many of your almost one million data points were geographical in nature. What did that data reveal?**

Like a lot of people, at first I didn’t appreciate how broad jazz was geographically early on. Jazz was not just coming out of New York, Paris, New Orleans, Chicago, and London. A lot of the more influential music was coming from outside these cities.
The exoticism of the pan flute is lost when
My analysis showed that over time these
Paris or London. At the time, the symphonic
Blues,” “Sweet Georgia Brown,” or “Dear
6
out they produced too much of it and were too
narrow stylistically, because when that type of
jazz went out of favor, Germany was no longer
a relevant source. Symphonic jazz had its
moment. But the cities and record companies
that prospered in the long run produced a
variety of jazz styles.

So Berlin’s jazz portfolio was
not diversified enough?
That’s right. Now, the political upheaval in
Germany that was developing did have some-
thing to do with Berlin’s fall from jazz favor,
but I found that it doesn’t easily explain jazz’s
current lack of association with Germany
because it turns out that architecture, film,
and a lot of other cultural outputs from that
period in Germany, the Weimar era, still
flourished after the rise of Nazis.

If you mention this early German jazz,
there are people who will tell you, “Oh, but
that’s not really jazz.” Well, maybe not as we
define it today, but no one back then would
have had a problem calling it jazz. Also,
everyone who played that symphonic style
of jazz is now forgotten whether they were
in Berlin or New York. That’s why I see it as
diversification problem.

What other—and perhaps more
successful—strategies did the
recording companies use to
actively influence the market
for jazz?
Recording companies had control over
various aspects of production. They would
select musicians, for example: larger compa-
nies tended to start with musicians who had
more technical training and could read music
quite well. Smaller companies tended to get
great improvisers.

When it came to marketing and adver-
tising, it was not uncommon for groups to be
given labels that would associate them with
a place, even if the relationship was fabri-
cated. The California Six could easily all
hail from Brooklyn and have never even been
to California. Record companies might set
up a deal with a record company in a different
city or a different country, and get access to
their musicians, who might sell very well in
the different company’s local market. Vice
versa, the foreign musicians might do well in
their local market because they are new and
interesting, and that might balance out the
different recordings a record company would
offer. For example, a group whose sound the
company knew was very different would not
call that group “the Harlem Standard Bearers.”
That would be a bad name for a group that had
a really unique sound. Companies some-
times would even re-release music under a
different group name. The record companies
were trying to figure out how consumers
would respond.

The book’s cover illustration tells
an interesting and significant
story about how firms marketed
jazz early on. Would you explain?
The top illustration on the cover is a pro-
tional image for the first group recorded as
a jazz group in April of 1927, the Original
Dixieland Jass Band. It is a caricature of a
group of African American musicians. By
today’s standards it’s a
stereotypically offensive
image, but it was not
unusual for the time.
The bottom image is a
photograph of the actual
Original Dixieland Jass
Band. They are white.

I’m not pointing this
out to say that those
record companies were
nefarious. This was, for
better or worse, a record company’s attempt at
explaining jazz to people who had never heard
it. If you’re a first mover in a new market,
to establish the market, you struggle with
trying to define the market. In the case of jazz,
this attempt at defining the market back-
ired because the association with African
Americans got of a lot of conservative Anglo
white people riled. That ended up influencing
managerial decisions later on.

I also found it interesting because people
who study rock and roll point out that you
often saw the opposite happen as record
companies tried to define that new genre.
A group that was in fact African American
would be depicted as white.

Jazz was a major musical
innovation. What lessons does
this story of jazz offer innovators?
The key lesson is how important it is to define
the market early and keep at it. Everyone
involved, from people running the business to
investors, is also trying to affect the under-
standing of what the market is, because the
first successful case of the market defines
the market.

When Netscape succeeded so hugely,
changed the way we understood what
dot-com companies were to be. What is going
to, in the long run, define green technology
will be the first huge IPO in that market.
That’s why there’s a lot of attention around
it. There has to be something for people to
grab onto, to understand, so they can then
compare one type of company to another, or
one type of product to another. If you don’t
understand it, then the market won’t arise.
THE RESEARCH

Most firms, when tapping consumers for new product ideas, take a one-size-fits-all approach and use the same platform with all consumers. But not all consumers are naturally creative and few have much experience with idea generation. These limitations can water down the value of the ideas they offer up.

Professor Olivier Toubia, working with Lan Luo of the University of Southern California, wanted to develop a way to help firms tease out better ideas from consumers. Research suggests that people who are knowledgeable about an industry tackle problem solving differently from those with less knowledge. High-knowledge consumers typically solve problems better when the problems are subdivided into more focused problems; therefore the researchers predicted that firms should solicit ideas from these consumers by decomposing the problem—describing the broader problem, but then asking consumers to focus on one aspect of that problem, such as ideas for household use, ideas for business use, and so on. On the other hand, low-knowledge individuals typically perform better when provided examples of solutions and then asked to come up with their own. This led the researchers to predict that firms should solicit new ideas from these consumers by offering examples of ideas that others have come up with. The researchers confirmed their predictions in a series of idea generation exercises.

THE APPLICATION

Marketing Managers

You can use this research to generate better quality ideas from consumers and to identify their needs to inform new product and service development. First, design your consumer idea generation platform to segment high-knowledge consumers from low-knowledge consumers in the field. Assign decomposed idea generation exercises to high-knowledge consumers without providing examples; assign low-knowledge consumers with idea generation exercises and provide examples, whether or not you use decomposition.

In their experiments, the researchers measured consumers’ level of knowledge of technology products, then divided them into high- and low-knowledge groups. In the first experiment some participants were merely asked for ideas about how to use QR codes (at a time when the codes were quite new and unfamiliar to many consumers). Other participants were given a few examples of possible ideas. The low-knowledge consumers generated better ideas when they were provided examples. In contrast, high-knowledge consumers did not perform as well.

In a subsequent experiment, the researchers added a decomposed approach, again dividing participants into high- and low-knowledge groups. Half of the participants were asked to come up with QR code ideas, while the other half were asked to come up with ideas for using the QR code on paper and then for using the code online. Some participants in each group were provided with examples; some were not. The researchers found that while all consumers produced better ideas when the problems were decomposed, high-knowledge consumers in particular performed well. Low-knowledge consumers in both groups produced better ideas when they were provided examples.

Olivier Toubia

Olivier Toubia is the Glaubinger Professor of Business in the Marketing Division at Columbia Business School.

READ THE RESEARCH


Columbia CaseWorks

A Lead User Template: Unlocking the Value of PWD

To stay ahead of the market, firms need to tap the experiences of people with consumer needs that aren’t being met. In this CaseWorks case, we worked with Pepsi to solicit new ideas from what we call lead users, people faced with extreme situations for whom no commercial solution is available. The mobility and sensory issues that people with disabilities (PWD) have always faced are those that the baby boomer generation now has, and will increasingly face as they age. So we turned to people with disabilities as lead users who could help us improve the shopping experience of anyone facing mobility or sensory limitations. The lead users we identified (e.g., blind directors, deaf musicians) innovate everyday because they have to adapt to the environment and develop their own solutions to meet their needs. —Olivier Toubia

For more information about this case, visit gsb.columbia.edu/caseworks.

THE IDEA

To tap consumers’ best ideas, customize an idea generation platform to fit their level of knowledge.

The Consummrate Creative Consumer
A recently transferred employee from Shanghai nails his pitch to Mr. Smith in Chicago but stumbles when talking to Mr. Chen from San Francisco. A visiting professor from Taiwan lectures fluently when showing a slide of a Grecian urn, but struggles to recall the word “translucent” when discussing a Ming vase. Why would seeing a Chinese face or even a Chinese vase disrupt a Chinese immigrant’s fluency in English?

New research by Professor Michael Morris explores the process through which reminders of one’s home culture can interfere with speaking a second language.

In recent years, the study of how cultural knowledge operates in the mind has focused on the dynamics through which culturally conferred cognitive structures become activated in particular situations. One of these dynamics is frame-switching, or the shifts in judgment that bicultural individuals make as they move between different cultural settings. A new immigrant may speak Chinese and interact according to Chinese norms at home, for example, but speak English and adopt Western mannerisms when in school.

This latest research builds on a decade of Morris’s work documenting that frame-switching occurs through an unconscious mental process called priming. Morris, working with post-doctoral research scholar Shu Zhang and former students Chi-Ying Cheng of Singapore Management University and Andy Yap of MIT, conducted a series of four experiments that showed frame-switching is an automatic process and therefore sometimes disrupts—rather than helps—performance in a second language. Second-language fluency is difficult because first-language structures in one’s mind can interfere with the second-language structures, Morris explains. In their first experiment, which simulated a conference call, they found that Chinese immigrants spoke English less fluently when speaking to a Chinese face (a photograph), compared with a Caucasian face. The second found the same effect from exposure to images of Chinese culture such as a Buddha statue or the Great Wall of China, compared with images of American culture such as the Statue of Liberty or Mount Rushmore. Both studies used an objective measure of fluency—words spoken per minute—as well as the subjective assessment of two judges who evaluated the recordings.

The third and fourth studies focused on investigating how cultural primes—iconic images that trigger cultural associations—can activate Chinese-language cognitive structures that interfere with English-language processing. One study showed that Chinese immigrants who were exposed to visual icons of Chinese culture were more likely to name pictured objects with literal translations from Chinese, such as calling pistachios “happy nuts” or calling a bulldozer an “earth-moving machine.” The other showed that after being primed with Chinese cultural images, immigrants were quicker to recognize these anomalous literal-translation phrases, an indication that these lexical structures had been cognitively activated.

Although this set of studies focused on language, biculturals become fluent not just linguistically but also socially—knowing a second culture’s norms for when to make eye contact and what emotions to express in what situations.

Biculturals become fluent not just linguistically but also socially—knowing a second culture’s norms for when to make eye contact and what emotions to express in what situations.
to cultural cues. “Our cultural scripts are triggered automatically by cues to the cultural expectations of a setting—sights, sounds, foods, even aromas that are evocative of a particular cultural identity,” Morris says. “But in culturally complex communities, this chameleon-like response doesn’t always serve us well. In many social settings in New York, for example, an immigrant would encounter Chinese faces or Chinese images even though it’s a situation governed by American cultural norms rather than Chinese norms. Automatic responses to culturally associated stimuli would interfere with the person’s efforts to adhere to American norms.”

Cultural cues that induce East Asian immigrants to speak English less fluently and behave less “Western” could hinder their hiring and promotion. For example, a manager interviewing a candidate from Japan might think that meeting at a Japanese restaurant would make the visitor more comfortable, but the setting may set up the visitor for a clash of activated cultural scripts. “This is something that happens in many organizations that receive international visitors or employees,” Morris says. “Someone will say, ‘the team from Tokyo is here, let’s take them to the sushi place around the corner.’ In reality, this may make it harder for the visitors to speak English fluently during dinner, because their Japanese language schemas will get activated by the Japanese cultural cues.” Better options? Suggest a traditional American steakhouse or the neutral ground of another culture’s cuisine.

Why would seeing a Chinese face disrupt a Chinese immigrant’s fluency in English?”
Finding the Fit That Makes Us Tick

In a new book, E. Tory Higgins shares the keys to understanding what motivates people—and how to unlock success and influence others.

How is this new book, Focus, different from your previous book, Beyond Pleasure and Pain, which also addressed how we think about motivation?

I wrote Beyond Pleasure and Pain to help people move beyond understanding motivation as a simple question of carrots or sticks. Heidi Grant Halvorson and I wrote Focus to show people how they can use motivational fit in life, be more successful and motivated with respect to their goals, and more effective in their relations with other people, whether it’s their children or their students or their employees. Focus is much more a practical guide.

How can we identify our own and others’ motivational focuses?

If you’re working with someone for quite a while, do they seem not to be satisfied with the status quo? Are they always looking for something better, to make progress? That kind of person is probably more promotion focused. They think in terms of gains. Emotionally, they tend toward being really happy and jubilant and eager or they’re looking sad and discouraged and disappointed.

If you’re working with someone who is more concerned with maintaining the status quo, who doesn’t like taking many chances, who has more of an “if it’s not broke, don’t fix it” outlook, that person is probably more prevention focused. They think in terms of preservation and preventing losses to what they already have. Emotionally, they are relatively relaxed and calm, or, if things aren’t going well, nervous and tense.

It’s important to say that we are not arguing that there are only two kinds of people in the world. We’re saying there are two kinds of motivation in the world, promotion and prevention. There are situations where everyone would be in promotion and there are situations where everyone would be in prevention. Someone can be prevention focused as a parent or spouse, but much more promotion focused on the job.

Can you give us an example of how these different kinds of focuses can play out on the job?

Consider a negotiation. In a negotiation there are two kinds of reference points. There’s the aspirational goal—the ideal result of the negotiation. Then there’s the walk-away price—the absolute minimum you want out of the negotiation. In between is the target, which would be a successful outcome. When we teach negotiations we train people to emphasize all three.

People with a strong promotion-focus emphasize the aspirational goal because that represents a motivational fit with their system. What’s the downside? The problem with promotion people is that if during the negotiation it looks like they’re not going to get their maximal, they may actually quit the negotiation and not make the agreement, even though the offer on the table is as good as the target. The flip side is that prevention focused people tend to focus just on the walkaway. They can end up getting less than they could have gotten if they’d kept their eye on the maximal as well.

It’s important to know whether you tend to be more promotion or prevention oriented and enter a negotiation knowing your
aspiration price, your target, and your reservation (or walk-away) price. It’s easy in the heat of the moment to emphasize the one that fits your system. When the negotiation gets to a certain point, the point where either an agreement or an impasse is about to happen, take a break. Go to the bathroom. Say you need to make a phone call. Then think about where you are in relation again to these different reference points.

You also need to do what you can to know the motivational focus of the other negotiator. If you are promotion-focused, there’s a risk when negotiating with someone who is prevention-focused. You may push so hard that you are actually going beyond that person’s reservation price. When you do that, that person will end the negotiation.

How can managers make the most of the two motivational focuses when working with employees?

The aim of giving feedback as a manager is to strengthen someone’s motivation so they can perform better in the future. Most people think of B. F. Skinner and positive reinforcement: the idea that you should reward behavior that you want repeated. But that research was on animals, not humans. And, Skinner aside, people tend to believe that it’s better to give positive feedback than negative feedback. But what you really need to do is give feedback that fits the person.

For someone who is promotion-focused, they need feedback that motivates them to seek out future gains. So if they’ve done well, the vigilance they need to stay motivated. Instead, use maintenance language. Say, “That was really good work. Just keep that up, keep maintaining that. That’s good.” To give negative feedback, you can basically call a failure a failure, within reason: “When you did X, you made a mistake. You need to be vigilant against those kinds of mistakes in order to maintain good performance.”

There’s also leadership style to consider. The management literature is very enamored of transformational leadership. It has good street cred. Transformational leaders are optimistic, eager, and enthusiastic. It’s a terrific fit for promotion employees and in America in general. That’s why it looks good. If you did the same thing in Japan, it would not do as well because they have more prevention employees. Wherever you are, you can do better by tailoring your style so that you are a transformational leader to your promotion employees but not to your prevention employees.

If promotion-focused people tend toward optimism and prevention-focused people tend toward pessimism, does that mean promotion-focused people are happier?

I can see why people might think that living a life full of joy and eagerness seems more pleasant. But all of us have failures in life. When you fail in prevention, it increases your vigilance. That system doesn’t mind having more vigilance. It fits, and you’re still highly motivated and it feels good to be highly motivated. But when you fail in promotion, you become discouraged. You lose your eagerness and it shuts down the system. It’s a non-fit. You are now living a life of unmotivated discouragement. At its worst, it leads to depression. Any clinician will tell you that the consequences of being very depressed are worse than the consequences of being very anxious, especially the risk of suicide.

One other thing: this question is related to asking yourself what kind of life you would like to live. Even in success, there is a difference between promotion and prevention. Quite literally, promotion people are idealists, which means they have rose-colored glasses. Prevention people are realists. You could easily argue living a life that’s realistic is better than living a life with rose-colored glasses that’s an illusion. That’s the deeper philosophical point of view. Do we really want to argue that promotion is better?

What advice do you have for people who lean strongly to one side or the other of these two focuses?

There are many circumstances that call for a strong prevention or promotional focus. Creating an innovative product would benefit from a strong promotion focus. Trying to create a reliable product would benefit from a strong prevention focus. But if you find that your extreme focus is beginning to hurt you more than help you, there are some things you can do.

Find a complementary partner with the opposite focus—on your management team at work, in your spouse at home. Your partner will naturally set constraints on you that will reduce the costs of your focus. You can also intentionally put yourself into your complementary state. If you are prevention focused and you’re assessing some decision in your usual hyper-vigilant way to the point of overkill, you need to stop and ask yourself what you would gain from each of the alternatives. That will put you in a promotion focus, and it will constrain your extreme prevention focus. And in a promotion focus you just want to get on with it. If you’re extremely promotion focused, you should ask yourself, what would I lose with each of these options? What kinds of things do I need to be careful about?

By the way, like everything else in life, it will take practice to be able to do this well. There’s also an unintended positive consequence to pushing yourself beyond your dominant state. You’ll see things you didn’t see before, because promotion and prevention are selective with respect to what you pay attention to. You’ll actually see information and options you hadn’t even considered before.
In a new book, Rita McGrath explains how companies can thrive in what she calls the “transient advantage economy.”

The first part of your book explains how the economy has changed in the last two decades, making sustainable competitive advantage untenable. Instead, you argue, companies should seek out transient competitive advantage.

I wouldn’t describe transient competitive advantage as something that companies want to seek out. But it’s the new reality, and companies that have learned to embrace it are prepared to do well. Obviously, a company would love an advantage that lasted a long time. But if you think, “This isn’t going to last too long, but I can make money out of it anyway” then you’re taking a pragmatic approach.

The fact is, sustainable competitive advantage just doesn’t exist in most sectors of the economy. Any industry that’s asset-light or doesn’t require ten years of drilling into the ground is going to be very vulnerable. That means the content industry, any services business, anything that had been physical that could be digitized—and that’s the bulk of the economy today.

How did these changes come about?

Companies can’t protect advantages the way they used to. People copy you, they match you. And that’s because of vanishing barriers to entry, globalization, and the digitization of the world.

We certainly saw early evidence of it throughout the ’90s, as the Internet became a commercial reality and the digital revolution swept through businesses like newspapers and music and movies. That’s when some industries started to get hit by the changes. Now we’re at an inflection point. People have talked about this before, but mostly as it relates to certain sectors. Now we’re starting to realize that there is a fundamental shift in the underlying economy.

In the book, you give the example of Research In Motion and describe how its competitive advantage with BlackBerry proved to be unsustainable.

Research In Motion had its roots in pagers. It wasn’t thinking at all about consumer devices; it positioned the
Any industry that’s asset-light or doesn’t require ten years of drilling into the ground is going to be very vulnerable.
BlackBerry as a business product. I remember when, if you asked executives to turn off their BlackBerries, it was as if you’d asked them to amputate a limb.

The thing that undid the company was the mindset that its product was going to be fine in the corporate space, because these smartphones and Apple products and Androids were just consumer devices—and that wasn’t its market. When Research In Motion finally realized that these newer products were a threat, it tried to reinforce the BlackBerry franchise and desperately tried to catch up with what it thought its consumers were demanding. But by then it was too far down the road.

If you went in with the idea that you’d have to take it apart in five or ten years, then you’re less likely to have gone overboard in creating a capital-intensive structure. In an ideal world, what you’re doing is continually upgrading your assets, so they don’t hold you back when it’s time to change.

What about the idea of competing within arenas, rather than industries?

It used to be, when things were more stable, that your most significant competitors were in the same industries. So if you were Ford, it was Chrysler. Intra-industry moves were few. But what about the ones to watch. What we’re seeing today is industries competing with industries. For example, we’re now spending less of our discretionary income on entertainment and meals out and more on our phones. So you’ll pass up dinner at a restaurant and spend that money on your data plan. And this is something that companies need to keep in mind—their competitors might be coming from entirely new directions. Executives need to think in a much more fine-grained way about how to make competitive moves.

Is there a company that has been successful at managing transient competitive advantage?

One wonderful example is America’s own Milliken and Co., the country’s last standing textile company. It transitioned itself very well from the world of making cloth and garments to the world of making advanced materials and chemicals that go into a lot of other companies’ manufactured goods.

Milliken’s success is tied to an idea you discuss in the book: the need for continuous reconfiguration. Isn’t it difficult to be always in a state of reconfiguration?

There’s expense, and there’s difficulty. The companies that are good at this don’t let themselves get overweight in an old advantage. One of the reasons that moving from an old advantage to a new advantage is expensive is that you build up assets and systems and structures. When you have to reconfigure them, it’s expensive. Instead, if you went in with the idea that you’d have to take it apart in five or ten years, then you’re less likely to have gone overboard in creating a capital-intensive structure. In an ideal world, what you’re doing is continually upgrading your assets, so they don’t hold you back when it’s time to change.

What does this new reality mean for individuals?

Well, there’s bad news and good news. The bad news is that people who don’t have the education, networks, or training are going to have a very difficult time demonstrating that they can add value as employees. So you need to take a proactive stance in building your career. We’ve heard that before, but I think now we’re really seeing the effects of these changes. On the plus side, careers are now going to be infinitely more varied. And there’s going to be a lot of opportunity for people who do have skills that are in demand. There are now many more ways to be successful, create an interesting life for yourself, and get paid well for doing it than there have ever been before.

Is the idea that you’d better start at the top?

To the very best and brightest, keys to the corporate jet don’t necessarily say, “You’ve made it.” For some people they do, and they’re really good at managing big systems and people. But there are other people whose instincts are more creative, and they want to take a blank sheet and fill it in. Or they want to open up completely new territory. And these are the people who will build your innovation capacity.

The big trick is going to be how we create systems so that people don’t get abused. When I look at my children and my friends’ children, there is this joke that they’re 22-22-22. They’re 22 years old, work 22 hours a day, for $22,000 a year. There used to be an apprenticeship model in a lot of industries, but you had the promise that it wasn’t going to go on forever. You’d move on to the next level after you’d proven yourself. What I worry about now is that some people, through no fault of their own, get stuck in these abusive situations. Coming to grips with the effects of a transient advantage economy is one of the biggest challenges we’re facing as a society.
Why Are There So Few Women in Corporate Leadership?

A study suggests the answer is linked to the behavior of both men and women at the top.

It may seem strange to ask—at a time when women account for almost 40 percent of all managerial positions, according to data from the Bureau of Labor Statistics—why so few women have made it to the very highest levels of corporations. Yet after decades of progress, the percentage of women in top management positions remains under 9 percent. And in professional positions (for example, chief financial officer) where women have done relatively well, the percentage of woman has actually declined in recent years, falling to 12.8 percent in 2011 from a high of 14.2 percent in 2004.

What factors make it more or less likely that a firm will have a woman as a top manager? While many anthropological and anecdotal studies have explored this question, few statistical studies have been undertaken.

New research by Professor David Ross, working with Cristian Dezsö of the University of Maryland and Columbia Business School doctoral student Jose Uribe, is one of the first large statistical analyses of whether a given top managerial position is likely to be held by a woman. Their study, which analyzed 20 years of data from the 1,500 largest US firms, identified a single significant predictor. “If a firm already has one woman in a top management position, then the odds that another woman will also have a top position is lower,” Ross says. “It’s as if women are over-distributed among firms, or spread out more evenly than chance alone would dictate.”

Researchers have offered a wide range of theories about the underlying causes of this phenomenon, which can be broadly divided into two categories: behavior by women and behavior by men. Behavior by women includes the tendency, among some women, to not seek each other out in a corporate environment. Prior studies have shown that junior women tend not to choose female mentors and that women at the senior level tend not to take on female mentees. “Women might actually be avoiding each other, almost as if they were magnets with opposite polarities,” Ross says.

Take the perspective of the lone woman in a firm who has achieved a senior position, he explains. She occupies what might be considered an ecological niche. “If you introduce another woman who could be a competitor, that represents a threat,” Ross says. “It is as if you have two hunting animals in an area of the forest where there is really only room for one.”

A junior woman at a firm may have other reasons to avoid seeking out a female mentor. For example, research has shown that some women have internalized society’s conflicting norms about female behavior. “Some young women will encounter a female executive and be put off that the senior woman is behaving in ways that executives tend to behave and not the way that society says women should behave”—confident and decisive, rather than inclusive and nurturing, Ross explains. “That can create personal friction.”

Behavior by men in the corporate sphere also exerts a significant influence. Organizations are under a good deal of pressure, both internally...
You might expect that when a firm chooses a woman as its chief executive, it is ushering in an era of other women being promoted to top management. But that isn’t the case.”

and externally, to alleviate their demographic disparities. If a firm has an all-male executive team, it may devote considerable resources to recruiting a high-profile woman from outside the firm or promoting a junior woman to the top team. However, once that first woman is in place, the urgency to find a second declines sharply.

“Even though a corporation might have only one woman in its top five positions, it sees itself as having moved one step closer to equality,” Ross says. “And frankly, that corporation is probably doing as well as or better territory—such as an all-male executive team—might be neutral or even positive. Yet once a minority reaches a certain threshold, the majority often feels threatened. Studies suggest this threshold is about 20 percent, which corresponds to one woman on a five-person team. “The attitude of the male majority might go from actively looking for a woman, and feeling good about that, to a sense that they already have one woman and don’t really need another,” Ross says.

All of these mechanisms provide theoretical reasons for why women are over-distributed in firms. Or, in other words, why a firm with one woman at the top is less likely to have another. In fact, the effect is particularly strong if a firm has a woman as its CEO. “You might expect that when a firm chooses a woman as its chief executive, it is ushering in an era of other women being promoted to top management,” Ross says. “But that isn’t the case.”

It is both a counterintuitive and troubling finding, but one that suggests that the reasons behind the continued lack of women in top management are complex and difficult to remedy. “We have evidence that male behavior is contributing to this, because we can look at similar job categories and see how women are being selected and placed,” Ross says. “And we can see how women are influencing this by looking at women CEOs who have the power to have a tremendous effect on the gender balance of the top management team.”

极端天气可以破坏城市的生产和其经济。来自飓风Katrina和Sandy的损失分别为约1500亿美元和6000亿美元，分别。基于的破坏和对交通系统的干扰可以延迟通勤者、卡车交付和供应链的中断。即使在极端天气条件是常态时，经济生活也会遭受破坏。温暖、潮湿的地区经济发展相对缓慢。研究显示，男性行为的不平等对这一现象的贡献是明显的，尤其是当公司有女性CEO时。

Profesor Marcelo Olivares wanted definitive evidence to show whether—and how much—extreme weather affects productivity. Olivares's experience studying inventories and production in US automobile assembly plants provided that opportunity. With Gérard P. Cachon and Santiago Gallino of Wharton, Olivares matched weather-station data with detailed weekly production data from US auto plants.

Extreme weather can wreak havoc on cities and their economies. Damage from hurricanes Katrina and Sandy is estimated at more than $150 billion and $60 billion, respectively. Weather-based power failures and disruptions to transportation systems can delay commuters, stall deliveries, and choke supply chains. And even where extreme conditions are common, economic life suffers. Regions with hot, wet climates are less productive on average.

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Some aspects of production are seasonal—carmakers produce and sell more convertibles in warmer, sunnier months, for example—so the researchers had to control for expected production drop-offs as well as those resulting from extreme weather. The characteristics of the plants are also important—newer plants tend to be located in southern US states, which have weather patterns different from Detroit. By focusing on the variation in production of each plant over time, the study explains how much of the production change can be explained by extreme weather and not just normal local conditions. Their data included weekly work schedules, which are planned with seasonal conditions in mind but don’t account for possible severe weather. By comparing the plans with actual work and weather station data, they could estimate how drastically weather affected production.
Next, they assessed economic impact. “By measuring the effect of a particular weather event together with the frequency of these events, we were able to calculate average production loss for a typical plant in the United States,” Olivares says. They learned that productivity declines by about 1.5 percent on average per plant due to each extreme weather event, with individual plant productivity declines ranging from as little as .05 percent to as much as 3 percent.

“Those numbers don’t seem very big,” Olivares acknowledges. “But in any given week the effect can be very pronounced. For example, extremely hot weather—defined as seven consecutive days of temperatures above ninety degrees Fahrenheit—can cause production declines of up to nine percent for that week,” he says. “That adds a lot of volatility into that plant’s production, which is costly to the manufacturer, who needs to be able to predict its production. So it not only reduces average production but also introduces variation, making it harder to control.”

The researchers also looked at extreme levels of wind (defined as 40 mph or more), precipitation (three or more consecutive days of snow or rain), and cold (below 15 degrees Fahrenheit). They found that extreme heat tends to have a greater impact than extreme cold, but snowstorms and intense heat reduce production about equally.

The researchers’ data does not reveal the specific ways in which bad weather can lower production. Do workers have a hard time reaching the plant? Is the supply chain disrupted? Both? To fill that gap, they talked to plant managers, who monitor weather constantly. “So they plan their inbound deliveries from suppliers based on weather forecasts,” Olivares says. “If a big snowstorm is forecast that will likely slow transportation, they try to get delivery to inventory before the snow comes. They also acknowledged that they see more employee absenteeism during extreme weather events.”

The researchers also found that plants struggle to recover after weather-related disruptions. “Production lapses one week could affect production the following week— if weather delays inventory, for example, the schedule gets knocked back,” Olivares says. “Plants may not catch up until two or three weeks later.”

The effects extend beyond the plant itself. In a follow-up study, the researchers looked at how extreme weather altered auto availability at dealerships. When a plant’s production is disrupted, deliveries to dealerships are also likely to be delayed. With less variety available to customers, sales drop.

Extreme weather even affects indoor production centers with temperature controls that allow operations under unusual conditions—an outcome the researchers didn’t expect. Office environments aren’t immune, either, Olivares says, noting research showing that weather can affect mood, which can diminish productivity.

As climate change threatens to make extreme weather more common, businesses may find it prudent to plan accordingly. The popular lean production model pioneered by Toyota, for example, may need changes. “Toyota’s goal was to eliminate all the waste in the process to increase overall productivity,” Olivares says. “That means operating with low levels of inventory, which means weather disruptions are likely to have a higher impact.”

Can different management approaches moderate the effect of weather on production? Can firms diversify production and suppliers geographically to hedge against the risk of extreme weather events? “Such questions of adaptation present a challenge for researchers and firms alike,” Olivares says. Business can’t change the weather. But, in the end, weather may change business.

Weather-based power failures and disruptions to transportation systems can delay commuters, stall deliveries, and choke supply chains.
THE IDEA
How the sequential nature of online reviews affects product ratings.

What’s in a Five-Star Rating?

THE RESEARCH
Online reviews for products and services are typically reported sequentially, rather than in parallel: new reviews come in all the time, not all at once. Most consumers, before submitting a review, are therefore exposed to reviews by others that have already been posted and tend to look at this history—particularly at the average review, often synthesized in a star or number ranking—before writing their own. Previous research has shown that a review tends to reflect not just a consumer’s personal opinion, but also the influence of reviews that preceded it.

In a recent working paper, Professor Omar Besbes, working with Marco Scarsini of the Singapore University of Technology and Design, examined how the sequential nature of reviews distorts the statistics of ratings (such as the average or their distribution) from what might be called the “true” statistics—those one would observe if consumers submitted their reviews all at once, without reviewing previously submitted reviews. The researchers analyze a broad class of consumer reporting mechanisms that account for past reviews, dividing those into two behavioral categories: compensating behavior and herding behavior. Compensating consumers award an inflated high score or an exaggeratedly low score in an attempt to shift the average of ratings toward the rating they believe the product deserves. Herding consumers, on the other hand, follow the prevailing opinion, shifting their own personal rating toward the average in the belief that the crowd must be right.

Whether consumers are herding or compensating, the average of reported ratings for a product will stabilize over time; however, the researchers found, this average rating might be above or below the “true” average, a difference they define as the bias gap. Compensating and herding behavior have very different effects on this gap, the researchers’ model showed. While compensating tends to have limited influence on where a score eventually stabilizes, herding can be very significant; while the average rating is highly influenced by the sequential nature of reviews, the position of a product or a service relative to competitors is usually preserved. The researchers further analyze the potential for manipulation of reviews and show that compensating behavior limits the impact of review manipulation. However, when herding behavior occurs, a few very early reviews can dramatically shift the trajectory of a product’s ratings toward the high or low extremes.

THE APPLICATION
This research highlights the difficulties of determining whether the true value or quality of a product or service is being reflected in the marketplace. Reviews have become an increasingly important tool for consumers as they make purchasing decisions but their accuracy is hard to track. Reviews are often bought (written for hire) or influenced (perks, discounts, or refunds are offered in exchange for writing a positive review or agreeing not to post a negative review). This research highlights the need to better understand how existing reviews are synthesized by consumers and the need to devise mechanisms to limit biases and manipulation in reviews.
In 2001, the US Congress passed the No Child Left Behind Act in an effort to measure and improve student performance in math and English language skills. The law required states to adopt standardized tests and to create timelines, with annual benchmarks, that would bring student proficiency levels to 100 percent by 2014. Schools were judged not only on their overall achievement rates, but on the performance of various subgroups, such as students from low-income families or historically disadvantaged ethnic groups. If any of these subgroups failed to meet the annual goals, the school would fail and therefore face penalties including the loss of funding and the possibility of restructuring or closure.

Under these new regulations, however, states were allowed wide flexibility. States were allowed to choose their own standardized tests, set their annual benchmarks, and consider various allowances when grading a school’s performance. The result? Small, often subtle differences in implementation led to significant differences in measured outcomes, according to new research by Professor Jonah Rockoff, who worked with Elizabeth Davidson of Teachers College and Randall Reback of Barnard College, both at Columbia University, and with Heather Schwartz of the RAND Corporation.

One of these subtle yet significant differences in implementation was the use, by some states, of a confidence interval, a statistical means of accounting for sampling error. Suppose a state set its math proficiency benchmark at 58 percent and 56 percent of students in a particular school score above the state’s proficiency level. The question then becomes: can state administrators be fairly certain that if all the students at the school took the test again, it would still fail to reach 58 percent? In order to provide more assurance that failing schools were truly below the benchmark, states adopted confidence intervals as high as 90, 95, or even 99 percent.

With a large confidence interval, the real bar is often far below the stated benchmark, Rockoff explains. “It might sound trivial, but with a very wide confidence interval, maybe only thirty percent of students had to pass the test,” instead of 58 percent, he says. “It’s odd, because we never use confidence intervals in grading; a student could not tell a teacher, ‘It’s true that I failed, but you can’t be ninety-nine percent sure that if you tested me again, I would still fail.’” Yet that is essentially new research shows that subtle differences in implementation led to wide discrepancies in measured outcomes.

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how many states implemented No Child Left Behind. And while some states had wide confidence intervals, others set none, leading to dramatic differences in reported failure rates.

Another implementation detail that had a significant effect on measured outcomes was allowing states to set the minimum size of its student subgroups. To some extent, this seems reasonable: If a school had only one student living in poverty, and that student failed the test, should the entire school fail? However, as with confidence intervals, the use of minimums varied greatly among states, with some states measuring subgroups in the single digits and others setting them many times higher. “I can’t imagine that the policy makers who designed No Child Left Behind would say they intended that in North Dakota, a school needs to have 40 poor students for the results of their testing to matter, but in South Dakota, you need only ten,” Rockoff says. “That goes beyond the intended flexibility.”

No Child Left Behind was intended to raise standards, not to compare student performance across the nation or make schools all teach the same material. But as the researchers show, even with flexibility on what schools are teaching, meaningful accountability requires consistency on implementation. “It’s fine if state administrators in Mississippi want to teach fifth-grade math differently than they do in Massachusetts,” Rockoff says. “But even if you give states flexibility with some big-picture items, you really need to nail down all of the details on how things get measured.”

These findings have implications for any large organization that wants to establish an incentive and accountability system, Rockoff notes. A conglomerate that wants to establish incentives might allow its various divisions some leeway on how they set their benchmarks. But this intention can backfire without sufficient measurement standards. “You can give flexibility about goals or performance,” Rockoff says. “But if you allow too much flexibility with measurement, the system will fail.”

Even if you give states flexibility with some big-picture items, you really need to nail down all of the details on how things get measured.”

Could Uncertainty Cause a Recession?

New research explores whether asymmetric information about corporate assets could have been the sole cause of the recent financial crisis.

Just over five years ago, the United States entered a period of economic decline that would become known as the Great Recession. Although essentially nothing had changed in the country’s productive capacity, it experienced a sharp drop in output, employment, and consumer consumption. And though there is widespread agreement that some contraction was inevitable in the housing sector, questions remain about how the crisis spread to manufacturing and throughout the broader economy.

New research by Professor Saki Bigio addresses these issues. Bigio sees recessions as periods of great uncertainty—in particular, uncertainty in the realm of how banks value a company’s assets. “In general, someone inside a company is thought to know more about the company’s assets than the banker on the outside,” Bigio explains. “But you can have a situation in which there’s a shock to the economy, and suddenly everyone who is lending money is facing even greater uncertainty about how a particular company’s assets will be affected.” The shock might be a decline in construction, an increase in the price of oil, or a political crisis in a certain region of the world. But the result is the same: an increase of asymmetric information, between insiders and outsiders, about the value of a company’s assets.

However, high levels of asymmetric information do not inevitably lead to recession. Some assets may fare better than others during times of uncertainty, and the performance of assets that increase in value may compensate for those that decline. But problems arise when the financial sector, which is continuously valuing assets, is less able to make accurate assessments. And when a company tries to pledge its assets—whether in the form of a new property it has acquired, a new client it has secured, or even a new marketing strategy it has developed—it may find itself unable to obtain financing.
“You can have a recession simply because it’s harder for banks to assess the value of assets,” Bigio says. “And that greater uncertainty begins to spread across the economy.”

Bigio tested this theory against the recent crisis in an attempt to determine whether uncertainty alone could have caused the recession’s magnitude. His first step was using the documented uncertainty about the value of stocks during the crisis, through measures such as volatility, as a proxy for banks’ uncertainty about collateral. Second, based on others’ recent research on the link between employment and lending, he theorized that companies were pledging their collateral in order to obtain financing to pay workers. His computer model showed that this amount of uncertainty could cause a drop in funding that could explain the extent of the crisis.

Bigio’s research was not aimed at proving that uncertainty in the form of asymmetric information was the actual cause of the crisis, but that it could have been responsible—and without any other contributing factors. “And in fact, it could have, very easily,” he says. “Perhaps the knowledge that asymmetric information could alone cause such a crisis will lead to actions to alleviate the risks. For example, it may be important to strengthen bank regulations. Furthermore, firms may want to develop trade and credit relationships with their partners so they are less dependent on external funding in the event of a downturn.”

This study explores a sharply different narrative from other attempts to explain the recession. Rather than hypothesizing that the crisis was caused by households that took on enormous debt that they could not repay, which in turn led to a drop in consumer spending, Bigio’s research explores whether banks’ unwillingness to lend, amidst this greater uncertainty, caused the crisis.

Before the recent recession, research on the effects of asymmetric information had gone somewhat out of style, Bigio notes. “The idea got some attention in the 1980s and early 1990s, but after that, it was completely abandoned as a topic in macroeconomics,” he says. “Now there is a lot more interest in this issue, even if exploring the idea in a practical form is very complicated.” By coming up with a model that others can use and adapt, Bigio hopes that further research will explore other realms in which asymmetric information may contribute to economic risks.
THE RESEARCH
The US bankruptcy code—specifically, Chapter 11—has existed more or less in its current form since 1978. One central rule, known as the automatic stay, prevents creditors and other claimants from demanding immediate repayment when a company files for Chapter 11, thereby providing time for a judge to oversee an orderly bankruptcy proceeding. Over the years, however, derivatives contracts, along with swaps and repos, have become exempt from the automatic stay, giving derivatives holders an edge—to the extent that they hold collateral, derivatives counterparties are repaid at the moment of a bankruptcy filing, while all other claimants (including secured creditors) are subject to the automatic stay. Because of this special rule, derivatives contracts essentially get repaid first.

In a recent working paper, Professors Patrick Bolton and Martin Oehmke examine the effects of this special bankruptcy treatment for derivatives contracts. Using tools from corporate finance theory, the researchers built a model to answer the following question: From an economic perspective, is it more efficient to have derivatives paid off first, before all other debt? Or would it be preferable to repay lenders to the firm first and then derivatives counterparties? These questions are not theoretical; when Lehman Brothers filed for Chapter 11 in 2008, the largest bankruptcy in US history, it held hundreds of millions of dollars in assets. Yet within hours of the bankruptcy filing, a large percentage of Lehman’s assets had already been claimed by counterparties to its derivatives contracts.

The researchers found that the current regulations reflect too narrow a view of the financial world. Giving special treatment to derivatives may make derivatives contracts safer, but transfers risk to other creditors, such as bank lenders, who are now second in line in the event of a bankruptcy. Bank lenders, anticipating this risk, therefore charge higher interest rates. When this feedback effect on a firm’s cost of debt is taken into account, it is usually preferable to put creditors rather than derivatives counterparties first in line.

THE IDEA
Reconsider derivatives’ privileged status in bankruptcy.

Should Derivatives Be Privileged in Bankruptcy?

THE APPLICATION
Policy Makers
The special status of derivatives in bankruptcy has become an important topic of debate in recent years among policy makers, legal scholars, and regulators (it is the subject of a recent Government Accountability Office (GAO) report, “Financial Company Bankruptcies,” GAO-13-622, Jul 18, 2013). The researchers’ study is the first formal analysis of the costs and benefits of the current provisions. Their findings suggest that the default risk, which under the current system is borne mostly by lenders to the firm, would be more efficiently borne by spreading the loss given default among all investors, including the derivatives counterparties.

Would it be preferable to repay lenders to the firm first and then derivatives counterparties?
A new metric uses publicly disclosed bank information to better predict credit losses from loans.

Financial crises across the world’s banking system are nothing new, having occurred regularly—if not always predictably—throughout history. Banks, investors, and regulators have sought ways to report and analyze credit risk and profitability as a means to head off such crises, but just how to measure these objectively and fairly remains controversial.

For most banks, lending is the primary activity and source of value creation. Loan yield provides a good estimate of expected interest income. Banks can estimate just how much value they are creating by subtracting expected credit losses from lending against expected interest income from lending, which gives one measure of profitability.

But established credit metrics and disclosures, based on the currently required incurred loss model, don’t predict credit losses very well. The prediction challenge is perhaps best reflected in how banks currently report allowance for loan and lease losses (ALLL) and the provision for loan and lease losses (PLL), two of the main credit-related disclosures. ALLL represents management’s best estimate of the total loans and leases (held for investment) that the bank believes it will be unable to collect, based on information and events as of the date of the financial statement. That’s an important detail: in estimating for ALLL, the regulatory rule is that banks can only use information and events as of the date of the financial statements. Net loans reported on the bank’s balance sheet are estimated by deducting the ALLL from gross loans. PLL represents the amount charged against revenue that reflects credit risk from actual write-offs of loans (net charge-offs) and the change in the ALLL during the reporting period. PLL usually does not incorporate the actual credit risk taken on in the period itself.

In the past, regulators offered more flexibility in calculating the PLL—managers were allowed to include some expected future losses in the provision. But over time, regulators put increasingly strict guidelines in place—the incurred loss model. As with ALLL, a bank can provide (i.e., charge) for losses only if it can document that the loss is probable and can be reasonably estimated. Regulators believe this is a more objective and reliable approach than allowing managers discretion about the uncertain future. They also argue that in the absence of such rules managers might manage earnings to make performance look more consistent or less volatile, and manage regulatory capital levels as well. “Under the current rules, a certain amount of ALLL can be counted as regulatory capital,” Professor Urooj Khan says. “Managers of banks whose pre-managed regulatory capital is low have incentives to use ALLL to report higher regulatory capital.” Indeed, research shows that earnings and capital get managed despite the rules.

Currently, accounting regulators are rethinking their approach. But are there currently available measures that can help to assess future credit losses? Khan and Professors Trevor Harris and Doron Nissim developed a timely, unbiased measure of expected credit losses that can be used to better assess the risks and profitability of lending. The researchers’ model combines publicly available credit-related measures disclosed by banks between 1996 and 2012, garnered from consolidated financial statements (FY9Cs) that bank holding companies are required to file with the Federal Reserve.

They developed their new metric, Expected-RCL, or expected rate of credit losses, using reported credit losses, nonperforming loans, average loan yield, and duration and composition of the loan portfolio. When they analyzed financial statement data using Expected-RCL, they found its predictive power offered a significant improvement over current metrics.

“We believe our measure is a better—more precise—predictor of expected credit losses than any of the existing credit risk-related metrics publicly disclosed in financial statements,” Khan says. “It can be used to better evaluate value creation and lending, as well as bank risk and performance to a large extent.” While there is no easy way to quantify the improvements that Expected-RCL offers over other measures, Khan notes, it performs substantially better than net charge-offs, realized credit losses, or the fair value of loans in predicting credit losses.

The researchers’ work comes at a time when standard setters, including the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB), are reconsidering the incurred loss model in recognition of the challenges it presents.

“The research offers standard setters and regulators material to contemplate as they consider giving managers more discretion in reporting expected credit losses,” says Khan. “It also offers academics a more informative measure to use in research, and it offers investors and banks a new measure to assess profitability and risk.”
Hedge Fund Activists’ Real Returns

New research shows that stock-price jumps following hedge fund activism are the result of genuine productivity gains, not mere financial engineering.

The market likes hedge fund activism—a lot. On the date a hedge fund announces plans to take an activist shareholder stance in a firm, the stock of targeted firms jumps 6 to 7 percent above the day’s average stock price gain. This enthusiasm suggests investors have high expectations of hedge fund intervention.

But critics claim those expectations are unwarranted. Targeted firms, they say, may pay more dividends in the short run but also take on more debt in lieu of shaking up underperforming firms or adding long-term value through real productivity gains. The critics argue that hedge funds make only quick cosmetic fixes and perform superficial financial engineering designed to produce only short-term gains.

Are hedge fund activist gains purely cosmetic, or do their interventions result in substantive long-term changes? Professor Wei Jiang, working with Alon Brav of Duke University and Hyunseob Kim of Cornell University, shows that improved performance in the wake of hedge fund intervention is a real phenomenon.

The researchers first looked at firm productivity, using the US Census’s annual surveys of US factories that employ two or more people. They found that hedge funds are not simply picking firms that specialize in particular industries. So they compared market performance with productivity surveys. They found that after a hedge fund takes an activist stance, productivity increases by 10 percent, on average.

How might this be happening? “One way to increase productivity is to sell off underperforming assets and concentrate on core competencies,” Jiang says. “We find that hedge funds not only improve the productivity of assets in place but that they push away underperforming assets—and, importantly, the assets’ new owners increase productivity, too.”

Just spinning off underperforming assets, while typically a good move, isn’t enough to warrant the kind of market reaction described above. The researchers find that the new hedge funds owners are able to operate firms’ remaining assets much more productively.

“Once we identified this channel we immediately asked, in what kinds of markets would this be best?” Jiang says. “Remember that while hedge funds are often not necessarily experts in a specific business—they plausibly don’t have more inside knowledge than a CEO or senior executive at a firm, though they might have a more objective opinion about its condition—they do tend to manage portfolios that specialize in particular industries. So they could have a better understanding of the interplay between different players in that industry.”

The researchers find that hedge funds prompt the largest gains in performance in industries that are not highly concentrated rather than in an industry with only a handful of players (such as soft drinks).

One noteworthy test the researchers conducted as part of this study examined when hedge funds shift their ownership stance from passive to active. When a fund (or any investor) accumulates 5 percent or more of ownership in a company and also intends to influence control of the firm, it must file a Schedule 13D form with the SEC. If the fund, despite its 5 percent holding, intends to remain a passive investor it can file a shorter form, the form 13G. The researchers found close to 300 cases between 1994 and 2007 where a hedge fund switched from a 13G to a 13D—that is, where funds didn’t change ownership stakes but did shift from a passive to active stance. The real effect—the 10 percent increase in productivity—occurs only after the fund shifts its stance.

“Our research provides strong evidence that hedge funds are not simply picking firms that will improve in the future regardless of their actions,” Jiang says, “but that they are targeting companies whose performance they think they can improve through shareholder activism.”

Wei Jiang is the Arthur F. Burns Professor of Free Enterprise, chair of the finance subdivision, and a senior scholar at the Jerome A. Chazen Institute for International Business at Columbia Business School.

READ THE RESEARCH

Columbia CaseWorks

Microsoft’s Attempt to Acquire Yahoo!: A Case in Letters

This CaseWorks case presents an example of how an activist hedge fund can have a real effect on a firm. I analyze how a hostile takeover can be difficult if the CEO of the target firm is unwilling to yield, even when the deal is favorable and has strong support from the majority of outside shareholders. In this case, Yahoo! rejected a lucrative deal from Microsoft, an offer that came with a heavy premium. After Microsoft’s hostile takeover failed, two hedge fund activists, Carl Icahn and Third Point, came in and succeeded in ousting Yahoo!’s CEO. We are still waiting to see how the new CEO is performing, but overall I think people agree Yahoo! has had a favorable turnaround. —Wei Jiang
Information Sharing, Social Norms and Performance

Marco Di Maggio with Marshall Van Alstyne of Boston University

Idea: This research considers how an anonymous online information-sharing platform affects productivity.

Applications: Allowing loan officers in the corporate division of a bank to share information anonymously on an online platform generated a productivity gain for each lower-skilled loan officer of about 10 percent, or about one additional year of education. Those who performed poorly in previous terms saw the largest increases. Overall, for large organizations who have a lot of dispersed employees working on related projects, information sharing produces a sizable productivity effect.

Read more about this research, featured in the October 2013 electronic issue, at gsb.columbia.edu/ideasatwork/infoshare.

How Price Promotions Influence Post-purchase Consumption Experience over Time

Leonard Lee

Idea: This study looks at the relationship between discounts and consumer satisfaction over time.

Applications: Promotions can help loosen consumers’ purse strings, but when a discounted product is consumed after a delay, a customer may become less likely to buy the product again or to recommend the brand to friends. Firms concerned with promoting consumer satisfaction and brand loyalty may want to pay more attention to whether customers are enjoying the consumption experience.

Read more about this research, featured in the October 2013 electronic issue, at gsb.columbia.edu/ideasatwork/delayconsumption.

Can Consumers Make Affordable Care Affordable? The Value of Choice Architecture

Eric Johnson with Allison T. Baiger of Columbia University, Tom Baker of the University of Pennsylvania, Ran Hassin of Hebrew University of Jerusalem, and Galen Treuer of the University of Miami

Idea: This study replicates choices consumers will make when choosing health insurance on the Affordable Care Act health insurance exchanges and finds that, on their own, consumers make unnecessarily costly choices. The researchers estimate that offering choice aids on the healthcare exchanges could save consumers and the US Treasury between 9 and 10 billion dollars annually.

Read more about this research, featured in the October 2013 electronic issue, at gsb.columbia.edu/ideasatwork/choosewealth.

Social Category Diversity Promotes Premeeting Elaboration: The Role of Relationship Focus

Katherine Phillips with Denise Lewin Lloyd of MIT, Cynthia S. Wang of Oklahoma State University, and Robert B. Lount Jr. of Ohio State University

Idea: This research investigates the cognitive processes that people use when anticipating meeting and working with colleagues from a different social category—gender, political affiliation, or race, for example.

Applications: This research suggests that, contrary to many diversity efforts that downplay difference for the sake of promoting harmonious relationships, promoting certain kinds of difference results in more effective individual preparation for team-based problem-solving work. Individuals who perceived themselves as less similar to colleagues prepared more thoroughly for meetings and were more effective at problem solving in teams.

Activating Brokerage: Inter-organizational Knowledge Transfer through Skilled Return Migration

Dan Wang

Idea: This research considers the barriers that skilled foreign workers confront in transferring knowledge when returning home after working in the United States.

Applications: Returnees are potentially powerful brokers of knowledge and innovation, but cultural and institutional barriers can impede the process considerably. Returnees can mitigate this by maintaining strong links in their home country, particularly in cultures that tend to be more closed. Firms can support returnees by creating an explicit expectation of knowledge sharing and by implementing programs that help returnees and their families reintegrate to life back home.

Read more about this research, featured in the September 2013 electronic issue, at gsb.columbia.edu/ideasatwork/returnees.
Here is where you’ll gain superior insight into the forces shaping business. Where top academic minds carry out game-changing research. And where leading-edge business insights are constantly informed by the world’s most dynamic business environment: New York City. Find yourself at the center of emerging thought. Only at Columbia Business School.

Learn more at gsb.columbia.edu/ideasatwork