ACCOUNTING
Cutting Through the Spin

TECHNOLOGY & STRATEGY
eBay Tips the Scales

MANAGEMENT
Building the Right Board

FINANCE
Predicting Payouts
Something significant will happen for the Smith School of Business at the Academy of Management’s annual meeting Aug. 1-5, 2014, in Philadelphia. Debra Shapiro, the school’s Clarice Smith Professor of Management, will start a one-year term as president-elect of the professional association.

The appointment by itself is impressive, considering the Academy of Management represents nearly 20,000 members in more than 100 countries. What adds to the distinction is that when Shapiro emerges as the association’s 71st president in 2015-16, she will be the third Smith faculty member to hold the position. Smith Professor of Management & Organization Kay Bartol held the post from 1984-85, and Smith Professor Emeritus Ken G. Smith led the academy from 2006-07. In the academy’s long history, only three other schools have produced as many presidents.

Media outlets including Financial Times and Bloomberg Businessweek focus on research output in top academic journals when they rank Smith’s faculty among the best in the world. These rankings are valuable, but the full impact of Smith thought leadership goes far beyond the published contributions.

Academy of Management service is one example among many. Gilad Chen, the Ralph J. Tyser Professor of Organizational Behavior, started in January 2014 as editor of the Journal of Applied Psychology. Wendy Moe, associate professor of marketing, recently won the 2014 Robert D. Buzzell Marketing Science Institute Best Paper Award. Meanwhile, Smith’s calendar is packed with events such as the Conference on the Regulation of Financial Markets at SEC headquarters, which took place May 16, 2014, in Washington, D.C.

All of these things combine to tell a story of faculty impact and thought leadership that truly spans the globe.

Alex Triantis
Dean, Robert H. Smith School of Business
University of Maryland
SAVY INVESTORS SEPARATE WISHFUL THINKING FROM MEANINGFUL FACTS IN EARNINGS STATEMENTS

Research by Michael Kimbrough

CUTTING THROUGH THE SPIN

Each quarter brings a flurry of news releases coming from publicly traded companies announcing their earnings, often with an explanation for the good or bad numbers. The companies have a lot riding on the highly scrutinized earnings reports: Stock price changes can be significant as the market reassesses the future prospects of a firm.

Some firms try to soften the impact of negative news by downplaying losses, but new research from Smith professor Michael Kimbrough shows that investors are smart enough to sift through the corporate spin and draw their own conclusions. Thus, managers have every incentive to lay out the details.

Kimbrough, associate professor of accounting, and co-author Isabel Yanyan Wang of Michigan State University, looked at earnings announcements for 94 companies from 1999 through 2005. They coded the announcements and compared the explanation companies provided for their results to the stock prices in the three days surrounding the announcement. They found that companies have a tendency to attribute good earnings news to their own management efforts, and bad news to other forces. They also found that investors are savvy enough to be skeptical of corporate explanations of earnings dips and spikes.

“Having information about what caused or contributed to earnings news should be useful information, but we also know that managers have a self-interest in trying to maximize the rewards for good news and minimize the penalties for bad news,” Kimbrough says. “That creates a challenge for investors in determining how much they are going to rely on the management explanations.”

He said the explanations can provide useful information for interpreting earnings news, but they also just might be a reflection of managerial self-interest. “Our paper examines the factors that might help the market better assess or determine an appropriate degree of reliance on managers’ explanations.”

For example, after 9/11 many companies blamed missed earnings on the terrorist attacks even when they weren’t a factor in the decline. Another example: In the early 2000s, Krispy Kreme used the low-carb diet craze as a reason for why their market share was decreasing.

“Just because you cite a cause, doesn’t mean that investors should actually believe that that’s the cause,” Kimbrough says. “Even though the facts you marshal may be true, your claim that those facts are relevant to interpreting your earnings news may not be. It’s not clear. Our study looks at the factors that investors consult.”

This does not mean managers should not provide context for an earnings report. “The crux of our study is that there is a role for managers to try to influence the market’s response,” Kimbrough says. “Investors do not just have to take the numbers as given without a context. Management can provide a context for investors to interpret the numbers. You could call it spin—and sometimes it can be spin—but it can also just be more information.”

The researchers found that investors don’t just respond unfavorably to a company’s poor earnings reports if the company offers a reason for the numbers. They actually try to differentiate or calibrate their response to the attributions based on other information.

“We find that investors look to cues like what has happened to other firms in the industry and whether they are experiencing the same difficulties,” Kimbrough says. “They also look at what kind of commonalities a firm has with the market or the industry over time. Both of those can be useful signals in ferreting out how plausible explanations are in an earnings report.”

Kimbrough says effective corporate managers are mindful of the fact that investors are sophisticated and will provide the necessary details to help interpret the earnings numbers. So for managers, the more verifiable details they can provide to back up earnings explanations, the better, he says. And for investors: View a company’s explanations as useful, but don’t just take the explanations at face value. Look at how persistent the good or bad news is in the industry, he says.

A buyer venturing through a recent eBay forum about a shipping delay contemplated posting an online review criticizing the seller for “laziness and lack of professionalism.” One thing holding the buyer back was fear of a retaliatory review from the merchant that would “tank my rating” as a future seller.

Forum participants cited eBay’s recent ban on such seller retaliation. They advised the buyer to claim more power in the situation but urged restraint—distinguishing between “mistake” and “fraud” in the transaction. Such a negative review, one responder said, could destroy that merchant’s business.

The discussion illustrates the premise of recent Smith research into manipulative behaviors in online buyer-seller reputation systems, where a high reputation score means more sales and ability to raise prices.

Such a system fuels an online marketplace, but participants “gaming the system” can make it sputter. In 2008 eBay navigated that storm when it acted against “strategic sellers” who were threatening buyers with retaliatory feedback to coerce positive transaction reviews.

Smith Information Systems Professors Siva Viswanathan and Goudong “Gordon” Gao measured buyer-seller reaction to the intervention through eBay’s seller-to-buyer power shift. Smith PhD student Shun Ye, a faculty member at George Mason University’s School of Management, also contributed to the study, initially titled “The Good, the Bad or the Ugly” to reference three distinct seller behaviors.

Unlike the good sellers, strategic merchants had manipulated the review system. The researchers set out to determine whether these players were “bad” (inherently low-quality sellers) or “ugly” (opportunistic sellers exploiting the loophole in the old system and then reforming their behavior after the ban on seller retaliation). “The strategic sellers were indeed ugly,” Viswanathan says.

Before eBay intervened, buyers and sellers were ranked by the same feedback rating system. Counterparts in a transaction could revoke or mutually withdraw negative feedback and ratings. They relied on one another to avoid becoming red-flagged in the eBay community because of a negative, or even neutral, review.

The merchants who gamed that two-way system threatened its integrity. “The tactic enabled low-quality sellers who, for example, cut corners in shipping fragile items to manipulate their reputations and masquerade as high-quality sellers,” Viswanathan says.

Purchasers not playing along were paying a price, as evidenced by a four-fold increase in unwarranted negative feedback left for them in a retaliatory way, an eBay spokesman reported in a 2008 interview for Fortune Magazine.

Merchant outrage erupted upon eBay’s subsequent ban on negative and neutral reviews by sellers. Company forums generated discussion supporting a user stoppage. Sellers argued that eBay had stripped their protection from deadbeat bidders or unreasonable customer demands.

The company countered that retaliatory seller feedback, more than a bad transaction, would drive a buyer away from eBay.

Following a weeklong seller boycott and policy implementation, eBay reviewers became more emboldened. “Buyers were more likely to leave negative feedback with sellers stripped of retaliatory power,” Gao says. “More surprisingly, those strategic sellers who initially reacted strongly by opposing eBay’s policy change were found to exert more effort to improve their service quality after the ban on retaliation and revoking.”

The study is among the first to measure how an online reputation system’s design affects seller behavior. Some eBay merchants exploited a seemingly even, two-way rating system between buyers and sellers and compromised their marketplace.

Banning the mutual revoking of negative reviews and curbing sellers’ ability to retaliate changed their behavior for the better, but at the expense of unduly shifting the balance of power to the consumer, Gao says.

Regardless, Gao says the policy appears to be the most effective option for eBay and other online markets. “There is no easy and straightforward way to calculate ‘revoked feedback’ data in a reputation rating system,” he says.

“Strategic Behavior in Online Reputation Systems: Evidence from Revoking on eBay” is forthcoming in MIS Quarterly.
Entrepreneurial boards typically stay actively involved in the growth of a new venture and can be critical to the company’s success. So it is important for startups to know which types of people they should offer board seats to.

Christine Beckman, associate professor of management and organization at the Robert H. Smith School of Business, looked at the influence of entrepreneurial boards and the makeup that helps startups grow quickly in a paper she co-authored for Academy of Management Journal. The authors followed 105 semiconductor firms founded in the United States from 1977 through 1990 to see how well the companies did and how the inaugural board members impacted success.

Typically in a startup, a small group of founders brings in a few outside advisers to form a board. Often venture capitalists or other early investors sit on the board. Sometimes startups might ask a large client to participate. Other times, spinoff startups might recruit someone from the parent company.

The researchers found that individual board members’ backgrounds and the makeup of the board as a whole both influence a startup’s success—in particular through the formation of alliances. For example, having a venture capitalist on a board can be a good thing for developing an alliance portfolio, but having all venture capitalists creates problems. “We looked at how board members influence the different types of alliances that startups create,” Beckman says. “We looked at alliances because our research shows that having a broad set of alliances is really useful for reaching all sorts of milestones for startups, such as raising money and scaling up.”

Alliances encompass licensing, manufacturing and marketing deals—or anything that can help a new venture grow faster. Forging multiple alliances usually bodes well for success. “Different kinds of people are going to bring different ideas and opportunities, so that should help startups create different kinds of alliances,” she says.

The ideal scenario is to assemble a board that is diverse in terms of the kinds of organizations that members represent (parent companies, clients, investors), the mix of industries they come from, and the regions they hail from.

The researchers also found that board members are more likely to deliver value when they have deep ties to the organization. This might be because board members who are also investors or clients do not lose interest over time.

The researchers also looked at individual board members to see how centrally involved they were in other boards and in the industry. Specifically, the researchers wanted to know whether it was better to have board members who sit on several semiconductor boards and how that might impact a startup.

They found the best scenario for a startup is to have multiple central board members also involved in other boards in the industry. “It makes sense—having a lot of people who are well-connected is useful,” Beckman says.

However, if a startup can attract just one industry heavy hitter to be a central board member, that person should not also be an investor in the firm. The researchers found that scenario can consolidate too much influence in a single person and restrict a firm’s growth.

“When you have an investor who is also a board member, and they are more central than everybody else on the board, they have too much influence,” Beckman says. “That one person only has one way of thinking about things and only one set of connections and tends to dominate, and all the other ideas and other connections just don’t get brought to the table.”

Beckman says entrepreneurs who fall into this trap eventually discover that their interests are not always as aligned with their board members as they initially think.

“Even though the investor has money in and they clearly want the firm to be successful, the ways that they think that can be accomplished might be different,” she says. “Even having the same big overarching goal is not enough if you have different pathways to get there.”

“Different kinds of people are going to bring different ideas and opportunities, so that should help startups create different kinds of alliances.”

—Christine Beckman
Assistant Professor of Management & Organization
NEW TOOL CAN HELP INVESTORS IDENTIFY COMPANIES MOST LIKELY TO PAY DIVIDENDS OR REPURCHASE STOCK

Research by Gerard Hoberg and Nagpurnanand Prabhala

PREDICTING PAYOUTS

After once competing almost exclusively with other computer makers, Apple has had to battle a more diverse group of rivals since launching its extensive line of music players, phones and tablets. Despite the skyrocketing popularity of the products and Apple’s financial success, some major investors have criticized the company for holding too much cash.

A pair of Smith researchers found the kind of dynamic pressure applied by Apple’s emerging competitors might be one reason some public companies are more likely to hold cash and less likely to pay dividends or repurchase stock.


Computational linguistics allowed Hoberg and Prabhala, along with Gordon Phillips of the University of Southern California, to identify companies most at risk for market encroachment — and predict which ones would be most likely to adopt conservative cash reserve policies. “People should really understand that the financial world is far more dynamic and changing than it once was,” Hoberg says. “You want to understand where it’s going next.”

The researchers examined nearly 43,000 documents, using keywords to count how many new competitors were entering an existing product space. Products in markets where firms are most rapidly revising their product vocabularies are considered highly fluid. The researchers found gambling to be an industry in flux in the late 1990s, as online threats, legal changes and Native American casinos brought in more competition. Likewise, biotechnology firms in 2008 faced fluidity as health care regulation and government approvals changed.

Today, communication and media companies are working in multiple arenas, and many of their product lines invite competition. “Anything that you do is copied very quickly,” Prabhala says. He compares the team’s research process to combing through social media feeds to determine who has the most activity and new friends. The research also easily identifies stagnant products and industries, such as lumber, chemicals and supermarkets. “Managers in those areas probably don’t need to hold a lot of cash,” Hoberg says. He cautions, however, that it is not necessarily easier for investors in these stagnant areas to demand payouts because managers might have personal incentives to keep cash in reserve.

“Companies that hold more cash are better able to respond to threats,” Hoberg says. “They could tap their reserve to innovate or add to a product line, or they might acquire companies that can improve their existing products and services.”

The cash might also be an incentive to unrelated companies who develop complementary products. As an example, Prabhala mentions an eyewear maker whose product works with Google Glass, knowing that Google is a solvent company with the ability to defend its market share.

In total, nonfinancial businesses in the United States doubled their cash balances to about $1.3 trillion during the course of Hoberg and Prabhala’s study from 1997 to 2008. “Holding stockpiles of cash definitely affects the market as a whole,” Hoberg says. “That has to change the decision-making of the rivals. You also have to ask if investors understand why the cash is there. And, second, are managers taking this too far?”

Ideally, the researchers say, firms should be more willing to return cash to investors when their product stabilizes. In the case of Apple, the company initiated a quarterly dividend and a $45 billion buyback program in 2012, and billionaire investor Carl Ichan recently abandoned his proposal to get Apple to buy back even more stock.

Guidance for Investors

The Hoberg and Phillips Data Library, updated in March 2014 to include data through 2011, has had more than 24,000 page views from more than 50 countries — an indication of the competitive insights available. Investors can apply the research in two ways:

- Visit the online library at alex2.umd.edu/industrydata and check the fluidity scores of specific firms. High scores suggest competitive threats — a strong incentive to hold cash and delay dividend payouts.
- Follow industry trends in real time to identify fluid product markets in which rivals frequently add new features. The cellphone industry, for example, has had this feel of constant change as smartphone technology has emerged.

“People should really understand that the financial world is far more dynamic and changing than it once was. You want to understand where it’s going next.”

— Gerard Hoberg, Associate Professor of Finance
The researchers analyzed 20,000 film reviews from Metacritic.com and looked at reviews of the same movie in pairs. They found that critics’ reviews came out on the same day, they were less likely to have read and been influenced by other reviews. But reviews filed on different days showed critics were influenced by other reviews they read, with ratings in 1 in 10 of the sets of reviews diverging by at least half a star on a four-star scale.

The researchers attribute the divergence to “a tension between wanting to be accurate—to provide the best, objective information—and wanting to differentiate oneself from peer reviewers.”

The working paper is “Competition and Social Influence among Critics.”

Judging Borrowers by the Company they Keep

Your friends say a lot about you—and can even determine whether you can get a loan, according to new research from Siva Viswanathan, Smith associate professor of decision, operations and information technologies.

Viswanathan has been studying crowdfunding markets, websites that allow borrowers to seek loans from many individual lenders, and how well untrained investors make up the “crowd”’s lending decisions. His study looks at one of the first crowdfunding markets, Prosper.com, in which people seek loans typically less than $25,000.

Like traditional banks, crowdfunding lenders use “hard” data, such as credit history and FICA scores, to make the right choices. In Viswanathan’s study (conducted with Smith PhD Mingfeng Lin, now at the University of Arizona, and Smith associate finance professor Naqurnanand Prabhal), borrowers with better scores got better outcomes.

The researchers found that the crowd is also very good at using “soft” information about borrowers to make investment decisions.

This information includes the borrowers’ self-created profiles, details information about why they need the loan, and lists connections to “friends” in their social network. Having a lot of friends doesn’t necessarily matter for borrowers.

What does matter is whether a borrower’s friends are actually lending to them, or are at least willing to lend to them. These people are more likely to get funded and get better interest rates, and are less likely to default on loans, says Viswanathan. The researchers also found that default seems contagious: If a borrower’s friends have defaulted, that increases the likelihood he or she will default.

“Judging Borrowers by the Company they Keep: Friendship Network and Information Asymmetry in Online Peer-to-Peer Lending,” was published in Management Science in January 2013

Paying the Troll Under the Bridge

Traders along the ancient Silk Road measured speed in terms of months and weeks. Pony Express riders counted days and hours. Then telegraph and ticker tape technology changed transaction standards to minutes and seconds.

“In every era, regardless of the relative speeds involved, traders who worked fastest have had an edge over their competitors,” says Albert “Pete” Kyle, the Charles E. Smith Chair Professor of Finance at the Smith School of Business, who started enforcing in 2007, were drafted to keep pace with change.”

“Today’s high-frequency traders have an additional advantage because even SEC has struggled to keep pace with change.”

He says current rules, which the SEC started enforcing in 2007, were drafted in an era when one to 10 seconds per transaction was considered slow. High-frequency traders have blown past this mark, measuring their speeds first in milliseconds and now in microseconds.

Kyle says some of the effects of the automation have been positive. Since trading has become more computerized during the past 15 years, transaction costs have fallen substantially. The downside is that high-frequency traders use their influence to extract tolls from investors who rely on their services for market access.

“One way to think about the situation is like a troll under a bridge who charges travelers something extra when they cross to the other side,” he says.

The going rate, about one penny per share, is not enough to worry small-time investors who usually buy fewer than 100 shares at a time. But the fees add up for the large institutional investors who dominate the markets.

To correct the situation, Kyle says the system needs a more level playing field designed to give all traders—fast and slow—a similar access. Regulation must be modernized in some straightforward ways to get the troll out from under the bridge.

Unfortunately, if Congress tries to write these rules itself, Kyle says the effort could backfire—producing increased profits for high-frequency traders. He says what the system needs is increased investment in economic and financial research.

“Regardless of where the knowledge comes from,” he says, “the process of evicting the troll from under the bridge will require close monitoring and experimentation to get things right.”

Featured Researchers

Christine Beckman, associate professor of management and organization, earned her PhD from Stanford University. She focuses her research on organizational learning and change, entrepreneurship and social entrepreneurship (for-profit education), social and interpersonal networks, organizational growth and survival, and technology and communication.

Gerard Hoberg, associate professor of finance, earned his PhD from Yale. His research interests include corporate finance, asset pricing, cash management, information asymmetry, and market microstructure.

Naqurnanand Prabhal, associate professor of finance, earned his PhD from New York University. His research interests include corporate finance, investment analysis, and financial econometrics.

Michael Kimbrough, associate professor of accounting and information assurance, earned his PhD from Indiana University in Bloomington. His research focuses on corporate financial reporting, with particular emphasis on firms’ voluntary disclosure practices and on accounting for intangible investment.

Guodong (Gordon) Gao, associate professor of decision, operations and information technologies, earned his PhD from the University of Pennsylvania. His research interests include IT’s impact on health care and innovation, and the transparency in service quality.

Guodong (Gordon) Gao, associate professor in the Decision, Operations and Information Technologies Department, received his PhD from the University of Pennsylvania. His research interests include IT’s impact on health care and innovation, and the transparency in service quality.

Siva Viswanathan, associate professor of information systems and co-director of the Center for Digital Innovation, Technology and Strategy (DIGITS), earned his PhD from New York University. His research focuses on emerging issues related to online firms and markets, and on analyzing the competitive and strategic implications of new information and communication technologies.
Executive Profile

Jennifer Clinton
EMBA '08

“There’s so much competition out there right now for resources among nonprofits. Essentially, you’re running a business but with a really important mission whose bottom line is making a difference for society.”

When Jennifer Clinton, EMBA ’08, accepted her position as president of the National Council for Visitors in 2012, she did so with the aim of helping the organization better articulate its core purpose.

Although the center had worked closely with the U.S. Department of State to promote international exchange for more than 50 years, it needed to do more to attract new partners and strengthen ties with local member organizations. So for much of her first 18 months on the job, Clinton oversaw a strategic planning process as well as a rebranding campaign that included a name change to Global Ties U.S. in January 2014.

“I’m a big believer in clarity of focus,” Clinton says. “People outside our circle of stakeholders and supporters had a hard time understanding what we did or why we did it.”

The 11 full-time staff members at Global Ties work largely to lead and support more than 100 member organizations across the country that implement the State Department’s International Visitor Leadership Program. It connects business, political and thought leaders from around the world with Americans interested in advancing international relationships.

Since launching the new identity, Clinton says recognition has increased at the State Department, on Capitol Hill and within the business community. Eight member organizations plan to change their names to reflect the Global Ties connection.

Clinton came to Global Ties after serving as executive vice president for The Washington Center for Internships and Academic Seminars, a hub for internship opportunities in the nation’s capital. It was while there that Clinton, who holds a PhD in French literature, decided to pursue an executive MBA through the University of Maryland’s Smith School of Business.

Today, Clinton’s business acumen is helping Global Ties’ members thrive in a challenging economy. The organization is funded largely by the State Department’s Bureau of Educational and Cultural Affairs, which continues to experience significant budget cuts. Global Ties saw its funding decline 12 percent over the last two years. Clinton is positioning the organization to become a better resource for others who want to provide professionals with in-depth experience in U.S. business, academic and government settings.

Inspired to a career in international relations by her own exchange experiences, Clinton also expects that Global Ties will create new programming to assist international students in the U.S. Many of her international exchange colleagues started their careers implementing programs abroad. That’s still a long-term goal for Clinton, who hopes to volunteer with the Peace Corps following retirement.

For now, the mother of a 6-year-old son does most of her traveling domestically to help member organizations. From her home base, her mission is crystal clear. “There’s so much competition out there right now for resources among nonprofits,” she says. “Essentially, you’re running a business but with a really important mission whose bottom line is making a difference for society.”

Recent titles from Smith School of Business faculty include:

Social Media Intelligence
Co-author: Wendy W. Moe, associate professor of marketing
Publisher: Cambridge University Press (Feb. 24, 2014)
Summary: Organizations ranging from Fortune 500 companies to political campaigns continuously monitor online opinions in an effort to gauge their actions. This book can help anyone facing the challenge of making sense of social media data to move beyond the current practice of social media monitoring to more comprehensive use of social media intelligence.

The Silk Road Rediscovered
Co-author: Anil K. Gupta, Michael D. Dingman Chair in Strategy and Entrepreneurship at Smith
Publisher: Jossey-Bass (April 21, 2014)
Summary: Pioneering Indian and Chinese companies are rediscovering the fabled Silk Road that joined their nations in ancient times. This is the first book to analyze the growing corporate linkages between the emerging markets, which will be two of the world’s four largest economies by 2025.

Research@Smith Calendar
May 29, 2014 Journal of Accounting and Public Policy Conference, College Park, MD
May 29-31, 2014 Conference on Frontiers of Hierarchical Modeling in Observational Studies, Complex Surveys and Big Data, College Park, MD
July 10, 2014 Tata Dialogue on Innovation, New York City
Oct. 9-11, 2014 National Association of Women MBAs Conference and Career Fair, Crystal City, VA
Oct. 10-11, 2014 Workshop on Health IT & Economics (WHITE), Washington, DC

To learn more about any of these events, send inquiries to editor@rhsmith.umd.edu.

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- Building the Right Board
- Predicting Payouts

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