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ANDREW AINSLIE
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GREETINGS FROM THE DEAN

DOES DIRECT BARGAINING BRING THE BEST PRICE?

HOW CAN TIMING OPTIMIZE EMPLOYEE EFFORT?

IS MARK-TO-MARKET ACCOUNTING REALLY TRANSPARENT?

WHAT IS THE COST OF COMPROMISE?
The world-renowned Simon faculty is known as much for its excellence in academic research as it is for its instruction and innovation. Simon professors keep the spirit of debate alive and well. Scholarly insights and breakthrough research make an impact in the classroom and raise the bar of excellence in today’s business climate.
Simon is one of the world’s preeminent research-oriented business schools. For almost half a century we have truly differentiated ourselves in our belief that economics and analytics provide the best tools to develop a deeper understanding of how today’s business works.

But Simon is more than a collection of brilliant business minds. It is a school that offers a transformative education by bringing those expert researchers into the classroom so our students can benefit in the most extraordinary ways. From Dmitry Orlov’s work on performance evaluations and incentive pay to Guy Arie’s research that offers a new model for multilateral bargaining, our faculty members touch nearly every industry of modern business.

I am also proud to point out the research on public firms voluntarily adopting mark-to-market pension accounting that is put forth by Simon professors Jaewoo Kim, Charles Wasley, and Joanna Wu. Together with Heikki Rantakari’s study of the best structure for group decision-making, the research pieces in this publication highlight how the current Simon faculty is continuing our school’s scholarly contribution to the academy and our corporate partners.

It is my pleasure to provide this glimpse into some of the exciting research being done by the faculty at Simon Business School. As more and more industries are realizing the incredible power behind Simon’s approach to smart, data-driven decisions, we look forward to more groundbreaking work from our faculty that will shape and transform our global marketplace.

Sincerely,

Andrew Ainslie
Dean
Simon Business School
University of Rochester
Guy Arie discusses a new way to look at bargaining.

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DOES DIRECT BARGAINING BRING THE BEST PRICE?

Research shows there might be a better way to bargain.
Generalized Insurance Bargaining
Guy Arie, Paul Grieco, and Shiran Rachmilevitch
A new paper by Guy Arie and two co-authors offers a new model of multilateral bargaining situations. The paper’s innovation lies in moving beyond bilateral to multilateral negotiations between suppliers—think hospitals and technology firms—and intermediaries, such as insurers and company purchasing departments.

As long as you give the users enough incentive to get the right price, they’ll actually get a better price.

“The way it was modeled before this paper was assuming everybody—all the hospitals and all the insurers—get stuck in one room and all pairs have to decide at the same time, and then they all leave. It doesn’t work that way in the real world,” Arie says. Rather, insurers and hospitals meet in pairs in succession, breaking one big interaction into a sequence.

“We recognize that this happens over and over every several years. For example, Excellus negotiates with URMC. Then they sit down with Rochester General. Every two or three years they come back and do that again,” he says.

The paper’s main takeaway is that price bargaining by an intermediary with a variety of suppliers can significantly increase prices for the end user. For example, university employees ordering a new computer through the purchasing department would get a better price bargaining on price directly.

“As long as you give the users enough incentive to get the right price, they’ll actually get a better price than the university that’s bargaining as a collective. That’s one of the implications of this research,” Arie says.

The model also shines a light on the effect of hospital mergers. Some of the models in use now “could make it seem as if a merger would help patients even though in practice it would increase prices,” Arie says. In the paper’s model, mergers tend to increase prices—an effect with important implications for regulators considering merger approvals.

Paul Grieco of Pennsylvania State University and Shiran Rachmilevitch of University of Haifa were the paper’s co-authors.
New research looks at the right time to provide both positive and negative performance assessments.
Optimal Design of Internal Disclosure
Dmitry Orlov
What is the optimal way for supervisors to design performance evaluations and incentive pay? A paper by Simon professor Dmitry Orlov shows that partial transparency about employee performance is the way to go.

“Well-managed firms are neither fully transparent nor fully opaque with their employees,” Orlov writes in “Optimal Design of Internal Disclosure.”

Giving feedback to employees can improve productivity, Orlov says. However, the greater the feedback, the higher the cost of compensation over time.

Orlov’s game theoretic model determines when and what performance feedback to provide and how it interacts with incentive pay. While the employee knows more about how much effort she is exerting, her supervisor controls the verifiable result of that effort, measuring and designing both a compensation plan and the flow of information.

Consider the long-term contracts of consulting firms. These pacts have an up-or-out structure that provides strong incentives for associates to work hard. Employees know the rules of the game: advance or be kicked out. If the firm implies an associate’s performance is under par but the employee is putting in a strong effort, he may work even harder. If he is shirking his work, however, he may start looking for a job elsewhere and devote less attention to his current employer. The optimal amount of information to share with a junior employee balances the agency costs and productive benefits.

“The problem is timing: If bad news is conveyed too soon, the employee will lose interest ... and start looking elsewhere,” Orlov says.

Generally, though, thumbs-up assessments are shared more frequently than negative feedback. To be biased in a positive way in communication is rational, Orlov says. However, when an employee has been performing his job well for some time, his supervisor should share more negative feedback. Having performed well for some time, the employee is fairly confident his job is secure and he has a stake in the firm, so poor feedback is less discouraging.

Finding the right balance of feedback transparency influences how employees decide to work in the future and how incentives are allocated.
RESEARCH IS TO SEE WHAT EVERYBODY ELSE HAS SEEN, AND TO THINK WHAT NOBODY ELSE HAS THOUGHT.
– ALBERT SZENT-GYÖRGYI

Hungarian-American physiologist and Nobel Laureate.
He is credited with discovering vitamin C and components and reactions of the citric acid cycle.
(September 16, 1893 – October 22, 1986)
Is Mark-to-market Accounting Really Transparent?

JAEGOO KIM
Assistant Professor

CHARLES E. WASLEY
Clinical Professor

JOANNA SHUANG WU
Professor of Accounting
Scholars explore two theories that may shed some light on adopting firms.

*Is Mark-to-Market Accounting Really Transparent?*
Economic Determinants of the Decision to Voluntarily Adopt Mark-to-Market Accounting for Pension Gains and Losses
Jaewoo Kim, Charles E. Wasley, and Joanna Shuang Wu
In recent years, a growing number of public firms have voluntarily adopted mark-to-market pension accounting, which requires companies to report gains or losses associated with their defined benefit pension plans in their income statements. It is a counterintuitive move; experts expect an increase in earnings volatility because of the unpredictable effect of future uncontrollable market factors on a firm’s pension expense. Why would adopting firms give up a reporting alternative with a built-in mechanism that smooths gains or losses in exchange for one that they know could increase earnings volatility?

Researchers have studied this action and proposed theories to explain it. Simon professors Jaewoo Kim, Charles Wasley, and Joanna Wu test two of these theories in a recent paper. They find that more than one explanation may be at work simultaneously, noting that costs and benefits of different accounting policies vary across firms. In one explanation, managers adopt mark-to-market accounting to achieve greater financial transparency.


But the reality is more nuanced. While adopting companies—AT&T, Verizon, and UPS have been among them—argue that the method benefits investors and analysts by improving transparency, observers note the potential for managers to use this method to alter their firms’ financial statements so they can report higher future profits. Companies can write off past accumulated losses as an adjustment to retained earnings in the year of the change, putting bad news behind them.

That, Kim says, is a motive researchers say is driven by a second explanation for employing mark-to-market accounting: managerial opportunism to increase firm earnings and possibly also CEO compensation. Using this method, companies can shield earnings and management compensation from amortization expenses down the line.

The choice to maximize managers’ own wealth may in fact reduce rather than increase firm value, Kim notes.

“The point here is, does adopting mark-to-market indeed improve transparency? Or do managers label their accounting choice as transparency, and in fact it isn’t? Is it window dressing, when the real goal is to increase manager compensation? We find that both could be going on at the same time,” Kim says.
What is the Cost of Compromise?

Authors offer insights into consensus decision-making and individual ownership.
The Politics of Compromise
Heikki Rantakari and Alessandro Bonatti

Available at SSRN.com
Abstract ID = 2444853

Find out more about Simon Business School’s research at:
simon.rochester.edu/research
When it comes to group decision making, which kind of structure works best? Simon professor Heikki Rantakari, with Alessandro Bonatti of Sloan School of Management at Massachusetts Institute of Technology, explores the effects of consensus decision making on group performance in “The Politics of Compromise.” The paper was published in American Economic Review.

Consider this: A university establishes a committee to revise the curriculum. Members then invest time and effort developing often-conflicting proposals, strategically deciding among themselves the type of proposals to work on and which proposals will receive support.

Here’s the problem at the heart of it, Rantakari says: Because the time and effort for the group to develop solutions is costly, the first person to present a concrete proposal gains bargaining power. The rest of the group can avoid further costs by approving his proposal. This can be problematic if proposals that are highly skewed toward one member are much less valuable than solutions that balance the interests of the group as a whole.

The need to build a consensus around a proposal can induce such compromise. Intuitively, the members will not support a proposal unless each of them perceives it to be sufficiently valuable to himself, and nobody should waste time developing proposals that they know will get rejected. But there is also a downside. The more a member needs to compromise on the content to guarantee support, the less interested he is in developing the proposal in the first place. This leads to inefficient effort and delay.

“The main tradeoff that we are considering is this idea that while compromise can be good for the overall value of the final product, by compromising, no single member feels strong ownership of the idea. There is a lack of incentive to see the idea through to completion. The goal is then to determine deliberation rules that balance these two effects,” Rantakari says.

“The same logic carries over to the group composition itself. If everybody agreed, everybody would want somebody else to do the work. So it’s looking at this idea where it is good to have a lot of disagreement in the group, and then how to use the deliberation rules to harness that conflict to create both effort and compromise.”

Overall, the organizational decision-making process should balance the quality of the proposals created with the time and effort it takes to develop and consider them.
Simon faculty members continue to make their marks as founders and editors of some of the world’s most highly acclaimed business publications. Many have also published books that are now used at top business schools.

Journal of Accounting and Economics

The *Journal of Accounting and Economics* encourages the application of economic theory to the explanation of accounting phenomena. It provides a forum for the publication of the highest quality manuscripts, which employ economic analyses of accounting problems.

Journal of Financial Economics

The *Journal of Financial Economics* provides a high quality professional outlet for scholarly studies of actual cases, events, or practice. Together, they provide a rich source of data that illustrate or challenge accepted theory and lead to new insights about the world. Applications and case studies are often included in the publication. The published pieces often raise new questions, or pose old questions in an innovative ways to theories, or document interesting phenomena.

Journal of Monetary Economics

The strong interest in monetary analysis has been matched in recent years by a growing attention to the working and structure of financial institutions. The role of various institutional arrangements, the consequences of specific changes in banking structure, and the welfare aspects of structural policies have attracted interest. The *Journal of Monetary Economics* provides a specialized forum for the publication of this research.