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Spring 2006 Volume 21, No. 1

Why Johnny Can't Choose: Economic Illiteracy in America

Ashok K. Gupta, *Editor-in-Chief*

"The American economy is the eighth wonder of the world; the ninth wonder is the economic ignorance of American people."
– Arthur Levitt, Former Chairman, American Stock Exchange[1]

In the year 2005, the National Council on Economic Education asked Harris Associates to survey 3,512 U.S. adults aged 18+ and 2,242 U.S. students in grades 9-12.[2] The major findings of the survey include:

- On average, adults get a score of 70 ("C" grade) for their knowledge of economics and personal finance, based on a 24-question quiz. Students' average score is 53 ("F" grade).
- 28% of adults and 60% of high school students get an "F" on the Economics Quiz.
- Only 50% of high school students say they have ever been taught economics in school (either in a separate course or as part of another subject).

There were, of course, variations in these scores based on education, gender, and age of respondents. And one can always question the validity of such tests and surveys. However, these findings to a certain extent support Arthur Levitt's observation on economic illiteracy in America. Similar surveys have been done in the past with similar results.

Why do we care about economic literacy? What do we mean by economic literacy? What kind of economic knowledge is most useful to the public to become "economically literate" as opposed to the professional economists?

We are not worried if we do not understand the principles of physics or the periodic tables of chemistry; why then should we care about economic literacy? Because economic illiteracy is dangerous. The economy touches everything we do. We are all amateur economists at work or at home. Scarcity is a fact of life and economics is about understanding the choices and making trade-offs among scarce resources.[3] Real life is about economics. "It is about finding a job, surviving a recession, battling inflation, saving for retirement, and investing in a mutual fund or playing the stock market."[4] Chris Farrell of *Sound Money*[5] argues that "the case for economic literacy is compelling to the extent that it helps people navigate better through this world. Economics offers insights into the issues that affect us as workers, consumers, savers, investors, and voters. For example, economists have something to say about the forces behind inflation and recessions, the direction of interest rates and stock prices, and the benefits and costs of international commerce." Gary Stern, president of the Minneapolis Fed, put it this way: "Economic literacy is crucial because it is a measure of whether

people can understand the forces that significantly affect the quality of their lives."[5]

There are several indications that the need for economic literacy is greater than before:

(1) ***Push toward individual risk-taking and individual responsibility***. "Individuals are increasingly expected to prepare themselves for rapid change and bear much of the risk from the economic ups and downs. For example, employers insist on their workers taking more responsibility for their retirement arrangements and funding. Colleges and universities count on parents and their children coming up with more tuition dollars on their own."[5]

(2) ***Information overload:*** Due to the revolution in communications, citizens have access to far more information on public issues than ever before. The media and the Internet are continuously feeding citizens with news, analysis, opinions and debate on public issues. We have more ways of communicating our views to public officials than ever before. As citizens of a democratic nation we are expected to participate, vote and make our views known to public officials[6] after digesting all the news we hear.

(3) ***Increased complexity of issues:*** Even though channels of communications have significantly increased, our understanding of economic issues, due to the increase in their complexity, has gone down. Globalization, rapid advances in technology, interrelations of markets and financial institutions, and quick transfer of money around the world have made public issues, especially economic issues, more complex and harder to understand.[6]

(4) ***Growth of experts:*** We now have a whole new industry of policy advisors and experts on economics. Rather than simplifying the decisions, these talking heads on TV often make issues even more complex and harder to understand than they really are. They seem to be in the business of impressing each other rather than helping the public.[6]

Economically illiterate citizens are likely to feel completely left out of any public debate and conversation about what is happening in the economy, how economic forces and decisions are going to affect them, what questions to ask, where to seek answers, which way to vote, and what to do about them. An economically illiterate public can be bullied by the politicians.

What does economic literacy mean? Does it mean a watered-down version of academic economics for the mass consumption? Or does it mean promoting slogans such as "markets are good and government is bad." There is some merit in Chris Farrell's idea of a "media" benchmark to thinking about economic literacy. He suggests, "Whether it's listening to the radio, watching television, reading a newspaper or magazine, economic literacy means that people have a *reasonable* grasp of the money, business, and economic issues being discussed."[5] Rivlin echoes similar sentiments in his definition of economic literacy "as a rudimentary working knowledge of the concepts and language of economic activity and economic policy, rather than the language of "economics." He continues, "The word 'economics' suggests the academic discipline taught in colleges and universities. That discipline, I am afraid, has become so abstract, so obsessed with mathematical modeling of an unreal world that it frequently does not have obvious relevance to what average citizens need to understand about economic activity and economic policy choices."[6] For example, an economically literate citizen should be able to understand, discuss and form opinions on issues such as the record high trade deficit. Should the public support trade barriers? Why do economists support open borders even though our trade deficit is increasing? Why are cable television fees increasing while the price of using cellular phones is decreasing? Is a college education still a worthwhile investment with students taking on more debt to earn a diploma than they did in the 1960s, 1970s, and 1980s combined? Where does growth come from? Why are some people rich and others poor? Does trade with other nations do more harm or good? Why is it that the economy sometimes slows and people lose jobs, and what can be done to bring unemployment down and living standards up? Will an increase in the minimum wage lead to greater unemployment? How can we finance and administer the Medicare program so that it provides adequate coverage at containable cost? Should we get rid of all the railroad crossings and instead, have cars travel under a railroad bridge?[5, 6]

In closing, it might be interesting to address some of the following issues: If economics is so important why is there such a wide gulf between economists and everyone else? What are the barriers to economic literacy? What is the private good from being economically literate? For example, do people who are more literate in economics earn more than those who are less literate? We know, for example, that in the 1990 census, in the 25-34 age group, men with bachelor's degrees in economics had median earnings 3 percent higher than the average for all college graduates in this age range, and by ages 35-44 that difference rose to 14 percent. For women those numbers were even higher: 13 percent and 53 percent, respectively.[7] Is there any public good from enhancing economic literacy

of citizens? For example, do we have evidence that enhanced economic literacy makes the economic system work better by influencing voters' and public officials' decisions at the national, state and local levels?

In this issue...

In this issue, we present a set of five articles, book reviews and an executive viewpoint.

In the first article of this issue, Pandit, Rubenfield and Phillips examine which of the three methods prescribed by SFAS 130, companies use to report comprehensive income in financial statements. The authors sample 100 annual reports of companies traded on NASDAQ to find that the dominant method for reporting comprehensive income is to include it as part of the Statement of Stockholders' Equity.

Using a market signaling framework, in the second article Rhim, Peluchette and Song study how the stock market responds to the expected financial performance of the firm at the announcement of CEO succession. This study also looks at the impact of hiring an inside vs. outside CEO and anticipated vs. unanticipated succession on financial performance.

The adaptive selling model has been around for more than two decades. In the third article of this issue, Eckert expands that model to achieve two objectives. First, to make the model more suitable as an organizing framework and to make future theory testing easier. Second, to add specificity to the basic advice "be adaptive" by offering the range of options for being adaptive.

The study reported in the fourth article by Swisher addresses the question that confronts investors with respect to dual-class firms (e.g. Google): "Are inferior voting shares inferior investments?" Results of the study show that investors in inferior-voting shares do not earn abnormally low risk-adjusted returns.

In the fifth article, Frye, Bennett, and Caldwell report the relationship between the emotional intelligence of teams and team interpersonal process. Two dimensions of team interpersonal process were considered: team task orientation and team maintenance function. Emotional intelligence was measured using the BarOn Emotional Quotient Inventory (EQ-i®) on a sample of thirty-three work teams. MAJB

Notes

1. Quoted on http://www.econ4u.org/problem.cfm
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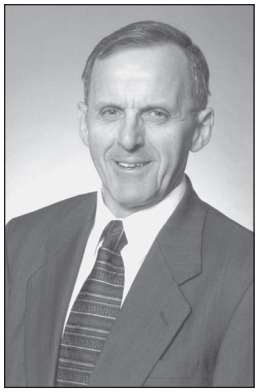
Planning in a Lingering Economic Recession



Adrian "Ed" Edwards,
Interim Dean,
Haworth College of Business,
Western Michigan University

In mid-June 2004, I was contemplating retirement from Western Michigan University. Having just returned from a leave of absence following my second tour as Chair of the Department of Finance and Commercial Law, I looked forward to teaching one more year. This would have concluded forty years as a professor at Western Michigan. Instead of spending my last year teaching a full load, doing committee work, working on articles and easing into retirement, I accepted what now looks like a 2-year appointment as Interim Dean of the Haworth College of Business. I figured that this should be a relatively easy tour and would top off my career.

Little did I know the role of an interim dean. What I learned first was that most faculty see an interim dean as a faculty member who is expected to know all the answers and to follow through on the previous dean's planning endeavors. I learned also that most faculty members expect interim deans to look after the short-run issues facing the college. Based on my finance and economics background I approached the interim position with the objective of keeping the bottom line at a respectable level. Then I would tend to the issue of how to assure that I was representing the college and providing for the growth and development of the faculty.

Jumping into the financial and economic aspects of running the college, I had to review the peculiar aspects of operating within an automobile state and how the university and the college are so closely intertwined. At the beginning of each decade since the 1950s, Michigan has suffered through a business recession. So, when the internet stock market bubble went kaput in March 2000, we, in Michigan, were faced with a couple of difficult years to be followed by a recovery in the automobile industry and subsequently the state economy would recover. Why should the first decade of the 21st century be any different? The economy would be down for the years 2000 and 2001. The recovery would begin in 2002 or 2003 and the automobile industry would be the catalyst in helping the state get back on its economic feet. Then things would be back to normal for the state.

The early years of this new decade, however, have been anything but routine for Michigan. The economy, led by the automobile industry, has not rebounded as in past years. Consequently, public academic institutions in Michigan have also come to the realization that things are not like the old days and higher education in the state is in for a not-so-robust economic recovery. Academic institutions

are finding they can not look to the state of Michigan to provide security. A number of factors are emerging on the horizon, signaling that state public educational institutions might have to adjust to a difficult future economic model.

The first indication of future economic difficulties could have been detected if we carefully analyzed the three-legged stool comprising the economic base from which public institutions derive their funding. The three legs of that base include state funding, student tuition rates and the returns from investing endowments and other sources such as alumni contributions. The first leg comes from the state funding. In the early 1990s the state of Michigan provided some public institutions with as much as 75 percent of their operating funding. However, this percentage was beginning to diminish and by 2005 it was less than 40 percent and decreasing rapidly. In other words, state-funded academic institutions were now becoming state-assisted institutions.

The second leg of the three-legged stool involves funding through increases in tuition rates. This was usually the direction taken by most public academic institutions where there had been a cut in state support. This created another problem. The drop in employment around the state was accompanied by a drop in spendable income. Many families who had been employed in some segment of the automobile industry found it difficult to make ends meet at home and still have sufficient funds to assist their children financially in their quest to fund their educations. They were being hit by one tuition rate increase after another. Where is the breaking point? How much is enough? When will public institutions price themselves out of the market? These were questions that haunted students and parents during much of the first half of this decade.

The third leg of the stool relates to the returns from the investment of endowments from alumni, boosters and others. This area now has the burden of bringing in more funds that can be utilized to substitute for the lost funds from lower state aid. With state assistance diminishing and the pressure of assessing higher and higher tuition rates, the onus for improving the bottom line is moving more and more to improving the returns on investing, endowments and the like. This, then, is the economic environment in which public academic institutions operate, and one in which a college dean becomes more and more involved in terms of short-term and long-term planning.

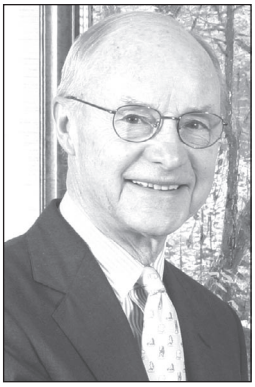
A second area in which an interim dean becomes deeply involved is that of representing each faculty member in his or her approach to meeting personal objectives. Some are seeking tenure, some are seeking promotion, and some are seeking external grants. Regardless of the needs of faculty members, they look to the interim dean to solve short-term issues. They look to the university administration for most of their long-term needs.

In such an environment, how does a college interim dean retain faculty? Most faculty members measure their success on the basis of their rank and salary. In good times, faculty who are productive researchers move up through the ranks and will be rewarded.

Areas where an interim dean can help during periods when the economic environment is not promising is to help faculty secure research funds, sabbaticals, leaves of absence, course release time, convention expenses and possibly market adjustments. This is an area wherein the interim dean can help retain good faculty. Interim deans may also be instrumental in assisting non-researchers to become more valuable faculty members. Where research is not their strength, faculty members may be placed in advising positions. If the faculty member is adept at leading student organizations to attain national status, then he/she could be assigned to lead such an organization and may be very productive in that area.

The two years I have served as interim dean have been very rewarding from the viewpoint of completing a career while gaining an appreciation for the administration of the university and the college. As I move towards retirement, I hope to assist the incoming dean with the peculiarities of becoming a dean for a public academic institution during trying times. MAJB

New Century Challenges and Executive Success



Stefan Anderson
Chairman, Emeritus
First Merchants Corporation

"You have been invited to join the most prestigious business honor society in the world. Congratulations! Tonight, I want to talk about two subjects: 1*) The challenges facing business and society as we begin this new century—especially those relating to ethics and environmental stewardship and* 2*) The qualities of a successful executive life."*
- Stefan Anderson.

Achievements and Challenges

We have entered the 21st century with well-deserved confidence in the strength of our free enterprise capitalistic system. All about us, we see reasons for this confidence:

1. The failure of collectivist economies in the late 20th century;
2. The energizing of old communism in China with dynamic elements of capitalism;
3. The unparalleled advances in in formation and life sciences, driven by business corporations working collaboratively with education and government;
4. Rising standards of living.

However, amidst these achievements, there are disquieting issues present today. Let me list five of them.

The first is the tarnished ethical reputation of American business leadership. The second is the need for business seriously to address our responsibilities for environmental stewardship. The third is accommodating the consequences of accelerating information technology. No less an authority than Dr. Rita Colwell, Director of the National Science Foundation, asked the question, "Can our institutions and government keep up with technology?" While the pace of technology advancement leads to greater efficiency and more perfect markets, it may also mean recurrent and more frequent corporate restructuring and downsizing as markets, needs, and processes change more rapidly.

The fourth issue is the increasingly short-term orientation of our financial markets. Professionals who drive these markets are pulling us into a sound byte world that encourages us to believe that a business' worth depends on what was earned in the last quarter and whether this figure was above or below their expectations. Each of you know that sustainable value has nothing to do with that, and we can hope that this is a fad that will pass.

The fifth issue is the growing disparity of incomes and wealth in our society. Census figures have shown that the income gap between the bottom 10 percent and top 10 percent of

This note is adapted from remarks made by Mr. Anderson at the 2005 Beta Gamma Sigma initiation banquet at the Miller College of Business, Ball State University.

income earners has grown dramatically during the last decade. This is much more than a business issue, but corporate scandals are helping to bring this issue to the fore. What does it bode for American business if the President of the New York Stock Exchange was paid $120 million a year, a figure that had no relationship to the services he performed, as valuable as they were? Recently, a large Indiana public company announced that senior executive compensation was up 18 percent from the previous year, despite the fact that earnings dropped 30 percent and the shareholder stock price dropped 19 percent.

One can say, of course, "Well, so what! The executive salary marketplace is driving that, and we have a healthy middle class so no one is hurt." As a business community, we are hurt in the long-term: our business system in this country has succeeded partly because of public trust. It succeeds best when all players believe that their workplace is characterized by fairness and equity.

The Business Ethics Issue

This leads into the first of the two topics on which I want to comment more extensively: promoting ethical conduct in business. I will speak as directly and honestly as I know how, recognizing that not everyone will agree.

You're all familiar with the stories connected with Enron, Worldcom, several leading mutual funds, Adelphia, Tyco International, etc. All of these publicized departures from ethical conduct have reached the courts of law. We are seeing corporate leaders being sent to prison and vilified in the press. All of these horror stories have in common falsified accounting, rule bending, and excessive personal gain at shareholder expense. Let me emphasize that these conditions are not present in most of corporate America.

Why have these scandals occurred? Why have we had recurring cases of executive self-gain at shareholder expense? First, the corporate governance model which holds the directors responsible to shareholders failed in these companies because of a lack of diligence on the part of directors and excessive collegiality between directors and chief executive officers. Secondly, corporate reward systems have gone awry. The huge size of the prize for senior executives in corporate incentive systems today can be inducement for boards and executive officers to bend the rules or look the other way. Thirdly, many of these reward systems are based on stock value and earnings. Stock valuation today has become excessively based on short-term factors; hence, the pressure to do what is necessary to improve short-term results and stock values. Fourthly, to be fair, we must recognize that there is a changing marketplace for elite talent. Corporate executives of large public companies can look to the NFL and NBA and say that their impact on their organizations is at least as large and as important. And, finally, I believe the ascendancy of relativistic ethics or conditional ethics in which we say something can be right or wrong depending on the circumstances relating to its occurrence makes ethical breeches more convenient and easier to rationalize.

What is being done about this apparent decline in ethical conduct of corporate leadership?

Congress enacted in 2003, sweeping legislation that set rigorous standards for the conduct of independent board of directors and public accounting firms. This is the so-called Sarbanes-Oxley legislation which is having a profound effect on American business governance. Secondly, corporate watchdog groups are proliferating. Preparing for an annual meeting of shareholders today is very different than it was ten years ago. Stockholder rights groups are stronger than ever before and this is good.

Additionally, more colleges, universities and business schools are bringing to the forefront courses on ethics and moral conduct. The Miller College of Business is one of these. Beta Gamma Sigma has also encouraged and informed this increased emphasis on ethics courses. (See the fall issue of the Beta Gamma Sigma *Exchange* magazine.)

How do we insure that our own path as business people is an ethical one? The answer isn't very complicated or fancy:

1) We should stick to the principles on which we were raised. We should embrace the standards we received through our spiritual and religious influences.

2) We should seek to be a part of companies that set the highest ethical standards . . . standards unequivocally say, "Our Code of Conduct prohibits, not only things that are wrong, but things that look wrong." This is the standard of my company and I am proud of it.

3) And finally, we should "practice" integrity. A couple of Sundays ago in a televised golf tournament, sportscasters talked about how Tiger Woods's swing was "grooved." He had practiced swinging it right so many times, he always did it right. We can groove our conduct the same way by doing the honest and disciplined thing again and again. Integrity, in the spirit of Tiger Woods, takes practice. No matter how much fancy theory and academic terminology surrounds the subject of ethics, this very simple truth is unassailable: integrity is

the habit of making the moral choices daily and consistently, especially under difficult conditions.

Business and Environmental Stewardship

Practicing ethical conduct brings us also to the second challenge: providing responsible environmental stewardship in our businesses. Let's define the issue here: in the face of increasing standards of living, and economic growth, is it possible that we are at the same time destroying or degrading the ecological support systems upon which our standard of living and our growth depend? Are we depleting the resources of water, air and biological elements upon which civilization and life depend?

Throughout the history of industrial countries, we focused our faith on our ability to produce, not on the resources and support systems for production. Resources seemed to be unlimited. That is no longer true. Today, for example, if China alone were to reach the stage where we are in America, where there was a car in every garage, that one country would need 80 million barrels of oil per day, more than whole world production today. Sir John Browne, the CEO of British Petroleum, acknowledged not long ago that climate change induced by our present models of economic development is a serious long-term threat. Some thinkers, like Lester Brown and Paul Hawkins, have suggested that our economic reward systems are in conflict with protecting the earth's natural systems. This is a big thought, and a challenging hypothesis.

One thing is clear: business is in the very middle of this enlarging debate. We have stood on the sidelines too long already. In your careers, be a player. Understand where you can be a voice for sound environmental practice. The world of your children may depend on it. I believe we have only one choice . . . to build a sustainable economy or decline. Ray Anderson, the President of Interface Carpet, says this more positively. He says, "American business can grow without damaging the earth," and his company is demonstrating that it can be done.

More business leaders today are understanding this. Be one of them as you leave here. Be proud to come from Ball State University, which is a leader in teaching and supporting sustainable practices.

Finally, there is a relationship between ethics and environmental stewardship. Caring for the world about us, its people, its animals, and its natural systems is doing the right and ethical thing. The great biologist, E. O. Wilson, in his recent book, *The Future of Life*, puts it this way, "The race is now on between the techno-scientific forces that are destroying the living environment and those that can be harnessed to save it. In the end, success or failure will come down to an ethical decision."

Reflections on Success

I will soon fully retire from a forty-five year career in business, thirty-five of which have involved serving as a senior executive. In the final section of my remarks, I would like to share some observations about the characteristics of successful executives.

First, however, think about the impact of the two so-called "laws" that roughly govern expectations in this technological age. "Moore's Law" was developed by Gordon Moore, one of the founders of Intel. It holds that the processing power of computer chips will double every twelve to twenty-four months. The second is Metcalf's Law, which was initially set forth by Robert Metcalf who designed the ethernet protocol for computer networks. Metcalf's Law states that the usefulness, or utility, of a computer network equals the square of the number of users; or put differently, with the addition of each new participant, or computer in a network, the value of the network output increases exponentially.

Together, these two "laws" suggest change is not merely a constant but that acceleration in the rate of change is the constant. That means more information, more information faster, more diverse sources of information, AND more importance in putting it all together in a coherent way.

Hence, characteristic number one of a successful executive is one who can think conceptually and who can integrate information from multiple functions and sources and use it to make decisions, both strategic and tactical. It means executives have to practice being intellectually broad, integrative and conceptual in their way of thinking. Functional expertise won't be enough, and isn't enough today.

Secondly, successful executives realize that values and culture play a huge role in the success of their business. Words like "sharing," "caring," "committing," "excelling," and "respect" are energizing words in successful companies. Organizations are successful because of what they believe in as well as what they do. Passion usually trumps raw competence.

Thirdly, successful executives grow throughout their career. Above all, they know that personal growth only comes from experiences outside their personal comfort zones.

Fourthly, successful executives strive to be leaders, not merely managers. Leaders are pushed up and forward by the people they work with because they earn respect and trust. Managers, on the other hand, are appointed by superiors. Successful executives are both managers and leaders.

Finally, successful executives know that what they do for a living is only part of living a rich and rewarding life. So finally, on that grand subject, let me share some personal advice

that I have given to young persons in my company for living that kind of life:

To Live a Rich Life

1. **Set your own definition for success.**
   Using other people's definition leads to unhappiness.

2. **Do good works.**
   We can't do well in life without doing good.

3. **Be serious about not taking yourself too seriously.**

4. **Accept yourself for who you are.**
   You make the best impression when you let yourself be you.

5. **Strive to understand, not just your job, but strive to see the big picture**.
   Understand how your job contributes to what the company is trying to achieve.

6. **Be positive.**
   Believe in possibilities.

Allow me to give you an example of points 4 and 5. *Accepting yourself for who you are.* The great baseball player, Yogi Berra, understood this. Folks laughed when he would say things unintentionally like, "You can observe a lot by watching." He was who he was and he never tried to be any kind of a fake human being. He accepted himself for what he was and went on to the Baseball Hall of Fame.

Understand how your job contributes to the big picture. This reminds me of the story about a visitor who observed stonemasons working on the National Cathedral in Washington, D. C. in the early '60s. He stopped to ask one stonecutter what he was doing; and the stonecutter said, "I'm cutting and hauling this darn stone." The visitor walked on and saw another worker doing the same thing and the visitor asked him the same question. The worker looked up with a smile and with an eye on the emerging steeple and said, "I'm building a cathedral." Always seek to see your role as part of a bigger picture.

Believing in the possibilities brings me back to Beta Gamma Sigma. On April 18, 1979, Ball State's chapter of Beta Gamma Sigma held its first meeting. The honoree that night was Ralph Whitinger. I would bet that "Believing in Possibilities" was the theme of his remarks. Later that year he spoke to another group on this subject. I kept a copy of his speech. Here is how he concluded it:

> "There is a sign in one of the General Motors plants that says, 'According to the theory of aerodynamics, as may be readily demonstrated through wind tunnel experiments, the bumble bee is unable to fly. This is because the size, weight and shape of his body, in relation to the total wingspread, make flying impossible. But the bumble bee, being ignorant of these scientific proofs, goes ahead and flies anyway and makes a little honey every day.'"

So remember: Build a cathedral, groove your integrity, protect our earth, fly like a bee, and make some honey! If you do this, do it with reflection and relish, cherish the process of thinking itself . . . and you and your generation will insure that good living remains in the business of making a living. MAJB

About the Author

Stefan (Steve) Anderson is a longtime advocate for the Miller College of Business, as well as a tireless supporter of Ball State University and the Muncie community.

In April, 2005 Anderson retired as chairman of First Merchants Corporation, a $3.1 billion company, which operates banks in Indiana and Ohio. He served as the company's CEO for 20 years. With a banking career that spanned more than 40 years, he has served on the board of directors of numerous companies, including the Federal Reserve Bank of Chicago.

Anderson, who earned a BA degree from Harvard University and an MBA from the University of Chicago, was awarded an honorary doctorate from Ball State University in 1993.

Current NASDAQ Corporation Methods of Reporting Comprehensive Income

Ganesh M. Pandit, *Adelphi University*
Allen Rubenfield, *Clark Atlanta University*
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Abstract

Statement of Financial Accounting Standard No. 130 (SFAS 130) was released in 1997 which required publicly traded companies to separately report comprehensive income in the financial statements. SFAS 130 prescribed three alternative formats for the presentation without mandating any one specific format. SFAS 130 also required certain details of comprehensive income to be displayed prominently in the financial statements. The current study examined the presentation of comprehensive income by a sample of companies traded on the NASDAQ market to determine the predominant method of presentation among these companies, five years after SFAS 130 became effective. Results of the examination of one hundred annual reports showed that a majority of the sampled companies used the third approach, which was to present comprehensive income as part of the Statement of Stockholders' Equity, as against the first two approaches that favored presentation of comprehensive income on the face of the Income Statement or in a separate statement. Further, the paper also discusses some ancillary findings pertaining to the presentation of the details of comprehensive income.

Background

Comprehensive Income and SFAS 130

In June 1997, the Financial Accounting Standards Board (FASB) released Statement No. 130 (SFAS 130), Reporting of Comprehensive Income, with its provisions being effective for fiscal years beginning after December 15, 1997. This FASB statement established standards for reporting and presenting comprehensive income in general-purpose financial statements. SFAS 130 was issued in response to users' concerns that certain changes in assets and liabilities were bypassing the conventional income statement and onto the Statement of Stockholders' Equity (FASB 1997, para 4). Therefore, SFAS 130 required companies to report all items that met the definition of comprehensive income in a prominent financial statement for the same period in which they were recognized. In accordance with the definition provided by Statement of Financial Accounting Concepts No. 6, comprehensive income was to include all changes in owners' equity that resulted from transactions of the business entity with non-owners (FASB 1997, para 8).

According to SFAS 130, there are items, referred to as Other Comprehensive Income (OCI), that are part of the total comprehensive income but generally are excluded from net income. Prior to SFAS 130, these items were disclosed as separate components of stockholders' equity on the balance sheet. Specifically, these items are (i) foreign currency translation adjustments, (ii) minimum pension liability adjustments and (iii) unrealized gains or losses on available-for-sale investments. Under SFAS 130, these three items are to be reported as OCI. Further, the FASB required the items to be reported separately from each other believing that information about the individual components of comprehensive income is more important than aggregated comprehensive income (FASB 1997, para 13). Subsequently, SFAS No. 133, Accounting for Derivative

Instruments and Hedging Activities, required that unrealized gains and losses on derivatives be included in the definition of OCI.

The intent of SFAS 130 was that "if used with related disclosures and other information in the financial statements, the information provided by reporting comprehensive income would assist investors, creditors, and other financial statement users in assessing an enterprise's economic activities and its timing and magnitude of future cash flows" (FASB 1997, para 12).

While the FASB required that "an enterprise shall display total comprehensive income and its components in a financial statement with the same prominence as other financial statements that constitute a full set of financial statements" (FASB 1997, para 22), it did not specify which format was required to present comprehensive income except that net income should be shown as a component of comprehensive income in that financial statement. Thus, as per SFAS 130, three alternative formats are allowed for presenting OCI and total comprehensive income. According to the first format, total comprehensive income is to be shown below net income in a traditional income statement (as a combined statement of net income and comprehensive income). Figure 1 provides an illustration of format 1. Hence, in the first format, total comprehensive income is the concluding line of the income statement.

According to the second format, total comprehensive income is to be reported in a separate statement of comprehensive income that begins with net income for the reporting period. Figure 2 provides an illustration of format 2. Finally, the third format allows reporting of total comprehensive income in the Statement of Stockholders' Equity, with a reconciliation of net income to total comprehensive income. Figure 3 provides an illustration of the third format.

Under SFAS 130, the FASB encourages reporting entities to display the components of OCI and total comprehensive income using the first or second format, as a part of the Income Statement or in a separate statement, respectively (FASB 1997, para 23). Regardless of which format is used, accumulated OCI for the reporting period should be presented on the balance sheet as a component of stockholders' equity, separate from additional paid-in capital and retained earnings.

Figure 1
Illustration of Format 1

Pandit, Phillips, and Rubenfield Inc.
Statement of Income and Comprehensive Income
For the Year Ended December 31, 2003

Sales	$1,000,000
Cost of goods sold	720,000
Gross margin	280,000
Selling and G & A expenses	90,000
Net income	$190,000
Add OCI:	
Unrealized holding gain, net of tax	45,000
Total Comprehensive Income	**$235,000**

Motivation for the Current Study

Since the release of SFAS 130, a limited number of studies examined the presentation of comprehensive income in the early years of implementation. Campbell, Crawford and Franz (1999) studied a sample of seventy-three (73) early adopters of SFAS 130 to examine their choice of format for reporting of comprehensive income and found that the majority of companies in the sample chose to report comprehensive income in the statement of stockholders' equity. Also, the same study found that "the firms that chose the statement of stockholders' equity format had a materially negative amount of OCI" (p. 18). Bhamornsiri and Wiggins (2001) found that a significant number of firms in the S&P 100 reported comprehensive income in the Statement of Stockholders' Equity, regardless of whether the OCI was negative or positive. Thus, Bhamornsiri and Wiggins found no evidence of a relationship between the positive or negative sign of comprehensive income and its ultimate presentation in the financial statements. However, they did find that in monetary terms, foreign currency translation adjustments represented the largest OCI component.

A few studies have examined the relationship between comprehensive income disclosures and the market's valuation of the earning information. In one such study, Smith and Tse (1998) suggested that financial statement users did not consider comprehensive income to be relevant in predicting future cash flows. Dhaliwal, Subramanyam, and Trezevant (1999) also found no evidence of a relationship between comprehensive income information and market valuation. Even in a very recent study, Dehning and Ratliff (2004) concluded that there was no difference in the way the market valued the comprehensive income disclosures after SFAS 130 became effective.

However, other empirical research about the usefulness of comprehensive income information, although limited, is noteworthy. For example, Hirst and Hopkins (1998) have concluded that a separate presentation of comprehensive income facilitated detection, by security analysts of active earnings management with the use of marketable securities portfolio. Also, Maines and McDaniel (2000) have found evidence that non-professional investors would use comprehensive income information in their decision

Figure 2
Illustration for Format 2

Pandit, Phillips, and Rubenfield Inc. Income Statement For the Year Ended December 31, 2003	
Sales	$1,000,000
Cost of goods sold	720,000
Gross margin	280,000
Selling and G & A expenses	90,000
Net Income	$190,000

Pandit, Phillips, and Rubenfield Inc. Comprehensive Income Statement For the Year Ended December 31, 2003	
Net income	$190,000
OCI:	
Unrealized holding gain, net of tax	45,000
Comprehensive Income	$235,000

making only if it was included in a separate financial statement rather than as a component of the statement of stockholders' equity.

Therefore, the current research only attempted to re-examine the comprehensive income presentation, five years after the implementation of the related standard, to determine if a majority of the sampled companies still continue with the third format of reporting the comprehensive income under the Statement of Stockholders' Equity. If five years later, most companies still were to report comprehensive income under the third format and in the process made the comprehensive income information less noticeable in the financial statements, one may have to ask whether or not it serves the intent of SFAS 130, which is to give prominence to the amount of change in stockholders' equity that is caused by non-owner transactions (FASB 1997, para 22).[1] The apparent lack of association between the comprehensive income information and investors' use of that information, as observed in the above studies, may be partially a function of the ordinary investors' level of understanding as to what is comprehensive income. More research may be needed to assess the investors' ability to evaluate the comprehensive income information, which is not the motivation for the current study.

Presentation Significance

During a reporting period, the income of an enterprise is best represented by the increase in its wealth. However, an increase in wealth may have occurred for a variety of reasons, some of which may not have been associated with daily operations. For example, wealth may change because of fluctuations in foreign currency exchange rates causing the U.S. dollar-value of subsidiaries to increase or decrease. Also, wealth may increase or decrease because of changes in economic conditions that cause current values of certain assets and liabilities to change. For example, changes in the stock market may result in unrealized holding gains or losses for investments held by the company. These changes in wealth are supposed to be captured by "comprehensive income." SFAS 130 intended comprehensive income to be an important measure of the overall performance of an enterprise. If comprehensive income is displayed as prominently as it was intended by the FASB, the purpose of presenting it will be well served.

A more prominent presentation of comprehensive income would be achieved better by using the second format of reporting. As mentioned earlier, Hirst and Hopkins (1998), and Maines and McDaniel (2000) have found evidence in favor of the presen-

Figure 3
Illustration for Format 3

Pandit, Phillips, and Rubenfield Inc.
Statement of Stockholders' Equity and Comprehensive Income
For the Year Ended December 31, 2003

	Total	*Comprehensive Income*	*Retained Earnings*	*Accumulated OCI*	*Common Stock*
Beginning Balance	$510,000		$60,000	$50,000	$400,000
Comprehensive Income:					
Net Income	190,000	$190,000	190,000		
OCI: Unrealized holding gain, net of tax	45,000	45,000		45,000	
Comprehensive Income		$235,000			
Ending Balance	$745,000		$250,000	$95,000	$400,000

> "The study explored the format of presentation of comprehensive income that is still predominant among these companies, five years after the release of SFAS 130."

tation of comprehensive income in a separate financial statement rather than as a component of the statement of stockholders' equity. In its 1996 exposure draft, the FASB indicated that the placement of comprehensive income in the financial statements could influence its perceived importance to investors. Therefore, the current study also supports the use of the second format of presentation, which would present the comprehensive income information in a separate statement of comprehensive income.

Purpose of the Current Study

The purpose of this study was to examine the presentation of comprehensive income in the financial statements of a sample of companies traded on the NASDAQ for fiscal years ended on or after December 31, 2002. The study explored the format of presentation of comprehensive income that is still predominant among these companies, five years after the release of SFAS 130. The reason NASDAQ firms were chosen for this study was that a large number of the firms traded on NASDAQ are technology firms or firms with highly volatile and dynamic nature of business. While the NYSE firms were also investigated, at the present time, limiting the current paper to NASDAQ stocks provided the desired perspective, that was, examining the current, volatile stocks that by definition are worldwide and aggressive as opposed to the old conservative stocks. Financial statements, prepared for the year ended on or after December 31, 2002 were selected because by then, a period of five years had elapsed since the date SFAS 130 was effective. This was believed to be an important milestone to assess the progress of implementation of the standard.

The significant decline in stock prices during the years 2000-2002 possibly had caused several companies to experience large unrealized losses on investment portfolios, which was a potential component of OCI (if those investments were categorized as available-for-sale securities). Similar to the Campbell et al. (1999) study and Bhamornsiri and Wiggins (2001) study, the authors wanted to explore the current correlation, if any, between the sign of the OCI and the presentation of comprehensive income in one of the three prescribed formats.

The study also investigated the following additional issues related to reporting comprehensive income:

Which component of OCI was dominant for the year of study among the companies sampled?

The interest in OCI dominance was primarily academic in nature. The theoretical rationale for this question was that, due to the fall of the stock market and consequent decrease in the value of investments, the authors expected a majority of the companies to report unrealized losses on AFS securities or an increase in minimum pension liability, which could have prompted them to bury the OCI as part of the Statement of Stockholders' Equity. Also, in a prior study, Dhaliwal, et al. (1999) found a correlation between the unrealized gain/loss on available-for-sale securities component of the OCI and the market's valuation of that information.[2]

If a company reported comprehensive income in its income statement (first format) or statement of stockholders' equity (third format), did the title of the statement include the words "Comprehensive Income?"

The interest in whether the title of the statement includes the term "comprehensive income" arises from the authors' belief that inclusion of this term in the title may bring prominence to the comprehensive income figure in the financial statements, especially when that figure is not being presented in a separate statement of comprehensive income (second format). The intent of the FASB in requiring the reporting of comprehensive income was to provide useful additional information to readers of financial statements about the overall performance of the entity that caused the stockholders' equity to change from the beginning to the end of the accounting year. If the comprehensive income figure is simply buried in the myriad of information presented in the financial statements without making a special effort to provide it some prominence, the readers are likely to miss the importance of that number. This is evident from the prior research (Hirst and Hopkins 1998; Maines and McDaniel 2000) that suggested that a separate statement of comprehensive income provided more information than the currently predominant practice of including it in the Statement of Stockholders' Equity.

Were the details of OCI reported in the body of the financial statements, or in notes to the financial statements?[3]

While the Notes constitute an integral part of the financial statements, presenting the comprehensive income information in the body of the financial statement may give it more prominence compared to its presentation in the Notes to financial statements.

Thus, the main objective was to determine how much prominence was

Table 1
Industry Classification of Sampled Companies

Type of industry	*No. of companies*
Biotechnology	6
Computer Hardware & Accessories	21
Computer Software	21
Manufacturers of non-computer products	14
Miscellaneous Business Services	8
Restaurants & Other Consumer Services	5
Retailers	11
Telecommunications	7
Other	7
Total	100

given to comprehensive income in the published financial statements to carry the intent of SFAS 130. Overall, the data showed that five years after SFAS 130 was adopted, reporting comprehensive income in the Statement of Stockholders' Equity was still the most popular presentation format for the NASDAQ companies in the sample.

Data Collection and Findings of the Study

The data for this study were collected from a random sample of companies traded on the NASDAQ, and included the relevant information contained in the published annual financial statements of one hundred companies for fiscal periods ending on or after December 31, 2002. The companies were selected at random in order to achieve a representation across different industries. The industry classification of the sampled companies is presented in Table 1.

For each company, the annual financial statements were examined for the presentation of OCI and total comprehensive income with reference to the questions discussed under "purpose of this study." The findings for the sampled companies are presented below. Wherever we make a reference to the term "significant," we intend to convey the meaning that a large majority of the firms in the sample chose a certain reporting style for the comprehensive income figure or its details. We do not refer to statistical significance of any observations since no statistical tests of significance were performed on the data.

Findings from the NASDAQ Market

Eighty-seven of the one hundred annual reports examined from the NASDAQ presented comprehensive income using the third format, which is to present it in the Statement of Stockholders' Equity. Five companies used the first format and presented comprehensive income as part of the Income Statement while the remaining eight companies used the second format of using a separate Statement of Comprehensive Income. Thus, reporting comprehensive income in the Statement of Stockholders' Equity is still the most popular presentation format for companies traded on the NASDAQ.

All thirteen companies that chose the first or second format also had positive OCI for the year of reporting. In addition, fifty-three companies or 61 percent of the companies that used the third format for presenting comprehensive income also had positive OCI, contradicting the findings of Campbell et al. (1999). The other 34 percent using the third format had negative OCI. Thus, the expectation that companies that used the third format of presentation of comprehensive income are more likely to have a negative OCI was not confirmed by this sample.

Among the NASDAQ companies in the sample, foreign currency translation adjustments was the most prominent item in the OCI, followed by unrealized gains or losses on available-for-sale securities. Furthermore, foreign currency translation adjustment was the most significant item, if not the only item, among the majority of the companies that reported positive OCI. Also, forty companies or 46 percent using the first or the third format added the term comprehensive income in the title of the financial statement. In such cases, the most commonly used titles were Consolidated Statement of Operations and Comprehensive Loss (e.g., Echostar Communications Corp.) or Consolidated Statement of Stockholders' Equity and Comprehensive Income (or Loss) (e.g., Veritas Software Corp.), depending on whether the company used the first or the third format.

Only three NASDAQ companies (Intuit, Northwest Airlines and Dollar Tree) presented the details of OCI in the Notes to financial statements. The rest presented the details in the body of the financial statements. The FASB prefers that such information be presented prominently since the details of OCI may be more important to the readers than total comprehensive income (FASB 1997, para 13). Also, among the eighty-seven companies that chose to report OCI in the Statement of Stockholders' Equity (the third format), the actual presentation of the total comprehensive income figure in the financial statements differed among the companies. While approximately 20 percent of the companies presented total comprehensive income in a separate column, the remaining companies reported total comprehensive income figure within the Total Stockholders' Equity column in the Statement of Stockholders' Equity. We found that the latter form of presentation of the total comprehensive income figure made it more difficult to locate it in the Statement of Stockholders' Equity.

An interesting finding was observed for a company, where the amount of positive foreign currency translation adjustment transformed a huge net loss for the year of study into a posi-

tive comprehensive income. In the previous years, when the overall OCI and the comprehensive income for each year were significantly negative, the company used the third format of presenting the comprehensive income in the Statement of Stockholders' Equity. However, in its most recent year, when the overall positive OCI resulted in a positive total comprehensive income despite a net loss for the year, the company chose to use the second format and presented its comprehensive income in a separate statement. It was unclear if the choice of format in this case was driven by the positive sign of the OCI and its effect on the total comprehensive income.

Concluding Remarks

While all one hundred companies in the sample are reporting changes in stockholders' equity from transactions with non-owners in accordance with SFAS 130, there is a very strong preference for using the third presentation format, which is to report it in the Statement of Stockholders' Equity. This is perhaps, because it is closer to what these companies were accustomed to using prior to the adoption of SFAS 130, and hence it maintains the status quo. Based on the findings of this study, it is not possible to conclude that it is more "convenient" to present the comprehensive income in the Statement of Stockholders' Equity in order to make its negative character, if any, less prominent, as claimed by the Campbell et al. (1999) study. In case of the sampled companies in the current study, a significant number of the companies that used the third format actually had reported positive OCI for the year of study.

Currently, there is not sufficient evidence to indicate that comprehensive income is a better predictor of future cash flows or has an impact on stock prices (Smith and Tse 1998; Dhaliwal et al. 1999; Dehning and Ratcliff 2004). However, as mentioned earlier, Hirst and Hopkins (1998) have concluded that financial analysts are more likely to detect evidence of earnings management on certain items only if those items are presented in a separate statement of comprehensive income. Further, Maines and McDaniel (2000) also have indicated that less sophisticated investors are more likely to use comprehensive income information for corporate and management performance assessment if it is included in a separate statement of comprehensive income. Therefore, we would like to suggest that in order to enable users of the financial statements to view the OCI and total comprehensive income information more fruitfully, companies may be encouraged to use the second format which presents the comprehensive income information in a separate statement. More conclusive research that shows the usefulness of the comprehensive income information in the investors' decision making process when that information is presented separately and outside of the Statement of Stockholders' Equity is strongly recommended. MAJB

Notes

1. However, one also has to remember that the FASB accepted the reporting of comprehensive income under the Statement of Stockholders' Equity which indicates that at the time SFAS 130 was released, they were satisfied with this format of presentation.
2. Note that in the Dhaliwal, et al. (1999) study, the overall conclusion was that they did not find comprehensive income to be associated with a firm's market valuation or a better predictor of future cash flows than net income.
3. An example of a Notes presentation may be found in Note 6 of the 2002 Annual Financial Statements of Intuit, Inc.

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Stock Market Reactions and Firm Performance Surrounding CEO Succession:
Antecedents of Succession and Successor Origin

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Abstract
This study investigates the effects of CEO succession on the stock and financial performance of large publicly held corporations over the years 1977-1994. Using a market signaling framework, this study examines how the stock market responds to the expected financial performance of the firm at the announcement of CEO succession. The impact of successor origin of the CEO on the financial performance of the firm is also investigated. Findings indicate that the stock market responded more favorably to the announcement of succession caused by unanticipated events than to announcements of anticipated succession. Although successions resulted in significant improvement in some aspects of financial performance, the findings could not be generalized across all financial performance measures. However, those firms with inside CEO succession performed generally better than those firms utilizing outside succession with respect to operations and profitability.

Introduction
CEO turnover has become a common occurrence in many large U.S. corporations over the past two decades (Boeker 1992; Grube 1995; Plitch 2003). Because of increased demands from institutional investors for improved management practices and greater pressure for corporate accountability from the general public, corporate directors are frequently responding to perceived downturns in performance by replacing the chief executive officer (CEO) (Bommer and Ellstrand 1996; Farrell and Whidbee 2002). Because the CEO plays such a key role in determining a firm's strategy, design, performance, and corporate culture, both internal and external constituents are likely to view succession as an indication of the firm's future. For example, such an event can enhance or diminish the power of organizational members and indicate how organizational resources will be allocated in the future (Friedman and Saul 1991; Ocasio 1994). Likewise, other stakeholders, such as shareholders and customers, see succession as a signal of future success or failure of the firm (Davidson, Nemec, Worrell, and Lin 2002; Friedman and Singh 1989; Lubatkin, Chung, Rogers, and Owers 1989). Thus, CEO succession is a critical event for virtually any organization.

Research on CEO succession has generally focused on the antecedents of succession, the origin of the successor, and the consequences of succession, such as its impact on firm performance or stockholder wealth. This study will address issues in each of these areas. Its significance is threefold: (1) while many studies have separately investigated either stock market reactions or financial performance surrounding CEO succession, the proposed study investigates both aspects of CEO succession; (2) using a market signaling framework, this study examines whether or not the stock market "correctly" responds to the expected financial performance of the firm at the announcement of CEO succession; and (3) this study investigates the association between

successor origin and subsequent performance. The remainder of this paper is organized as follows. A theoretical framework is presented, further developing the above three issues. This is followed by a description of the event study methodology used for this study, as well as information about the sample design and data sources. Following a discussion of the empirical results of this study, the paper concludes with suggestions for further research.

Theoretical Development

Because CEO succession is one of the most important processes of corporate control and is a critical determinant of the firm's adaptability to the rapid changes in the corporate environment, it has been a topic of intense interest in both the popular press and academic journals. Empirical findings, however, have provided mixed results. This is echoed in a review of the succession literature by Kesner and Sebora (1994, 327) who state that "...there is little that we know conclusively, much that we do not know because of mixed results, and even more that we have not yet studied." This study will address antecedents of succession, successor origin, and signaling implications of succession for expected firm performance and stock market reactions.

Antecedents of Succession

A number of researchers have examined factors preceding CEO change, arguing that the reasons for such change can be viewed as either planned or unplanned (Datta and Guthrie 1994; Denis and Denis 1995; Worrell, Davidson, and Glascock 1993). Normal retirement is an example of planned or anticipated change, whereby CEOs announce their intentions to step down from their position at some future date. Such anticipated events, referred to as relay succession, typically involve the identification and grooming of an heir apparent (Cannella and Shen 2001; Clutterbuck 1998; Shen and Cannella 2003). Since the capital market is aware of the anticipated replacements of CEOs due to retirement, the stock market would not react abnormally to announcements of expected CEO succession. According to Denis and Denis (1995), firms experiencing normal retirements of CEOs do not exhibit performance declines prior to a management change, but do show small performance improvements with such changes.

However, other studies have focused on unanticipated CEO succession, where poor organizational performance results in involuntary CEO turnover, such as dismissal or forced resignation (Davidson, Worrell, and Dutia 1993; Coughlin and Schmidt 1985; Warner, Watts, and Wruck 1988; White, Smith, and Barnett 1997). A study of stockholder reactions to CEO firings found that nearly three-quarters of the firms were performing poorly in the two years prior to the announced dismissals (Worrell, et al. 1993). Denis and Denis (1995) documented empirical evidence that firms with forced resignations exhibit significant decreases in operating performance prior to CEO changes and significant improvements afterward. Recent research indicates that CEOs, who are appointed under conditions of financial stress, face significant pressure to turn the firm performance around quickly (Shen 2003). For the firms with poor financial performance, dismissal announcements or signs of forced resignations of CEOs might send a positive signal to the stock market. If corporate performance is perceived as being attributed to the leader, such announcements may be viewed as an initial step for leading the firm to better performance. Thus,

H1: *The stock market reacts more favorably to unanticipated CEO succession announcements (e.g., firing, face-saving forced resignation, and internal power struggle) than to anticipated CEO succession announcements (e.g., retirement).*

In the context of market signaling, firms with unanticipated CEO changes, on average, would enhance their financial performance. Otherwise, the stock market's favorable reactions (as hypothesized in H1) to different types of CEO succession are not economically rational and can be evidence against capital market efficiency. The second hypothesis is, therefore, contingent upon the test result of the first.

H2: *Favorable stock market reactions to unanticipated CEO succession announcements reflect, on average, the improved financial performance of the firm in the post-succession period.*

Origin of Successor

The origin of the successor is one of the more frequently examined CEO succession issues. Recent findings would suggest, in situations of poor organizational performance or bankruptcy, outsider appointments result in a more favorable reaction in the market (Davidson, et al. 2002; Lubatkin, et al. 1989; Shen and Cannella 2003) or positive firm performance (Shen and Cannella 2002; Denis and Denis 1995). However, prior research documents that insider succession is more common than outsider succession (Comte and Mihal 1990; Dalton and Kesner 1983, 1985; Friedman and Singh 1989). Some view inside succession more favorably because insiders may provide constancy and stability of the organization, while outsiders may represent discontinuity and disruption. For example, Kotter (1982) provides a strong argument for the benefit of insiders due to their knowledge about the firm and established social networks. This is supported in research findings showing positive market reactions

to internal succession following the death of a CEO (Worrell and Davidson 1987). Likewise, Friedman and Singh (1989) found that when CEO change was initiated by normal retirements or disabilities in health, successions were overwhelmingly from inside the firms. A more recent study by Clutterbuck (1998) found that a majority of the firms preferred an appointment from within the firm, making the succession as seamless as possible. Thus,

H3: *Firms with insider succession, on average, financially perform better during the post-succession than the firms with outsider succession.*

Method and Sample

This study employs the event-time methodology and the market model to estimate the expected returns on the common stocks of the sample firms.[1] The procedure is summarized below. For security *j*, the prediction error (PE) is calculated by using the market model for event day *t* as in:

$$PE_{jt} = R_{jt} - (a_j + b_j R_{mt}) \quad (1)$$

where R_{jt} is the rate of return on security *j* for day *t*, and R_{mt} is the return on the market index on day *t*. The coefficients *aj* and *bj* are OLS estimates from a market model regression for security *j*. The coefficient estimates are obtained using 250 days of pre-event (pre-CEO succession from DAY-310 to DAY-61) stock returns, and the prediction errors (CPE) are calculated for the two-day announcement period only (i.e., DAY0 and DAY+1, where DAY0 is the event day).

For a sample of N securities of CEO turnover firms, the mean prediction error (MPE) of the N-security portfolio return is defined as:

$$MPE_t = \frac{1}{N} \sum_{j=1}^{N} CPE_{jt} \quad (2)$$

The cumulative mean prediction errors (CMPE) from *t* to *t+n* are defined as in:

$$CMPE_t = \sum_{t=t}^{t+n} MPE_t \quad (3)$$

The expected values of the MPE and the CMPE are zero in the absence of abnormal performance in stock prices. To test whether the abnormal portfolio daily return on day *t*, *MPEt*, is statistically different from 0, the t-statistic is computed as:

$$t = MPE_t / s(MPE)_t \quad (4)$$

where $s(MPE_t)$ is the sample standard deviation of the portfolio returns during the event period except two-day announcement period.

To test whether the cumulative abnormal return from t until t+n, CMPEt,t+n, is significantly different from 0, the t-statistic is computed as:

$$t = CMPE_{t,t+n} / s(CMPE_{t,t+n}) \quad (5)$$

where $s(CMPEt,t+n)$ is the square root of $n*s(MPE_t)$ and is the sample standard deviation of the portfolio abnormal returns computed as before.[2]

This study also employs a mean difference t-test to investigate any significant difference in financial performance between pre- (i.e., YR-3 to YR-1) and post-succession (YR+1 to YR+3) periods around the announcement year (YR0). Various profitability measures (e.g., Net Profit Margin, Return on Total Assets, and Return on Shareholder's Equity), liquidity measures (e.g., Current ratio) and asset utilization measures (e.g., Total Asset Turnover) are examined between the two sub-periods.

Data Sources and Sample Design

The preliminary sample includes all firms in the list of the top 800 highly paid CEOs that were reported in *Forbes* magazine, 1995. For these 800 firms in the preliminary sample, 858 CEO successions were identified over the years 1977-1994. Five additional screening criteria were used in selecting the final sample from the 858 successions:

1. CEO succession is verified with the *Wall Street Journal* to identify the exact dates of public announcements of the succession.[3]

2. Industries are defined by two-digit SIC Code, with those firms in the utility industry being deleted. Because the industry is heavily regulated, financial performances are usually not comparable to other firms' in different industries.

3. The firm's financial and accounting information should be available from three electronic datbases: COMPUSTAT, DISCLOSURE on CD-ROM, and CRSP.[4]

4. The firm's financial and accounting information should be available for seven years (from YR-3 to YR3) around the announcement year (YR0) of CEO succession.

5. CEO demographic/experience related/compensation data are available from *Forbes* and other sources. These data include age, educational background, functional background, tenure with firm, base salary, and incentive compensation of succeeding CEOs.

These additional restrictions reduce the final sample to 211 CEO successions over the years 1977-1994. In order to investigate the stock market reaction to the announcement of CEO successions, the announcement date of the CEO succession is the earliest reporting date provided

Table 1
Profile of CEO Successions and Descriptive Statistics of Financial Performance

Panel A. CEO Successor Profile and Demographic Variables

Variable	*Variable Description*	*N*	*Mean*	*Std Dev*
AGE	CEO Age	208	53.313	5.977
TENURE	Tenure with the Firm	211	20.104	12.637
SALARY	Base Salary (in $K)	208	658.260	408.599
OCOMP	Other Compensation (in $K)	165	173.570	380.349
SGCOMP	Stock Gains (in $K)	57	653.333	1087.060
TCOMP	Total Compensation (in $K)	211	962.934	923.440
OSHIP	Stock Ownership (in%)	102	0.414	1.604

Panel B. Educational Background of Successors (N=125)

Degree	*No College*	*BS/BA*	*MBA*	*MS/MA*	*Doctoral*	*Other Professional*
N	8	50	38	10	4	15
%	6.4	40.0	30.4	8.0	3.2	12.0

Panel C. Functional Background of Successors (N=192)

Function	*Operations/ Technical/ Production*	*Marketing/ Sales/ Retailing*	*Finance/ Banking/ Insurance/ Investment*	*Administration (HR Mgmt, etc.)*	*Others (Legal/ Medical/ etc.)*
N	64	28	63	23	14
%	33.3	14.6	32.8	12.0	7.3

Panel D. Turnover Reasons (N=129)

	Anticipated Reason (expected retirement)	*Unanticipated Reason (death, health, poor performance, legal problems, forced resignation, other personal reasons)*
N	86	43
%	66.7	33.3

Panel E. Selected Financial Performance Measures

Variable	*Variable Description*	*N*	*Mean*	*Std Dev*
TA	Total Asset (in $MM)	211	10242.600	20860.880
SALE	Net Sales (in $MM)	211	6577.220	12127.080
OIBDEP	Op Income Bef Dep (in $MM)	210	895.306	1761.360
EMPLOY	Number of Employees (in 000)	210	43.141	70.339
EPS	EPS Before Non-Recurring Items	211	0.911	3.256
HOLDER	Number of Shareholders (in 000)	210	78.274	255.083
CUR	Current Ratio (in times)	157	1.777	0.921
DEBTR	Debt Ratio	208	0.221	0.142
COGSR	COGS/SALE	211	0.684	0.165
ADRI	AD/SALE (AD intensity)	81	0.041	0.042
RDRI	RD/SALE (R&D intensity)	108	0.032	0.033
ROA	Return on Total Assets	211	0.042	0.061
ROE	Return on Equity	211	0.093	0.153
TATO	Total Asset Turnover (in times)	211	1.066	0.883

by the *Wall Street Journal* and the *Wall Street Journal Index*. The announcement day (DAY0) and the following day (DAY+1) are defined as the two-day announcement period. The event period (or control period) includes the 119 days from DAY-60 to DAY+60 around the announcement day except the two-day announcement period. This event period is divided into the 60-day pre-announcement period (from DAY-60 to DAY-1) and 59-day post-announcement period (from DAY+2 to DAY+60). Similarly, in the investigation of financial performance surrounding CEO successions, YR0 is the announcement year of CEO succession and the control period is defined YR-3 to YR+3 around the announcement year (YR0).

Sample Description

The 211 firms in the final sample are from 40 different industries, although approximately 60 percent of the sample firms (131 of 211 firms) are concentrated in eight industries. This distribution of the sample firms across various industries suggests that the empirical evidence in this study is not industry-specific. The final sample firms are also distributed fairly evenly over the years 1977-1994. Table 1 presents a profile of the 211 CEO turnovers and descriptive statistics of selected financial performance measures during the succession year (YR0).[5]

As shown in Panel A of Table 1, the average CEO age is fifty-three years old, with twenty years tenure with the firm. The average total compensation for the successor equals approximately $962,000. On average, these CEOs own 0.41 percent of the firm's common shares outstanding. Panel B indicates that about 94 percent of the CEOs hold a college degree, with 30 percent also having an MBA degree.

With respect to functional background of the successor, Panel C presents data showing that approximately half of the successors have a background in a line function such as production and sales (or related areas) and about one-third have backgrounds in finance or related staff functions. Among the identified 129 firms, two-thirds of the turnovers were anticipated (planned retirement), while the remaining third were due to unanticipated events, such as death, health, and forced resignation, as shown in Panel D.

Panel E describes the summary statistics of selected financial performance measures during the succession year (YR0), including the firm size as measured by total assets and net sales, profitability as measured by return on assets or return on equity, liquidity as measured by current ratio, intensity measures of advertising expenses and R&D expenses compared to net sales, and total asset utilization as measured by total assets turnover. On average, the firms hold $10 billion in total assets and about $6.58 billion in sales. The average firm generated 4.2 percent return on asset and 9.3 percent return on shareholders' equity.

Empirical Results

Stock Market Reaction to the Announcements of CEO Succession

Using the standard event study methodology discussed in the previous section, the stock market reaction to the announcement of the 209 CEO successions in the sample was investigated.[6] Table 2 shows that the average daily abnormal portfolio returns are 0.0040 percent, 0.3843 percent, and 0.0289 percent for the pre-announcement period, the announcement period, and the post-announcement period, respectively.

The table also shows MPE and CMPE around DAY0. While the average daily abnormal returns for the pre- and post-announcement periods were not significant at any conventional level, the average daily abnormal return for the announcement period was significantly positive at the .01 level. The significant positive abnormal return during the two-day announcement period suggests that the stock market reacted favorably to the announcement of CEO turnover. This evidence is consistent with the findings of previous studies of CEO successions (Davidson, Worrell, and Cheng 1990; Lubatkin, et al 1989; Murphy and Zimmerman 1993; Worrell and Davidson 1987).

To further examine the stock market reaction with respect to different reasons for CEO succession, the reasons of CEO succession for 129 firms were identified. These firms were classified into the 'Anticipated' category if the succession was anticipated by the planned retirement of the pre-

Table 2
Mean and Cumulative Prediction Errors around the Announcement Day

Period	*Average Daily Abnormal Return (%)*	*Standard Error (%)*	*t-statistic*
Pre-Announcement	0.0040	0.0161	0.248
Announcement	0.3843	0.0110	35.165**
Post-Announcement	0.0289	0.0153	1.890

DAY	*Mean Prediction Error (%)*	*Cross-Sectional Std. Dev. (%)*	*N*	*t-statistic*	*Cumulative MPE (%)*
-60	0.1040	0.13167	209	0.790	0.10401
-50	-0.11024	0.13146	209	-0.839	-0.01557
-40	0.04183	0.11438	209	0.366	-0.09814
-30	0.00837	0.13422	209	0.029	-0.18079
-20	-0.04729	0.11156	209	-0.424	-0.14966
-15	0.26988	0.12617	209	0.935	-0.15791
-10	0.03049	0.12956	209	0.235	-0.13050
-5	-0.05113	0.18077	209	-0.283	-0.2073
-4	0.19547	0.11993	209	1.630	-0.0118
-3	0.41147	0.16582	209	2.481*	0.3996
-2	-0.05591	0.11936	209	-0.468	0.3437
-1	-0.10446	0.14934	209	-0.699	0.2393
0	0.37338	0.15826	209	2.359*	0.6127
1	0.39524	0.16342	209	2.419*	1.0079
2	-0.01909	0.12877	209	-0.148	0.9888
3	-0.04563	0.11498	209	-0.397	0.9432
4	0.06223	0.13576	209	0.458	1.0054
5	0.14321	0.15637	209	0.916	1.1486
10	-0.00157	0.11202	209	-0.014	1.3819
15	-0.05384	0.14031	209	-0.384	1.4450
20	-0.04932	0.10382	209	-0.475	1.7133
30	0.06694	0.11656	209	0.574	1.9017
40	-0.05338	0.10660	209	-0.501	2.3998
50	0.06702	0.11737	209	0.571	2.4954
60	0.34426	0.12653	209	2.722**	0.7141

* indicates the statistic is significant at the .05 level and ** at the .01 level.
Note: N=209, two observations lost due to insufficient number of daily returns in the 121-day event period around the announcement date.

Table 3
Average Daily Abnormal Returns for the Three Periods around the Announcement Day Conditional on Reasons for CEO Succession

	Reason: ANTICIPATED (N=86)			Reason: UNANTICIPATED (N=33)		
Period	*Average Daily Abnormal Return (%)*	*Standard Error (%)*	*t-stat*	*Average Daily Abnormal Return (%)*	*Standard Error (%)*	*t-stat*
Pre-Announcement	0.0044	0.0186	0.2354	-0.0261	0.0471	-0.55476
Announcement	0.2249	0.2341	0.9604	0.9241	0.4120	2.2433*
Post-Announcement	0.0047	0.0229	0.2042	0.0606	0.0487	1.2446

* indicates the statistic is significant at the .05 level.
Note: N=119, 10 observations (of the 129 firms with reasons identified) were deleted because succession had occurred during takeover attempt, making it impossible to isolate the event.

decessor or into the 'Unanticipated' category if succession was caused by death, health, poor performance of the firm, legal problems, forced resignation, and/or other personal reasons of the predecessor, merger/acquisition-related, and restructuring/reorganization of the firm. Ten observations were deleted because the CEO succession had occurred during an attempted takeover of the firm and it was impossible to isolate the market's response to the announcement. With the remaining 119 successions, two portfolios were constructed around the event—one portfolio of eighty-six firms with anticipated causes of CEO succession and the other portfolio of thirty-three firms with CEO succession due to unanticipated causes. The observed favorable stock market response to the succession announcements would be different if the market incorporates the reasons for CEO succession. While the stock market has already adjusted prices if the CEO succession is planned and thus anticipated, the market reaction would be more sensitive to the element of surprise (unanticipated).

Table 3 reports the stock market reaction to different reasons for CEO successions. For the thirty-three CEO successions due to unanticipated events, the average daily abnormal return during the announcement period was 0.9241 percent, significantly positive at the .05 level. However, the average daily abnormal return for the anticipated succession portfolio during the same period was 0.2249 percent, not significantly different from 0. The difference in abnormal returns between the "ANTICIPATED" portfolio and "UNANTICIPATED" portfolio was significant at the .05 level. This evidence suggests that the stock market reacts differently, depending on the cause of the succession. It is worth noting that this finding is consistent with the efficient market hypothesis, in which the markets react to new information that is not anticipated, which supports Hypothesis 1.

In a similar vein, firms were classified into "GOOD" performance and "POOR" performance categories based on the firm performance (adjusted for the industry medians) during the 3-year period prior to the succession announcement (i.e., YR-3 to YR-1).[7] As shown in Table 4, for the 71 successions by the firms that performed below the industry median during the 3-year period prior to the announcement, the average daily abnormal return was 0.5470 percent during the announcement period, significant at the .01 level.

This abnormal return for the "GOOD" performance portfolio was 0.3027 percent, which is significant at the .01 level. While the magnitude of abnormal return was greater for the "POOR" performance portfolio than for the "GOOD" performance portfolio (0.5470 percent vs. 0.3027 percent), this difference was not statistically significant at the .05 level and does not support Hypothesis 2. The results indicate that the market responds more favorably to the suc-

Table 4
Average Daily Abnormal Returns for the Three Periods around the Announcement Day: Conditional on Firm Performance during the 3-year Pre-Announcement Period (YR-3 to YR-1)

	Performance: GOOD (N=136)			Performance: POOR (N=71)		
Period	*Average Daily Abnormal Return (%)*	*Standard Error (%)*	*t-stat*	*Average Daily Abnormal Return (%)*	*Standard Error (%)*	*t-stat*
Pre-Announcement	-0.0172	0.0174	-0.9902	0.0542	0.0303	1.7866
Announcement	0.3027	0.0126	24.0475**	0.5470	0.0717	7.6306**
Post-Announcement	0.0131	0.0178	0.7354	0.0504	0.0322	1.5638

** indicates the statistic is significant at the .01 level.
Note: N=207, two additional observations were lost due to missing values of relevant accounting information.

cession announcements by the firm that performed below the industry median during three-year period prior to the announcement than to the announcements by the firm that performed better than the median of the peer group. However, the magnitude of seemingly favorable market reaction is not statistically significant due to wider variations in abnormal returns.

Financial Performance around the Announcements of CEO Succession

To investigate changes in financial performance around succession announcements, the deviation of performance measures from the industry medians was used. Because the 211 firms in the sample are distributed across various industries, it is possible that the industry-specific variation in such financial measures would bias empirical findings. Deviation from the industry median as a performance measure was used for adjustment of the industry-specific variation in the cross-sectional sample. Table 5 reports the selected financial performance measures (adjusted for industry median) during the three years prior to and three years after the announcement.

T-tests were performed and results indicate that significant differences exist for most of the measures. The adjusted firm size (measured by the total assets or net sales) significantly increased at the .05 level between the pre- and post-announcement periods. This increase indicated that, between the three-year pre- and post-succession periods, the sample firms grew in size (measured by either total assets or net sales) at a faster rate than the average of the peer group. Similarly, the firm's operating income and net income increased more than the industry medians between the two periods around the CEO succession. Increases in firm size, operating profits, and net profits were statistically significant at the .05 level, as indicated by two sample mean difference t-tests. Because of the increase in debt ratio and decrease in current ratio, the sample firms, on average, appeared to be more aggressive in financing. While it is difficult to generalize whether or not the firm improved its financial performance based on the observed financing behavior, greater use of debt financing (which is cheaper than equity financing but riskier) and better use of short-term assets (as compared to peers) can be an indication of long-term improvement in financial performance. The sample firms did not exhibit significant changes in other measures of financial performance such as earnings per share (EPS), asset utilization, return on assets, and return on equity between the three-year pre- and post-succession periods. Overall, the results suggest that the sample firms improved their financial performance in several areas around the announcement of CEO successions.

The two sub-samples were constructed based on the firm's average ROE during the three-year pre-succession period in comparison to the industry median. If the firm's average ROE was higher than the industry median during the three-year period prior to succession, the firm was included in the "GOOD" sub-sample and otherwise in the "POOR" sub-sample. One hundred and thirty six (136) firms were in "GOOD" performance sub-sample and seventy-one firms in "POOR" performance sub-sample. Although the gap between the two sub-samples was reduced

Table 5
Results of Mean Difference t-Test of Financial Performance Measures between the 3-year Pre- and Post-Announcement Periods around CEO Succession

Variables	*Variable Description*	*Period*	*Mean*	*t-stat*
TAD	Total Assets (in $MM)	Post	2109.390	2.254*
		Pre	1826.498	
SALED	Net Sales (in $MM)	Post	6740.153	2.124*
		Pre	5735.114	
OIBDD	Operating Income B. Depreciation (in $MM)	Post	1060.236	2.468*
		Pre	858.260	
NID	Net Income B. Non-recurring Items (in $MM)	Post	295.140	2.426*
		Pre	236.216	
EPSD	EPS B. Non-Recurring Items (in $)	Post	1.533	0.692
		Pre	1.235	
TATOD	Total Asset Turnover (in times)	Post	0.080	-0.087
		Pre	0.082	
DEBTRD	Debt Ratio	Post	0.019	3.634**
		Pre	-0.002	
ROAD	Return on Assets	Post	0.019	0.734
		Pre	0.018	
ROED	Return on Shareholder's Equity	Post	0.013	-0.424
		Pre	0.019	
CURD	Current Ratio (in times)	Post	-0.157	-4.153**
		Pre	-0.022	

* indicates the statistic is significant at the .05 level and ** at the .01 level.
Note: Variable names ending with D indicate the measure is relative to the industry norm. The adjustment is performed by taking the deviation from the industry median. Empirical results would be enhanced by the peer group adjustment since the adjusted variable is expected to eliminate industry-specific variations.

with respect to several performance measures during the post-succession period, the firm performing better than the industry median prior to the succession continued its better performance over the three-year period after the succession. This evidence indicates that, unless additional factors are considered, the prior performance itself appeared to be a significant indicator of firm performance during the post-succession period for the sample firms. This study also investigated the difference in firm performance with respect to the origin of the successor (inside vs. outside). Mean difference t-tests showed that those firms with inside CEO succession performed generally better than the firms succeeded by outside CEO during both pre- and post-succession periods. This evidence is consistent with the empirical results of previous studies (e.g. Dalton and Kesner 1985) arguing that inside origin is better due to a smoother transition. These results support Hypothesis 3 in that the origin of the CEO affects firm performance.[8]

Discussion and Conclusions

This study employed standard event study methodology to investigate stock market reaction to the announcements of CEO succession over the period of 1977-1994 and examined changes in financial performance around the successions with respect to antecedents of succession and origin. The evidence was consistent with favorable stock market reaction to the announcement of CEO succession. This significantly favorable stock market response was more pronounced when the reason for CEO succession was incorporated in the analysis of market reaction. Findings indicate that the market responded more favorably to the announcement of succession caused by unanticipated events than to announcements of anticipated succession. It is consistent with the efficient market hypothesis: The capital market already incorporated anticipated events into stock prices and responds only to unanticipated events. Contrary to previous studies of CEO successions, performance measures adjusted for peer group median were used to consider variations across different industries. However, most of the results of tests for different financial performance appeared either insignificant or inconsistent with the hypotheses. Nonetheless, there are a number of research and methodology issues that warrant further investigation and suggestions for future research are summarized below.

This study used a two-digit SIC code to define the firm's peer group and therefore, the industry classification is broad. Since variations in industry are still wide for many performance measures, a narrowly defined industry classification (e.g., three- or four-digit SIC code) is suggested for peer group adjusted measures. However, it should also be recognized that the finer the industry classification, the greater chance of losing some observations. Since the financial sector is heavily regulated, additional sample screening for the firms in the financial industry (i.e., SIC code between 6000 and 6499) is suggested. This procedure will also reduce the sample size.

Another issue that has received scant research attention is the association between successor origin and ownership structure of the firm. In recent years, there has been substantial growth in the influence of institutional investors who control mutual funds, public/private pension plans, and endowment funds (Salwen and Lublin 1992). Because of their fiduciary responsibility, these investors believe that they should have an active role in monitoring the firms in which their clients invest. This would place considerable pressure on boards of directors to bring about change in poorly performing organizations (Useem 1993) and to improve short-term performance of the firm (Narayanan 1985). This is supported in a recent study of 219 successions in which poorly performing firms with large proportions of stock held by institutional investors were more likely to select an outside successor (Bommer and Ellstrand 1996). Thus, it is highly probable that the board of the firm is controlled by insiders (e.g., major shareholders, board of directors and officers) if the firm's inside holding is considerably high. The insider-controlled board may prefer inside successors to outside newcomers to reduce informational asymmetry between principal and prospective candidates in the top-level managerial labor market. In a similar vein, if institutional investors require more accountability of managerial performance, they tend to introduce fresh leadership from outside the firm. Thus, it is worthy to investigate different stock market reactions with respect to ownership structures, as well as the association between CEO turnover, ownership structures, CEO demographics, and post-succession firm performance. MAJB

Notes

1. See Peterson (1989) for a review of this methodology.
2. The validity of this test statistic is hinged on the assumption that the abnormal portfolio returns are independent and identically distributed.
3. The number of CEO successions is reduced to 386 after screening of this criterion.
4. Center for Research in Security Prices, University of Chicago.
5. Although a final sample of 211 firms is used, some accounting measures (e.g. ROE, ROA) are available for fewer numbers of companies, due to missing values of such measures in COMPUSTAT.
6. Two observations are lost due to the insufficient number of daily returns in the 121-day event period around the announcement date.

7. For a performance measure relative to the norm of peer group, the deviation of the firm's average ROE from the industry's median ROE during the three-year period prior to the succession announcement (YR-3 to YR-1) was used. Although the results are not reported here, they are not varied when other perfomance measures such as ROA or Profit Margin are employed in order to classify a firm into "GOOD" or "POOR" performance categories. Two additional observations were lost due to missing values of relevant accounting data.
8. Due to space limitations, tables of these results were not included but are available upon request from the authors.

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Adaptive Selling Behavior: Adding Depth and Specificity to the Range of Adaptive Outputs

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Abstract

Working from the expanded model of adaptive selling behavior offered by Eckert and Plank (2004), this paper attempts to add greater depth and specificity to the adaptive output categories making them more useful for research advancement and for both the teaching and execution of an adaptive selling approach. Relevant literature is identified, organized, and offered as theory sources to support and expand the adaptive selling model.

Introduction

Adaptive selling as a concept has passed its twenty-year anniversary as a distinctly defined selling approach (Weitz 1981). The basic concept has been considered at the conceptual level (e.g. Weitz, Sujan and Sujan 1986), its measurement has been addressed (e.g. Robinson, Jr., Marshall and Lassk 2002; Marks, Vorhees and Badovick 1996), it has been related to other behaviors and positive sales outcomes (e.g. Park and Holloway, 2003; Withey and Panitz 1995), and there have been recent attempts to broaden and expand the concept (e.g. Brennan and Turnbull 1999; Eckert and Plank 2004).

This paper aims to continue the expansion work. It starts with the basic adaptive selling model put forth by Eckert and Plank (2004). That model posits three stages to the Adaptive Selling Process. First, there are the inputs to a selling interaction that form the characteristics of that selling situation; second, there are the behaviors undertaken to process and understand those inputs; and third, there are the ranges of outputs possible as an adaptive response to the situation created by the inputs.

The goal in this work is to expand on the output stage by adding depth and specificity to the suggested adaptive outputs offered by that model. The value in this approach is two-fold. The first value is related to research. This paper is not a traditional theory test, but instead attempts to expand and further specify an existing model, making it more suitable as an organizing framework and making future theory testing easier. Thus, in each discussion of the adaptive output categories, literature is cited with the intent of highlighting relevant work. The aim was not to be exhaustive in this, but to show how the model could be used to organize existing literature and to allow a researcher to use the cited literature as a starting point for future theory creation and testing.

The second source of value comes from adding specificity to the basic advice "be adaptive." It is not very valuable to tell students and/or sales professionals to "be adaptive" without helping them understand the range of options they have for being adaptive. The model presented and the resultant structure it provides offers a much more concrete roadmap for teaching and executing adaptive selling.

The four output categories identified in Eckert and Plank (2004) are designed to capture the range of adaptations available to the salesperson. These include possible adaptations of the information shared, the solutions suggested, the communication approach utilized, and the selling process used. While these four categories of adaptive output behavior are interconnected, each is sufficiently unique to represent a separate category of output behavior. Each is discussed below in expanded depth and specificity. Table 1 documents the basic adaptation categories and their sub-categories.

Information Adaptations

The first category of customization is the information that the salesperson may or may not offer in response to the particulars of the

Table 1
Four Categories of Adaption Possibilities

Information Adapting the information that the salesperson may or may not offer in response to the particulars of the selling situation	• *Content and Focus* Adapting the substance of the information shared with the customer. • *Flow* Adapting the quantity, frequency, and timing of the information sharing
Solution Adapting the actual solution offered as a response to the needs and situation of the buyer	• *Core Offering* Adapting the underlying content of the suggested solution • *Augmentations* Adapting the services and augmentations that get bundled together with the core offering • *Price / Cost* Adapting the price or cost factors • *Logistics* Adapting the basic logistics of the deal such as the solution's timing, quantity, and delivery terms
Communication Adapting the two-way communication process that is essential to selling	• *Influence Strategies* Adapting the form or the source of the influence strategy employed by the salesperson • *Style* Adapting the communication approach in response to the differing communication styles of the customers • *Source Factors* Adapting the credibility, similarity, and physical attractiveness of the message sender • *Message Factors* Adapting the order and sidedness of the arguments, and the basis for the persuasive appeal • *Delivery Channel / Method* Adapting the media or channel salespeople use to deliver their messages
Process Adapting the arrangement of the resources used during the selling process	• *Selling Approach* Adapting the basic selling approach utilized such as being transactional versus relational in approach • *Personnel Involved* Adapting the arrangement and assignment of human resources to the selling interaction • *Order and Length* Adapting the sequence of the selling activities or the length of time spent in any given stage of selling • *Environment* Adapting factors such as the setting and location of customer interactions

selling situation. In practice, not all customers need the same information, yet many salespeople still give what amounts to a glorified "canned" presentation. Within this area there are two basic characteristics of the information that are ripe for customization.

Information Content and Focus

This element deals with the substance of the information that is selected to be shared with the customer. What topics should it address (e.g. Reid, Pullins and Plank 2002)? What approach might the information presentation take (e.g. Fennis, Das, and Pruyn 2004)? How deep or strategic should the information be (e.g. Schultz and Evans 2002)? Should the information be focused on the business needs or focus on relationship building efforts (e.g. Jacobs, Evans, Klein and Landry 2001)? Another consideration in this area is the idea that the delivery of content is not the only part of the message that can be altered. Instead, the relational communication approach (Soldow and Thomas 1984) would argue that the intent of the message (versus just the specific words utilized) can substantially influence the norms of communication that develop between the parties, and these norms can alter such factors as who controls the interaction and how positively or negatively information is received. Specific examples include:

- A customer who has made similar purchases before may not need the background information that is required by a new purchaser of the product.
- A buyer who is most concerned about delivery performance and timetables does not need information on the innovativeness of the product.
- A salesperson may spend time sharing information about his or her family status and educational background with a client with whom he or she wishes to have a strong personal bond.
- The "out" vendor provides information designed to position the suggested change as more fruitful than the existing solution and with a low level of change-caused disruption.
- A salesperson may decide it is appropriate to share a few "inside secrets" to demonstrate trust and cooperation with a loyal long-term customer, while not sharing such information with a casual customer

who may not keep that information in confidence.

- A salesperson may respond to a question with a question in order to regain control over an interaction.

Information Flow

This element deals with the quantity, frequency, and timing of the information sharing (e.g. Funkhouser 1984). How often should information be exchanged? How much information should be exchanged? When should information be exchanged? For instance, recent work by Hunter (2004) indicates that information overload might be a detriment to a salesperson's sales performance, and this same concept could be applied to overloading the customer with information, thus minimizing sales success. Examples:

- A salesperson may decide to postpone the presentation of a critical issue during a meeting at a noisy restaurant with many distractions because the environment makes the timing poor for such a discussion. (timing)

- A salesperson may share information concerning the performance record of his or her product immediately after a key competitor has had a problem in this same area. (timing)

- A salesperson may offer a bottom-line oriented presentation for a "driver" personality customer who may not need great amounts of supporting material, while offering a more detail laden version of the presentation for a more careful decision maker. (quantity)

- A salesperson may set up a schedule of monthly information exchange with a high potential client, while only checking in quarterly with a low potential prospect. (frequency)

The main point related to this category of adaptation is that salespeople must be ready to alter the information they share with the prospect or customer based on the situation. Thought should be given to this prior to engaging in information sharing episodes. In addition, salespeople should expect to continue to alter their informational approach as a buying situation unfolds and changes.

From a research perspective, this area can borrow from the advertising literature regarding concepts such as effective reach and frequency levels. These concepts can be translated into adaptive selling oriented suggestions. For a review of these basic advertising concepts most texts will suffice (e.g. Belch and Belch 2004). Approaches that use information processing theory may also be relevant and worthwhile to consider (e.g. Hunt and Bashaw 1999).

Solution Adaptations

The second category of customization involves making adaptations in the actual solution offered as a response to the needs and situation of the buyer. This category falls into the "one size does not fit all" approach. Obviously, if customized engineering work or consulting services are the product then this is a basic tenet of the selling approach. However, the overwhelming majority of product offerings are customizable at some level. This may include alterations in the core product or service as well as customized bundles of the augmented components of the product such as delivery, support, packaging, financing, information, etc. So, in reality, there are very few industries that sell a standard, un-customizable product; instead, most sell solutions to the buyer's problem, and those solutions need not be uniform. Below, four categories of alterations are reviewed. Combined, they form the range of product adaptation options.

Core Offering Alterations

This involves adapting the underlying content of the suggested solution. This is especially relevant in situations when the core offering is by definition highly customized (e.g. consulting services). But this also may be relevant when a company sells multiple standardized solutions that approach the underlying problem or need from a different angle. In addition, recent research has started to consider whether the service and relationship elements of modern exchange are indeed the "new logic" of marketing (Vargo and Lusch 2004). This thinking could push an adaptive seller to rethink the core offering and whether to alter the offering itself or the communication of it to focus more on the service and relational elements. Specific examples include:

- A computer company may sell one system built from independent PCs that are connected via an internal network, and another system where a mainframe provides the power and "dumb" terminals provide the interface. These could solve the same basic problem, but do so in quite different ways.

- A salesperson for a training firm suggests that client one attend a public session, while suggesting that client two hosts a customized and dedicated training session.

- In a situation in which there are strong product and service elements to the core product, a salesperson may focus on one or the other depending on the value equation being utilized by the buying firm.

Augmented Offering Alterations

This involves adapting the services and augmentations that are bundled together with the core offering, even if that core offering is a service. Offering different levels of warranties (e.g. Soberman 2003), service support (e.g. Eckert and Goldsby 1997),

inventory support (e.g. Huiskonen, Niemi and Pirtilla 2003), or training support can all be relevant customization options that create unique offerings to different customers. Examples include:

- A firm may have a basic service contract that comes standard with its product, but also offer a higher level service contract to those customers that put a premium on service.
- For a new customer, a salesperson may offer to show up at the customer's site on the first day of delivery as a way to support and enhance the service provided.

Price Alterations

This involves customizing the price or cost factors. This includes bottom line price alterations but may also include customizing the financing and payment plan options. Much of the research on pricing does not utilize the salesperson context, but there are studies that do look at the adaptability of price (e.g. Raju and Zhang 2005; Avlonitis, Indounas and Gounaris 2005). Some case study work specific to sales has indicated that enabling salespeople to make better decisions as to the price customization offered has a positive effect on performance (Kern 1989). Additionally, the price elasticity of the market in which a salesperson functions may determine his or her ability to use price as an adaptive output (for a recent elasticity discussion see Bijmolt, van Heerde, and Pieters, 2005). Practical examples include:

- A firm may offer a financing deal to certain financially strong customers.
- A firm may offer a lower core price for a brand new customer as an incentive to make that first purchase.
- A salesperson may have to create price advantages through value-adding services because of high price sensitivity in a particular selling market.

Base Solution Logistics

This involves customizing the basic logistics of the deal such as the solution's timing, quantity, and delivery terms or location. Examples include:

- A firm can offer bulk delivery of a large quantity when warranted or offer a sequence of small, frequent deliveries for a customer practicing JIT.
- A firm may offer a small quantity "trial run" order for a reluctant customer.
- A firm may expedite the production of an order for a critical customer, while sticking to the standard schedule for a less loyal customer.

Ultimately, if a salesperson is practicing an adaptive selling approach, solution customization will be part of this approach. Looking at this category in total brings into play research related to how customers define value (Lindgreen and Wynstra 2005; Plank and Ferrin 2002) and the research considering an augmented or expanded product concept (e.g. Payne and Holt 2001).

Communication Adaptations

Fundamentally, selling is a two-way communication approach and thus by its nature allows for communication adaptability. This includes adapting the influence strategies employed, altering the style in which the message is presented, adapting the various message source elements, customizing the message itself, and altering the delivery channel of the message. Each is discussed below.

Influence Strategies

Some models attempt to capture the concept of influence strategies. For instance, Spiro and Perreault, Jr. (1979) identified five different influence strategies (legitimate, expert, referent, integration and impression management) that could be employed by a salesperson depending on different situational factors. In the selling context, a common distinction is made between coercive and non-coercive strategies. In general it has been found that more coercive strategies can compel compliance in the short run, but tend to hinder the development of relationalism between buyer and seller (Boyle and Dwyer 1995; Boyle, Dwyer, Robicheaux and Simpson 1992). Thus, depending on the salesperson's goal (short-term gain versus long-term implications), an adaptive salesperson might alter the influence strategy utilized. A specific example follows.

- A salesperson may communicate in a more legalistic way (e.g. citing the specific terms of a contract in a formal letter) with a transactional customer, while attempting to meet collaboratively to discuss issues with a long-term oriented client.

Style Differences

Many models of communication style differences exist, and these can be used as guides for salespeople to alter their communication approach with any given customer. For instance, the Social Style model (Merrill and Reid, 1981) is one that is often taught in sales training seminars. Altering communication style has been considered in the sales literature in general (e.g. Dion and Notarantonio 1992; Williams and Spiro 1985) and specifically connected to the stage of the buyer-seller relationship (Miles, Arnold and Nash 1990). Examples of this approach are described below:

- A salesperson may rearrange a presentation so that it focuses more acutely on a bottom-line measure of success when making the presentation to a "driver" style person.

- A salesperson may address how a solution will impact each of the buyer's team members in order to be more persuasive to a buyer with an "amiable" style (who often looks to build internal consensus for a decision).

Source Factors

Typical source factors include the credibility, similarity, and physical attractiveness of the message sender. These have been considered as relevant in the selling context in both the academic literature (e.g. Lichtenthal and Tellefsen 2001: Liu and Leach 2001; Dwyer, Richard and Shepherd 1998; DeShields, Kara and Kaynak 1996; Sharma 1990) and the industry press (e.g. Peterson 1999; Johnson 1994). In addition to these traditional source elements, in the increasingly global business world, cultural adaptations by the salesperson and their appropriateness and reception are ripe areas for study (e.g. Pornpitakpan 2005 and 2002; Tsalikis, DeShields, Jr. and LaTour 1991). While source factors can't always be altered in the short term, over a longer term, when considering the breadth of potential personnel involved in the delivery of a message, these factors are still ripe for customization. Examples include:

- A salesperson may utilize another member of the sales team to deliver a negative message because this person is more similar to the buyer and thus may face less resistance.

- A salesperson may provide significant outside support for a claim in a situation where he or she might not carry credibility with the customer (e.g. situations outside his or her area of expertise or where he or she is considered biased).

- A salesperson dresses down when visiting the plant personnel versus dressing up when visiting the corporate executives.

Message Factors

Traditionally, in communication theory, message factors include the order of the arguments, the sidedness of the arguments, and the basis for the appeal being made (see O'Keefe, 2002 for a full review of these concepts). All of these remain relevant in this context. Sidedness of the argument has been considered in the adaptive selling context (Smith and Hunt 1987); it was found that two-sided arguments led to greater message recall. In addition to these traditional message factors, non-verbal cues can be considered a part of the message delivered by the salesperson (Stewart, Hecker, and Graham 1987). Non-verbal cues in the selling context have been recently explored by Leigh and Summers (2002), with mixed results as to their effect on the reception of the sales message. In each of these cases, salespeople have control over these message factors and thus could customize these to best match the selling situation. Examples include:

- A salesperson may present a side-by-side product comparison versus the competition, or present only the features and benefits of the product he or she represents.

- A salesperson could focus the message to the customer in relation to how the product will help the customer capitalize on an opportunity or the salesperson could focus the message on how the product will overcome a problem or obstacle.

- A salesperson could take a socially open stance with a client while trying to encourage a discussion of personal or relational matters, while taking a more formal non-verbal approach when dealing with task oriented endeavors.

Delivery Method / Channel

Salespeople also control the media or channel they use to deliver their messages. Such messages could include product presentations, responses to objections, or discussions of service options. Channels could include traditional face-to-face meetings, phone calls, e-mails and other e-forms of communication. The appropriateness of the message channel is an adaptive consideration and specifically has been the focus of recent research by Cano, Boles, and Bean (2005) who found different media types (e.g. face-to-face versus e-communication) were preferred differently by buyers depending on the stage of the buying process. In other relevant research, Kennedy and Deeter-Schmelz (2001) considered how online purchasing was used more often with routine orders and by purchasers who defined themselves as more innovative. Again the core of this research is the identification of the adaptive relationship between type of customer, type of purchase, and communication channel. This type of research can be used to craft heuristic rules about what communication channel to employ given certain sales situations. Examples of both include:

- A salesperson can choose to deliver the message in a face-to-face meeting or via a PowerPoint presentation emailed to the customer.

- A salesperson might make a written request for product specification information versus having a casual meeting with an engineer associated with the project.

- A salesperson could use the SPIN questioning method (Rackham 1988) in a moderately complex situation but use the PRIME selling method (Thull 2003) in a more complex situation.

In a broad context, there are many ways for a salesperson to alter their communication approach with different buyers. In most cases while

it might be easier to use the most common or most natural communication approach, the above information suggests the most effective approach should be an adaptive decision, not a result of habit.

From a research perspective, the communication literature, including core communication models such as the Elaboration Likelihood Model, is rich with material related to these categories and already has been a source of theory for this area (e.g. Sparks and Areni 2002; Lichtenthal and Tellefsen 2001; Schmitz 1995). Additional sources of theory could include work on considering the impact of technology on the buyer-seller communication process (e.g. MacDonald and Smith 2004).

Process Adaptations

The final adaptation category is that of process. This has to do with how the salesperson will arrange the resources used during the selling process. This could include altering the people involved, altering the steps used, altering the time spent in any given stage, or altering the interaction environment. In addition, process adaptations can include altering the basic selling approach utilized. The point is that making alterations is within the control of the seller and thus forms the final category of customization options. The underlying factors of this category are discussed below.

Selling Approach

Should a salesperson take a customer oriented approach? For instance, DelVecchio, Zemanek, McIntyre, and Claxton (2003) found that taking a customer oriented approach was most suited for situations in which the buyer had high levels of authority within the buying firm. Should the approach be focused on short-term gain or immediate results? Avila, Inks and Chapman (2003) concluded that approximately half of a salesperson's customers preferred a transactional approach (although this result was self-reported by the salepeople). Should the approach be via telemarketing (e.g. Moncrief, Shipp, Lamb and Cravens 1989), traditional outside sales, or a key account management approach? For instance, Ulaga and Sharma (2001) suggest a key account strategy as the best counter to complex buying situations. These types of selling approach factors can be customized based on the selling situation and thus are process customization options (for additional work that can be applied to selling approach adaptation see Beverland 2001; Szmanski 2001; Wagner, Klein and Keith 2001; Sharma1997; Cardozo, Shipp and Roering 1987). Practical examples include:

- A salesperson may take a consultative approach in a complex situation with a high potential customer, versus taking a more tell and sell approach with a low potential customer in a very simple context.
- A firm may use outbound telemarketing to secure orders in a straight re-buy situation.
- A firm may launch a key account approach in response to a client who has a significant strategic interest in the outcome of the potential purchase.

Personnel Involved

This can be thought of as a game of chess; which pieces will you move where? For instance, Sengupta, Krapfel, and Pusateri (2000) offer advice about which salespeople would be best suited for a key account situation. A selling interaction can be approached with a lone salesperson (e.g. the "lone wolf" work of Dixon, Gassenheimer and Barr 2003), with ad hoc help from other departments, or with a formalized selling team (e.g. Deeter-Schmelz and Ramsey 1995; Moon and Gupta 1997). Such decisions are a fundamental part of the customization options and can be used to best match-up with the underlying selling situation. Examples include:

- A salesperson may arrange for the firm's logistics person to attend a meeting where the buyer's logistics person will be in attendance.
- A firm may create a formal selling team in response to a customer who has a formal buying team.

Order and Length

Order and length have to do with altering the sequence of the selling activities or altering the length of time spent in any give stage (e.g. Shays 2001; Macintosh and Gentry 1999). These alterations can be made in order to put the best possible interaction sequence together given the selling situation. Examples include:

- A salesperson may jump right to a close/order generation with a satisfied customer in a re-buy situation.
- A salesperson could begin an interaction with an issue resolution meeting because the buyer had a bad prior experience with the salesperson's firm.
- A salesperson may spend a great deal of time in needs identification with a new task client, versus shortening this stage for a client who is in a re-buy situation.
- A salesperson may invite a skeptical buyer to a plant tour to help solidify the quality argument.

Environment

Environment alterations deal with changing factors such as the setting and location of customer interactions (e.g. Schurr and Calder 1986). Environmental factors were considered by

McElroy, Morrow and Eroglu (1990) in their article on "atmospherics" in the personal selling context. Specific examples of such alterations include:

- A salesperson may set up a lunch meeting with a client in order to reduce office distractions.
- A salesperson may invite a client to the salesperson's facility in order to gain home-turf advantages.

The process adaptations have to do with altering the underlying structure, order, and method of the sales call. Adaptation behavior in this area would seek to match the selling process with the buying process as was considered in Tanner (1996). For additional theory development in this area even biological work could be tapped as evolutionary adaptations also deal with adaptation at the underlying process level.

Conclusions

By expanding the depth and specificity of the output categories in the adaptive selling model it has become more useful on two levels. First, its value as a research model is increased because it better organizes existing literature in selling, suggests areas where non-selling literature could be tapped as theory development sources, and offers future researchers a starting point for further research endeavors.

Second, the more specified model has value because it offers a much more concrete roadmap for teaching and executing adaptive selling. As expressed earlier, it is not very valuable to tell students and/or sales professionals to "be adaptive" without helping them understand the range of options they have for being adaptive. The expanded model presented here solves this problem. In addition, these further specified range of output options can now be connected to the behaviors that enhance adaptability potential such as active listening and probing in order to create a more tangible and useful overall model of adaptive selling. MAJB

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Dual-Class Companies: Do Inferior-Voting Shares Make Inferior Investments?

Judith Swisher, *Western Michigan University*

Abstract

A dual-class share structure allows managers or original owners to retain control of a firm, while providing public equity financing. In the U.S., a firm generally issues superior-voting shares to managers or original owners, and inferior-voting shares to the public. As a result of the separation of control and risk bearing, the potential for agency problems exists. Theory predicts and some evidence shows that the use of a dual-class share structure leads to a lower firm valuation than would otherwise exist. However, theory also suggests that separation of control and risk bearing might be desirable in some situations, since it allows managers to make long-term investments without fear of a hostile takeover. Thus, a dual-class share structure could result in superior performance. This study addresses the question that confronts investors with respect to dual-class firms: "Are inferior-voting shares inferior investments?" Specifically, this research investigates the stock performance of companies that have dual-class shares. Overall, results show that investors in inferior-voting shares do not earn abnormally low risk-adjusted returns. Investors in non-IPO inferior-voting shares earn positive abnormal risk-adjusted returns.

Introduction

A topic that has received wide attention in finance research is the issuance by firms of more than one class of stock, with different voting rights. In the U.S., managers or the original founders of the firm typically hold superior-voting shares, while inferior-voting shares are available to ordinary investors.[1] By design, the total voting power of the superior-voting shares is greater than that of the inferior-voting shares. Thus the owners of the superior-voting shares effectively control the firm, and investors who hold inferior-voting shares have limited influence over management.

Theory points out the potential agency problems associated with separating voting rights from cash flow rights (Jensen and Meckling 1976). For example, if managers award themselves high salaries and consume expensive perquisites, they receive the full benefit of these excesses, but the costs are shared among all stockholders. The potential for agency problems is greater for dual-class than for single-class firms, since the owners of the dual-class firm's inferior-voting shares are powerless to prevent such behavior on the part of management. Indeed, Smart and Zutter (2003) note that managers of their sample dual class firms earn higher compensation than other managers, after controlling for several factors that affect compensation levels. On the other hand, researchers argue that a dual-class share structure can provide an effective defense against a hostile takeover (Jarrell and Poulsen 1988), thereby allowing a firm to make long-term investments or investments in firm-specific managerial human capital (Denis and Denis 1994). Such opportunities could lead to better firm performance than would otherwise be possible.

The purpose of this research is to examine the stock performance of inferior-voting shares, which is a relevant question for investors today. The recent IPO of Google, Inc. was widely followed by investors because of the popularity of Google's search engine. However, Google has a dual-class share structure: Class B shares are entitled to ten votes, but Class A shares have only one vote. Although co-founders Sergey Brin and Larry Page and CEO Eric Schmidt together own about one-third of the outstand-

ing shares of Google, they control over 80 percent of the votes. Google is but one of many companies with dual class shares. Thus, evidence on the stock performance of inferior-voting shares is of interest to investors.

Overall, results of this study show that a dual-class share structure does not lead to poor investment results. For the sample as a whole, abnormal returns of inferior-voting shares are not significantly different from zero. Because the underperformance of IPOs relative to non-IPO firms is widely documented in finance literature,[2] the sample is partitioned into IPO and non-IPO subsamples. Results of this robustness check show that abnormal returns for IPO inferior-voting shares are negative and marginally significant, but abnormal returns for non-IPO inferior-voting shares are positive and significantly different from zero. Moreover, IPO abnormal returns are significantly lower than those of non-IPO sample firms. Since the underperformance of IPOs is well known, this result is not surprising. In general, results of this research provide assurance to investors that, on average, inferior-voting shares are not inferior investments. Indeed, investments in non-IPO inferior-voting shares earn, on average, positive abnormal risk-adjusted returns.

Prior Literature

Dual-class firms have long been of interest to researchers.[3] As early as 1983, Levy examines the price differential between shares with superior voting rights and their corresponding shares with inferior voting rights.[4] He finds that the size of the price differential is related to the difference in the voting rights of the share classes.[5] More recent research focuses on the private benefits that accrue to controlling shareholders (Smart and Zutter 2003, Nenova 2003, Modigliani and Perotti 1997, Rydqvist 1996, and Zingales 1994). Since the potential exists for controlling shareholders to extract private benefits at the expense of inferior-voting shareholders, a natural question is whether investors holding inferior-voting shares earn abnormally low returns.

> "...on average, inferior-voting shares are not inferior investments."

On the other hand, the dual-class structure could have benefits for firms. Some researchers point out that the short-term focus of shareholders can lead managers to make suboptimal investment decisions. Stein (1988) shows that information asymmetry between managers and investors can prevent firms from accepting long-term investments, since the short-term focus of investors could make the firms susceptible to takeovers. Other researchers argue that a dual-class share structure allows firms to invest in firm-specific managerial human capital (Fischel 1987 and Denis and Denis 1994). A dual class share structure could, therefore, result in superior long-term firm performance.

One line of research on dual-class companies focuses on the market reaction to dual-class recapitalizations. Some evidence shows that the market responds negatively to announcements of dual-class recapitalizations (Dann and DeAngelo 1988, Jarrell and Poulsen 1988), but other researchers find no abnormal market response (Partch 1987, Millon-Cornett and Vetsuypens 1989). Chang and Mayers (1992) find evidence that the market reaction is related to the initial level of manager vote ownership. Shum, Davidson, and Glascock (1995) find evidence that the market reaction to dual-class recapitalizations is dependent on whether shareholders are adequately compensated for their loss of voting rights. This line of research provides insights into dual-class recapitalizations and demonstrates that voting rights are viewed as valuable by shareholders, but it does not directly examine the investment performance of such stock, given the share structure. Thus the question facing investors remains unanswered: "Do inferior-voting shares make inferior investments?"

Bohmer, Sanger, and Varshney (1996) study a sample of ninety-eight dual-class IPOs issued from 1984 to 1988. They find that dual-class IPOs outperform a matched sample of single-class IPOs over the three years following the offers. They conclude that, under some circumstances, firms benefit from consolidated control. Thus IPO evidence from the 1980s for dual-class firms is consistent with the idea that a dual-class share structure allows for optimal investment decisions and superior performance. However, since the underperformance of IPOs relative to non-IPO firms is well established,[6] it is unknown whether these results generalize to all dual-class firms.

This research extends and updates the work of Bohmer, Sanger, and Varshney (1996) by examining the stock performance of a recent sample of dual-class firms (both IPOs and non-IPO firms). In contrast to most prior research on dual-class shares, the analysis is not conditioned on an event such as a dual-class or single-class recapitalization. Instead, the purpose of this research is to examine the stock returns earned by ordinary investors in inferior-voting shares on an ongoing basis, which is accomplished by using the Capital Asset Pricing Model and the Fama French (1993) three-factor model.[7] The analysis consists of two parts.

First, the whole sample is analyzed to assess the overall stock performance of inferior-voting shares. Second, because the underperformance of IPOs relative to non-IPO firms is widely recognized, sample returns of inferior-voting shares are divided into IPO and non-IPO subsamples. Following Bohmer, Sanger, and Varshney (1996), who examine stock returns for three years following the IPO, those returns that occur within three years of a firm's IPO are classified as IPO returns, and the remaining returns are classified as non-IPO returns. Thus, as a robustness check, the IPO and non-IPO subsamples of inferior-voting shares are examined to assess their performance.

Table 1
Descriptive Statistics for Firms With Dual-Class Shares By Year

	Total Assets ($ Millions)			*PE Ratio*		
Year	*Mean*	*Median*	*N*	*Mean*	*Median*	*N*
1990	649.3	189.0	149	22.8	13.7	130
1991	636.9	213.8	158	27.9	17.5	135
1992	671.0	242.1	165	33.2	17.5	144
1993	714.1	247.2	181	40.0	18.7	154
1994	764.5	202.5	217	40.6	17.8	184
1995	919.9	243.7	232	55.0	16.6	209
1996	1,175.1	287.1	250	45.4	20.0	219
1997	2,236.0	420.0	255	55.2	20.7	224
1998	2,780.2	531.9	254	34.4	19.8	230
1999	3,452.6	530.7	263	35.8	17.3	219
2000	3,020.9	577.0	256	44.9	15.5	210
2001	3,202.6	597.5	240	81.7	20.5	185
2002	3,194.0	738.8	221	60.9	23.9	167
2003	3,434.7	842.3	213	40.4	19.0	166

Sample Description

Sample firms are identified by searching the CRSP database for common stock class "A" or "B" shares that have monthly returns during the sample time period of 1990 to 2003. The search yields 595 companies with class A and/or class B shares.[8] For most companies, the superior-voting shares are privately held. However, for seventy-nine of these companies, two classes are publicly traded and included in CRSP. Although many inferior-voting shares are termed "A" shares, the designation is not uniform. Thus the shares must be more closely examined to identify the inferior-voting shares.

Two methods are used to determine which is the inferior-voting class for these seventy-nine firms. First the average price and trading volume of the two classes are compared. Evidence shows that inferior-voting shares generally trade at a discount to their corresponding superior-voting shares (Smith and Amoako-Adu 1995). In addition, average trading volume should be greater for the inferior-voting shares, since by design the number of inferior-voting shares generally exceeds that of superior-voting shares. Comparison of average price and trading volume of the two classes identifies the inferior-voting shares for fifty-seven of the seventy-nine companies. For the remaining twenty-two firms, SEC filings (proxy statements and 10Ks) are examined to determine which shares have inferior voting power.

Each stock is required to trade for at least twenty-four months during the sample period, which eliminates ninety-four firms. Included in this number are firms that initiate a dual-class structure during 2002 (16 firms) and 2003 (15 firms). The final sample consists of the inferior-voting shares of 501 firms (429 firms with one class trading and 72 firms with two classes trading).

Tables 1 and 2 examine the distribution of sample firms over time. Table 1 reports the mean and median total assets and price-to-earnings (PE) ratios for those sample firms for which data are available in Compustat. Both mean and median total assets increase substantially over the sample period. The mean PE ratios increase during the bubble period, but the increase is much smaller for the median PE ratios.

Table 2 reports the average length of time over which the dual-class shares trade during the sample time period of 1990 to 2003. Results are broken out by the year in which the dual-class shares begin trading. For the sample as a whole, the average length of trading time during the sample period is more than seven years (88.5 months). Over one-third of the sample (38.7%) initiates its dual-class structure prior to 1990 when this analysis begins. For these firms, the average length of time for which returns are available during the

Table 2
Initiation of Dual-Class Structure and Trading Time in Months

Initial Year In CRSP Database	*Number of Sample Firms*	*% of Sample Firms*	*Average Number of Monthly Returns*	*Number of IPOs*	*Number of Dual-Class Recaps*
Pre-1990	194	38.7	113.3	112	82
1990	17	3.4	123.1	11	6
1991	18	3.6	92.8	11	7
1992	24	4.8	95.6	11	13
1993	20	4.0	85.5	11	9
1994	48	9.6	86.7	38	10
1995	39	7.8	71.5	29	10
1996	39	7.8	67.7	31	8
1997	27	5.4	55.6	21	6
1998	22	4.4	55.8	15	7
1999	28	5.6	48.8	20	8
2000	15	3.0	41.9	10	5
2001	10	2.0	29.0	3	7
Whole sample	501	100.0	88.5	323	178

Table 3
Average Monthly Portfolio Returns By Year

	Monthly Returns (%)				
Year	Whole Sample	IPOs	Non-IPOs	CRSP VW Index	T-bills
1990	-2.07	-2.63	-1.99	-0.39	0.61
1991	3.19	2.53	3.28	2.53	0.38
1992	2.05	2.54	2.01	0.75	0.22
1993	2.67	2.97	2.63	0.93	0.26
1994	-0.43	-1.70	-0.16	-0.02	0.27
1995	2.20	1.70	2.39	2.59	0.39
1996	1.60	1.71	1.58	1.66	0.40
1997	1.90	1.65	2.01	2.32	0.36
1998	0.45	0.46	0.45	1.91	0.26
1999	1.22	0.19	1.46	1.98	0.41
2000	-0.24	-1.69	0.07	-0.84	0.45
2001	2.05	4.90	1.56	-0.81	0.29
2002	-0.71	-4.17	-0.18	-1.79	0.16
2003	4.24	4.92	4.19	2.46	0.17

sample period (beginning in January 1990) is over nine years (113.3 months). As one might expect, firms that initiate trading in the later years of the sample have, on average, fewer months of returns. No dual-class initiations for 2002 and 2003 are included in the sample, since the requirement of a minimum of twenty-four monthly returns eliminates those firms.

Table 2 also reports the number of dual-class initiations that are implemented at the time of an IPO (323) as opposed to a dual-class recapitalization (178). Consistent with evidence that IPOs occur in cycles (Helwege and Liang 2004), dual-class initiations through IPOs appear to occur in cycles.

Portfolio Construction

To conduct the analysis, 168 equal-weighted monthly portfolios are formed over the sample period of 1990 to 2003. For each month, all inferior-voting shares that have stock returns during that month are included in calculating the equal-weighted portfolio return. On average, the monthly portfolios include 263 firms, with a minimum and maximum of 194 and 315 firms, respectively. Table 3 reports the average monthly returns by year for the portfolios and for the CRSP value-weighted index. Yearly averages of 1-month T-bill rates are also reported. The portfolio average monthly returns for the whole sample by year range from a low of –2.07 percent in 1990 to a high of 4.24 percent in 2003.

The IPO monthly portfolios include firms for the first three years following their IPOs. Although Table 2 reports that 323 sample firms initiate dual-class share structures at the time of their IPOs, fifty-two of those IPOs take place more than three years before the beginning of the sample period. Thus 271 firms are included in the IPO portfolios. The non-IPO monthly portfolios include all other returns. So, for example, Kenneth Cole Productions conducted an IPO in June 1994 in which class A shares were sold to the public. Kenneth Cole returns from July 1994 through June 1997 are included in the IPO monthly portfolios, while subsequent Kenneth Cole returns are included in the non-IPO monthly portfolios.[9]

Methods

The returns to investors in the inferior-voting shares are analyzed using two methods, the Capital Asset Pricing Model (CAPM) and the Fama French (1993) three-factor model. Although the CAPM is widely recognized and used, researchers argue that it does not account for all risks that are priced by investors. In addition to market risk, which is considered by CAPM, the three-factor model takes into account differences in risk related to firm size and a firm's book-to-market ratio. Both of these models offer the advantage that they do not require knowledge of sample firm size, which can be difficult to determine for firms with classes of privately held shares.

The 168 monthly portfolio returns described in the previous section are analyzed using the CAPM:

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + \varepsilon_t \qquad (1)$$

where
R_{pt} is the portfolio return in month t,
R_{ft} is the rate of return on T-bills in month t (representing the "risk-free rate"), andR_{mt} is the return on the CRSP value-weighted index in month t (representing the "market return").

Estimation of the model yields two coefficients. The α, which of the primary focus of this research, captures the abnormal return after controlling for market risk. A positive (negative) and statistically significant α indicates that portfolio returns are significantly higher (lower) than would be expected, after controlling for the level of market risk. The β is the traditional measure of market risk.

Next, to consider other risks in addition to market risk, the Fama French three-factor model is estimated:

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + sSMB_t + hHML_t + \varepsilon_t \qquad (2)$$

where
SMB is the Fama French factor for size, calculated as the return on a portfolio of small stocks minus the return on a portfolio of big stocks, and HML is the Fama French factor for book-to-market, calculated as the return on a portfolio of high book-to-market stocks minus the return

on a portfolio of low book-to-market stocks.[10]

Again, α captures the abnormal return, but now after controlling for market risk, the size effect, and the book-to-market effect. The β again measures the degree of market risk, s captures the size effect, and h captures the book-to-market effect. As with the CAPM, the α is the primary focus of this analysis. A positive (negative) and statistically significant α is evidence of abnormally high (low) portfolio returns, after controlling for market risk, the size effect, and the book-to-market effect.

The analysis outlined above examines the performance of inferior-voting shares without regard to whether the firm has recently conducted an IPO. Bohmer, Sanger, and Varshney (1996) study the returns of inferior-voting shares over the three years following IPOs during the 1980s, and find evidence of abnormally good performance compared to other IPOs. However, the IPO literature widely reports abnormally low returns for firms following IPOs (see, for example, Ritter 1991 and Loughran and Ritter 1995).

Consequently, to test the robustness of the results of the analysis outlined above, sample returns are divided into IPO and non-IPO subsamples. The analysis is then repeated: both the IPO and non-IPO subsamples are analyzed using the CAPM and the Fama French three-factor model. The IPO monthly portfolios include monthly returns for the first three years following the IPOs of sample firms.[11] The non-IPO monthly portfolios include all other returns.

Finally, to statistically test the differences between the IPO and non-IPO returns, both models are modified to include dummy variables for the IPO returns, and interactive variables are constructed to capture the differences in the coefficients for the risk factors. The IPO portfolio returns and the non-IPO portfolio returns are included simultaneously in the analysis. Specifically, the following models are estimated:

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + \gamma IPO + \delta(R_{mt} - R_{ft}) * IPO + \varepsilon_t \quad (3)$$

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + sSMB_t + hHML_t + \gamma IPO + \delta(R_{mt} - R_{ft}) * IPO + \eta SMB_t * IPO + \theta HML_t * IPO + \varepsilon_t \quad (4)$$

where
IPO is a dummy variable that is set equal to 1 for IPO portfolio returns, and 0 otherwise.

Thus γ captures systematic differences that exist between IPO and non-IPO returns. The interactive variables control for differences between IPO and non-IPO returns in terms of market risk, size risk, or book-to-market risk. The focus of this analysis is two-fold: α and γ. A positive (negative) and statistically significant α represents abnormally good (bad) returns for non-IPO inferior-voting shares after controlling for the risks included in the model, and a statistically significant γ is evidence of a significant difference between the IPO and non-IPO returns of inferior-voting shares.

Table 4
OLS Regression Results

$$R_{pt} - R_{ft} = \alpha + \beta_1(R_{mt} - R_{ft}) + \varepsilon_t$$

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + sSMB_t + hHML_t + \varepsilon_t$$

α	β	s	h	Adj. R^2	F-Statistic
0.402*	0.912***			62.65	281.08***
0.132	0.913***	0.769***	0.439***	89.94	498.57***

*** Indicates statistical significance at the 1% level, ** at the 5% level, and * at the 10% level.

Results

Proceeding with the analysis, the 168 monthly portfolio returns are analyzed using the CAPM and the Fama French three-factor model. Results for the CAPM in Table 4 show that the α, which is the focus of the analysis, is positive and significantly different from zero at the 10 percent level, indicating an abnormal monthly return of 0.402 percent after controlling for market risk. The α estimate for the Fama French three-factor model is not significantly different from zero. The adjusted R^2 of 89.94 shows that the Fama French three-factor model better explains the variation in returns than does the CAPM (adjusted R^2 of 62.65). Although the three-factor model fails to show abnormally good performance, it does not indicate that investors do poorly when investing in inferior-voting shares.

The previous analysis examines the performance of inferior-voting shares without regard to whether the firm has recently conducted an IPO. However, the underperformance of IPOs relative to other firms is well documented in finance literature.[12] In addition, Bohmer, Sanger, and Varshney (1996) find evidence of abnormally good performance during the 1980s for inferior-voting shares over three years following IPOs compared to other IPOs. Consequently, as a robustness check, IPO and non-IPO returns are analyzed separately, since prior research suggests that performance could differ between the two subsamples.

Panels A and B of Table 5 report results of the analysis separately for IPO and non-IPO returns. Based on the CAPM, IPOs earn risk-adjusted returns that are not significantly

Table 5
OLS Regression Results for IPO and Non-IPO Returns

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + \gamma IPO + \varepsilon_t$$

$$R_{pt} - R_{ft} = \alpha + \beta(R_{mt} - R_{ft}) + sSMB_t + hHML_t + \gamma IPO + \delta(R_{mt} - R_{ft})*IPO + \eta SMB_t*IPO + \theta HML_t*IPO + \varepsilon_t$$

α	β	s	h	γ	δ	η	θ	Adj. R^2	F-Statistic
Panel A: IPO Returns									
-0.148	1.256***							50.20	169.37***
-0.536*	1.241***	1.157***	0.606***					75.31	170.80***
Panel B: Non-IPO Returns									
0.523**	0.850***							60.92	261.35***
0.268**	0.857***	0.704***	0.428***					87.32	384.46***
Panel C: All Returns									
0.523**	0.850***			-0.672	0.406***			53.05	127.20***
0.268**	0.857***	0.704***	0.428***	-0.804***	0.384***	0.453***	0.178*	78.57	176.42***

*** Indicates statistical significance at the 1% level, ** at the 5% level, and * at the 10% level.

different from zero (α not significantly different from zero). However, results of the three-factor model show negative abnormal returns of –0.536 percent for IPOs (α is marginally significant at the 10% level), after considering market risk, size risk, and book-to-market risk.[13] Results for non-IPO firms in Panel B are strikingly different. Both the CAPM and the three-factor model show positive abnormal returns for the non-IPO returns, after considering risk. The abnormal monthly returns for the two models are 0.523 percent and 0.268 percent, respectively (α significant at the 5% level). These results suggest that a dual-class share structure allows managers to make risky investments that otherwise would not be possible, resulting in abnormally good returns.

To statistically test the differences between IPO and non-IPO returns of inferior-voting shares, models 3 and 4, which include an IPO dummy variable and interactive variables, are estimated using both IPO and non-IPO portfolio returns. Panel C of Table 5 reports the results. Consistent with the results reported above, both models show positive abnormal returns for the non-IPO inferior-voting shares (α significantly greater than zero), after considering the various risks. For the CAPM, the coefficient for the IPO dummy variable is not significantly different from zero. As in the previous analyses, the three-factor model better explains the variation in returns; it has both a higher adjusted R^2 and F-statistic than the CAPM. The estimated coefficient of -0.804 percent for the IPO dummy variable indicates that the abnormal, risk-adjusted monthly IPO returns are, on average, 0.804 percentage points lower than those of non-IPO returns. These results are consistent with the those in Panels A and B. Results also show that IPO inferior-voting shares have significantly more market risk, size risk, and book-to-market risk than do non-IPO inferior-voting shares. The estimated coefficients of the interactive variables are all positive and significant at the 1 percent level. This evidence indicates that investors in dual-class IPOs face significantly more risk than do investors in dual-class non-IPOs, and are less likely to have abnormally high risk-adjusted returns.

These results for inferior-voting IPOs are hardly surprising, since the underperformance of IPOs is well documented in finance literature.[14] In their analysis of dual-class IPOs, Bohmer, Sanger, and Varshney (1996) compare the performance of their sample firms to a sample of single-class IPOs. This research measures the performance of the inferior-voting IPOs relative to the whole market and relative to non-IPO inferior-voting shares, which have abnormally good returns. Thus the results reported in Table 5 are not inconsistent with the findings of Bohmer, Sanger, and Varshney, who compare inferior-voting IPOs with other IPOs.

Conclusion

This research investigates the returns earned by investors in the inferior-voting shares issued by dual-class companies. Researchers point out the potential agency problems that exist when voting rights are separated from risky cash flow rights. However, some researchers argue that the short-term focus of shareholders can lead managers to make suboptimal investment decisions. A dual-class share structure circumvents this problem, and thus could allow for better performance. Overall, this research finds no evidence that a dual-class share structure leads to poor results for investors. For the sample as a whole, abnormal returns after controlling for risk are not significantly different from zero.

Partitioning the sample into inferior-voting IPO and inferior-voting non-IPO returns, however, reveals some differences in performance. Investors in inferior-voting shares during the three years following an IPO earn abnormal returns relative to the market that are negative and marginally significant after controlling for risk. However, when the returns earned by IPO investors are

compared to the returns earned by non-IPO investors in inferior-voting shares, the IPO investors earned negative abnormal returns that are significantly worse than those earned by non-IPO investors. This result is not surprising, since the underperformance of IPOs relative to other firms is well documented in finance literature.

In contrast to the IPO returns, the investors in non-IPO inferior-voting shares earn positive abnormal, risk-adjusted returns. This evidence suggests that a dual-class share structure allows managers to make risky investments that lead to better returns. Overall, this research provides assurance to investors that, on average, a dual-class share structure does not lead to poor stock performance. Indeed, aside from the well known underperformance of IPOs, the inferior-voting shares provided investors with abnormally good average returns. MAJB

Notes

1. The term "ordinary investors" is used to describe investors who are not part of the select group that is allowed to hold superior voting shares.
2. See, for example, Stoll and Curley (1970), Ibbotson (1975), Aggarwal and Rivoli (1990), and Ritter (1991).
3. See, for example, Smith and Amoako-Adu (1999), Taylor and Whittred (1998), Birgul, Gibson, and Tuchschmid (1996), Smith and Amoako-Adu (1995), and Zingales (1994).
4. Although the superior-voting shares of most dual-class firms are privately held, for a small number of dual-class firms both inferior and superior classes trade publicly.
5. Although the difference in the voting rights could have an impact on the value of the shares when the dual class structure is implemented, only a change in the relative voting rights should result in a change in the stock values. Thus the returns to the inferior-voting shares should be unrelated to the voting rights.
6. See, for example, Ritter (1991) and Loughran and Ritter (1995).
7. Both the Capital Asset Pricing Model (CAPM) and the Fama French three-factor model are widely used in finance research. The CAPM is a standard model that is taught in undergraduate investments courses. Although the Fama French three-factor model was developed more recently than the CAPM, Arnott (2005) points out that thousands of published articles and doctoral dissertations have used the Fama French three-factor model.
8. Two companies are not included in this number. Shares of Tele Communications are excluded from the analysis since the firm has class A and B shares for the company along with two sets of class A and B shares that are tracking stocks. Berkshire Hathaway is also excluded since the dual-class structure does not concentrate control with original owners or managers.
9. As noted previously, classifying a firm's returns that fall within three years of an IPO as IPO returns is based on Bohmer, Sanger, and Varshney (1996).
10. See Fama and French (1993). Fama French factor data are obtained from Ken French's web site. The factors and details on their construction are available at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html
11. Classifying a firm's returns that fall within three years of an IPO as IPO returns is based on Bohmer, Sanger, and Varshney (1996), who analyze returns for three years following IPOs.
12. See, for example, Ritter 1991.
13. Of the 168 IPO monthly portfolios in the sample time period, ten portfolios are comprised of fewer than ten firms. Eliminating those ten months from the analysis yields similar results, but the alpha is no longer statistically significant.
14. See, for example, Ritter (1991) and Carter, Dark, and Singh (1998).

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Team Emotional Intelligence and Team Interpersonal Process Effectiveness

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Abstract

In this exploratory study, the relationships between the emotional intelligence (EI) of self-directed teams and two dimensions of team interpersonal process—team task orientation and team maintenance function—were investigated using the five dimensional model of emotional intelligence measured by the BarOn Emotional Quotient Inventory (EQ-i®) in a sample of thirty-three work teams. Average team emotional intelligence scores were calculated by aggregating the individual emotional intelligence scores of each team member and dividing the sum by the number of team members. Regression analyses of team averaged emotional intelligence across all five sub-dimensions of the EQ-i® reveal significant predictive relationships between team averaged interpersonal EI and Team Task Orientation (r =.37) and team averaged interpersonal EI and Team Maintenance Functions (r =.31). Team averaged interpersonal EI predicted 10 percent of the variance in Team Maintenance Function while team averaged interpersonal EI and team averaged general mood EI combined to predict 16 percent of the variance in Team Task Orientation. Directions for future research are presented.

Overview

Emotional intelligence, broadly defined as the emotional, affective, and social skills dimension of general intelligence, is likely to garner the attention of researchers as team based job design systems continue to be adopted by organizations. Over the past decade, organizations have increased the use of self-directed (or self-managed) teams to accomplish work tasks and organizational goals (Hackman 1990; Sundstrom, DeMeuse and Futrell 1990; Salas, Dickinson, Converse and Tannenbaum 1992; Guzzo and Salas 1995). Since teamwork is by nature a social endeavor that involves individuals engaged in interpersonal interactions and adapting to an array of individual differences (i.e., work style and personality differences) as well as environmental and job demands, it is likely that emotional intelligence will become a requisite aptitude for individuals employed in team-based organizations (Prati, Douglas, Ferris, Ammeter and Buckley 2003). After all, effective team functioning is contingent, at least in part, on individuals mentally processing affective information and using it to engage in effective interpersonal interactions with fellow team members.

Emotional intelligence has been examined at the team level of analysis in samples of university students. In these studies, the emotional intelligence scores of individual team members were aggregated and averaged across teams to compute an average team emotional intelligence score. Team averaged emotional intelligence scores have been associated with various team performance outcomes in student groups (Jordan, Ashkanasy, Härtel and Hooper 2002; Wolff, Pescosolido and Druskat 2002). Jordan and his colleagues (2002), for example, found the average level of overall emotional intelligence in self-directed teams of undergraduate students at an Australian university to be related to team process effectiveness

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and team goal focus; two measures of team performance. Additionally, the empathy dimension of EI was found to predict the emergence of informal leaders in a sample of MBA students who worked in intact, self-managed teams (Wolff et al. 2002). These researchers contend that empathy is the individual difference that is the basis for the cognitive processes that enable individuals to accurately assess and understand members' emotions and emerge as an informal team leader.

Given the fact that conflict (functional and dysfunctional) typically arises in work teams, Jordan and Troth (2004) conducted an investigation of the influence of emotional intelligence on team performance during a problem-solving task with a focus on identifying the conflict resolution styles adopted by teams. Data were collected from a sample of 350 undergraduate university students who worked in teams of four to five members. It was hypothesized that teams with higher levels of emotional intelligence would: a) perform better on the problem-solving task than teams with lower average emotional intelligence; b) adopt collaborative (integrating) conflict resolution styles and c) experience less relationship conflict and more task conflict than teams with lower average levels of emotional intelligence. On the other hand, teams with lower average levels of emotional intelligence were expected to a) adopt avoidance or dominance conflict resolution styles; b) experience higher levels of relationship conflict; and c) experience lower levels of task conflict than their counterparts with higher average level emotional intelligence. As expected, teams with higher average levels of emotional intelligence performed better on the problem-solving tasks and adopted integration (collaboration) as their preferred style of conflict resolution. The authors concluded that, "teams composed of individuals high in emotional intelligence, particularly the ability to deal with one's own emotions, may be more inclined to listen to alternative viewpoints and seek superior solutions without feeling threatened by the possibility of being wrong." (Jordan and Troth 2004: 211) These findings suggest, it is reasonable to expect the emotional intelligence of individual team members to enhance or hinder the development of effective team interpersonal processes; a critical component of team performance (Baker and Salas 1992; Brannick, Salas, and Prince 1997).

> "...emotional intelligence of individual team members...enhance or hinder the development of effective team interpersonal processes."

While these studies report evidence of a relationship between the average emotional intelligence of teams and team interpersonal process effectiveness, they are somewhat narrow in scope in terms of the samples (college students collaborating on assigned class projects) and measures used. A recent meta-analysis conducted by Van Rooy and Viswesveran (2004) found that emotional intelligence measures have predictive validities of .24 in employment settings and .10 in academic settings. This evidence suggests that although emotional intelligence measures are valid predictors in both employment and academic settings, they are less predictive in academic situations. In addition, the research conducted to date in academic samples (Jordan and Troth 2004; Jordan et al. 2002; Wolff et al. 2002) used emotional intelligence measures developed on an ability (competency) based model of emotional intelligence, one that narrowly conceptualizes and measures emotional intelligence as one's ability to perceive, assimilate, understand, and manage emotions (Salovey and Mayer 1990; Mayer, Caruso and Salovey 1999). Some scholars criticize the competency-based Salovey & Mayer model of emotional intelligence by stating that such models fail to adequately consider the broad range of non-cognitive aptitudes and abilities that influence interpersonal interactions between individuals (Goleman 1995; Bar-On 1997). Alternative models of emotional intelligence are based on a broader conceptualization of the construct. For example, the Goleman model (Goleman 1995; Goleman, Boyatzis and McKee 2002) conceptualizes emotional intelligence as encompassing four non-cognitive components of interpersonal competence: self-awareness, self-management, social awareness, and relationship management. Similarly, the Bar-On model theorizes that emotional intelligence is comprised of five non-cognitive dimensions, abilities, and skills labeled interpersonal EI, intrapersonal EI, stress management EI, adaptability EI, and general mood EI (Bar-On 1997; 2000).

In light of the proliferation of self-directed work teams, the relationship between team emotional intelligence and team interpersonal process effectiveness merits empirical examination in employment settings. We contend that investigating the relationship between emotional intelligence and team process in an organizational setting using a more broad-based measure of emotional intelligence—one specifically designed to capture the cooperativeness and general mood of team members as they engage in interpersonal interactions and work together in self-directed teams—will provide insights into interpersonal factors that con-

tribute to effective team functioning. The BarOn EQ-i® is such an instrument; it is particularly well-suited to measuring the interpersonal aspects of emotional intelligence in work settings (Van Rooy and Viswesvaran 2004).

Since Bar-On (1997) conceptualizes emotional intelligence as a multidimensional array of non-cognitive capabilities, competencies, and skills, he designed the EQ-i® instrument to be a *process-oriented* measure to capture respondents' *potential* for emotionally intelligent behaviors. The BarOn EQ-i® reports six scores for each respondent; an overall EQ-i® score as well as five composite scale scores labeled intrapersonal EI, interpersonal EI, adaptability EI, stress management EI, and general mood EI which are formed from fifteen subscales (see Figure 1). The Intrapersonal composite is comprised of five subscales that focus on emotional self-awareness, assertiveness, independence, and self-actualization. Respondents' "people skills" are assessed in the Interpersonal composite with three subscales designed to measure empathy, interpersonal relationships (e.g., cooperativeness and capacity to forge and maintain interpersonal relationships), and social responsibility (e.g., the propensity to contribute to their social or work group/team). The three Adaptability composite subscales measure respondents' capacity for reality testing (seeing things as they actually are rather than as one wishes them to be), flexibility in adjusting feelings, thoughts and actions to match conditions as they change, and aptitude for creative problem solving. Stress tolerance and impulse control are assessed and reported in the two subscales reported in the Stress Management composite score. Finally, two subscales that measure optimism and happiness makeup the General Mood composite; these subscales measure respondents' capacity for optimism and happiness (satisfaction with oneself, life in general and others).

Figure 1
BarOn Emotional Quotient Inventory (EQ-i®) Composite Scales and Subscales

Overall EQ-i® Score
Intrapersonal Composite Sub-scale
Emotional Self-awareness
Assertiveness
Self-regard
Self-actualization
Independence
Interpersonal Composite Sub-scale
Interpersonal Relationship
Social Responsibility
Empathy
Adaptability Composite Sub-scale
Problem Solving
Reality Testing
Flexibility
Stress Management Composite Sub-scale
Stress Tolerance
Impulse Control
General Mood Composite Sub-scale
Happiness
Optimism

We cannot, of course, conduct a complete review of the emotional intelligence literature in this article. For more expansive reviews of the various emotional intelligence models, we recommend that readers refer to Ciarrochi, Chan and Caputi (2000), Dulewicz and Higgs (2000), Bar-On (1997), Goleman (1995), Mayer, Caruso and Salovey (1999), and Van Rooy and Viswesveran (2004). It should be noted that several of these authors suggest that the different conceptualizations of emotional intelligence are complementary rather than contradictory.

The present study examines the collective emotional intelligence of teams with respect to team interpersonal process, a widely accepted indicator of team performance (Brannick and Prince 1997). More specifically, we examine the relationship between team averaged emotional intelligence and two dimensions of team interpersonal process: team task orientation (focus on performance of the task itself) and team maintenance functions (focus on maintaining amiable group relations), in a sample of work teams. Brannick and Prince (1997) highlight the importance of process measures of teamwork by noting "...team process measures may give us a truer picture of team function than do outcome measures...the interpersonal part of [team] process can be thought of as providing the grease that keeps the parts of the team working together smoothly" (Brannick and Prince 1997:10). Our research focuses on the two dimensions of emotional intelligence, interpersonal EI and general mood EI, which capture the interpersonal dynamics and interactions that occur among team members. In this study, specific attention is focused on the quality of team interpersonal processes as the work team sets shared goals, allocates tasks, and works cooperatively toward achieving team goals. The present investigation is driven by two questions: Does the aggregated emotional intelligence of teams represented by team averaged emotional intelligence predict team task orientation and team maintenance functions? Are specific composite scales of emotional intelligence better predictors of team task orientation and team maintenance functions than others? We expect total (overall) team averaged emotional intelligence to be positively and significantly associated with team task orientation and team maintenance functions. Furthermore, we expect team averaged interpersonal EI and team averaged general mood EI to have stronger relationships with team task orientation and team maintenance functions than overall team averaged EI since the focus of items included in these two EI composite scales were specifically designed to measure various aspects of interpersonal interactions between team members.

Method

Participants

We surveyed a distributor of promotional products headquartered in a large Midwestern city with multiple locations and a nationwide sales force. Employees were organized into self-managed work teams, each responsible for a particular job function. For instance, the customer service team took phone orders, the inventory team ensured there was stock, the finance team secured payment, and the warehouse team made sure the order was ultimately delivered to the customer. There were also outside sales teams who secured the order with the help of their merchandising team as well as the technical and marketing teams. These teams fit Hackman's (1990) definition of an organizational team, that is, teams included in the study were identifiable work teams that had one or more tasks to perform, and they operate in an organizational context.

While this promotional products organization had over 1000 employees, surveys were e-mailed to the approximately 400 employees who had access to their own company e-mail account. They were asked to voluntarily participate in a study for three local university professors. As an incentive to participate in the study, respondents were assured confidentiality and offered a chance of winning one of three restaurant gift certificates to be drawn in a lottery. Of those e-mailed, 135 completed the two-part survey for a 34 percent return rate. Due to missing data, five surveys were excluded from the analysis, thus reducing the sample to 130.

Data were analyzed from 130 survey respondents comprising thirty-three functional work teams. Teams ranged in size from two to thirteen members with an average size of four. Only teams with at least half of the members responding where included in the analysis. Of the employees who participated in this study, 103 were women (79%) and 27 (21%) were male. The sample was predominately Caucasian American (98%). The mean age of respondents was 36, (age range 23 - 55 years; SD = 9.40) and the average work experience was 17 years. Participants completed online team interpersonal process effectiveness and emotional intelligence questionnaires. Respondents first completed the team interpersonal process effectiveness measures; they were asked to complete the survey with their current work team in mind (e.g. Finance, Human Resources, Marketing, etc.). Upon completion of those surveys, respondents were linked to the 133-item self report, web-based version of the EQ- i®

Table 1
Means, Standard Deviations, Cronbach Alphas, and Zero Order Correlations among Study Variables

Variable	*Mean*	*SD*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*
1. Overall EI	96.29	9.82	1							
2. Intrapersonal EI	95.05	11.77	.96**	1						
3. Interpersonal EI	98.06	8.43	.55**	.40*	1					
4. Stress Management	100.35	8.38	.75**	.66**	.19	1				
5. Adaptability EI	96.97	9.09	.91**	.90**	.35*	.67**	1			
6. General Mood EI	96.11	8.16	.79**	.68**	.63**	.49**	.59**	1		
7. Team Task Orientation	5.32	.82	.33	.27	.37*	.28	.19	.40*	1	
8. Team Maintenance Function	5.06	.78	.13	.08	.31**	.16	.01	.13	.72**	1
9. Team Size	3.94	2.45	.12	.10	.18	-.09	.05	.24	.03	.06
10. Cronbach Alpha for each scale			.96	.93	.85	.84	.86	.90	.91	.93

N = 33 Teams; *one-tailed test, p< .05; ** p<.01)

questionnaire. It took approximately 40 minutes for subjects to complete the team interpersonal process effectiveness and emotional intelligence questionnaires. They were later provided individualized confidential feedback about their emotional intelligence scores.

Table 2
Factor Loadings for Team Task Orientation-Team Maintenance Functions Scale

Item #	*Factor 1 (Team Task Orientation)*	*Factor 2 (Team Maintenance Function)*
The team set goals effectively	.866	.239
The team continuously improved	.796	.346
The team was efficient at problem solving	.813	.414
The team set high quality standards	.856	.236
The team resolved conflict among members	.312	.811
Each member contributed significantly to the team	.200	.808
Team members were friendly and cooperative	.230	.878
Team members helped each other beyond what was required	.386	.787

Measures

Emotional intelligence

The 133 item online version of the BarOn Emotional Quotient Inventory EQ- i®, a self-report measure, was used to assess subjects' overall emotional intelligence. As noted previously, the EQ-i® measure is composed of fifteen subscales that are organized to report a Total EI score as well as a score on each of five composite scales: Intrapersonal EI, Interpersonal EI, Stress Management EI, Adaptability EI, and General Mood EI (see Figure 1). Each item on the EQ-i® is presented as a declarative statement phrased in the first-person singular. Subjects responded to each statement by choosing one response on a 5-point Likert scale; 1 = not true of me and 5=true of me. Raw scores were transformed into standard scores with a mean of 100 and a standard deviation of 15.

The EQ- i® was scored by Multi-Health Systems, the firm that publishes the questionnaire. The company provided the total EQ-i® score and five composite scale scores (Intrapersonal EI, Interpersonal EI, Adaptability EI, Stress Management EI, and General Mood EI) for each subject. The Cronbach alpha reliability for each composite scale is reported in Table 1. The reliability of the EQ- i® measure in the present study, .86, is comparable to the reliability values reported in the EQ- i® Technical Manual and the literature. Respondents reported their names and the work team in which they worked. This information was used to configure respondents' EI, team task orientation, and team maintenance function scores into appropriate work teams. The data from each team member were aggregated across the team and used to compute a team average EI score for total emotional intelligence as well as team average scores on each of the five EQ-i® composite scales; thus six scores, team averaged Total EQ- i®, team averaged Intrapersonal EI, team averaged Interpersonal EI, team averaged Adaptability EI, team averaged Stress Management EI, and team averaged General Mood EI, were computed for each of the thirty-three teams included in this study.

As noted, we were particularly interested in the 24-item interpersonal EI and 17-item general mood EI composite scale scores as they were designed to measure individuals' "people skills." Empathy, cooperativeness and the ability to forge and maintain interpersonal relationships are measured by items in the interpersonal EI composite while items that assess the ability to have a pleasant disposition, positive attitude, and remain optimistic are measured in the general mood EI composite. The reliabilities of the overall EQ- i® measures are reported in Table 1.

Team Interpersonal Process

Team Task Orientation and Team Maintenance Function, both aspects of team interpersonal process, were assessed with an 8-item instrument based on a measure developed by Watson, Ponthiue & Critelli (1995). A factor analysis was conducted to identify potential sub-scales. Two subscales were uncovered; one set of items that assess the extent to which team members focus on team tasks and another set that measures the extent to which team members cooperate with each other. The results of the factor analysis are reported in Table 2. We labeled Factor 1 "Team Task Orientation" (α = .91). Items such as "sets goals effectively," "continually improves," "efficient problem solving," and "sets high quality standards," are descriptive of behaviors that focus the attention of the team on its tasks. Four items that reflect the extent to which team members assist each other as they work together comprise Factor 2, which we labeled "Team Maintenance

Table 3
Results of Hierarchical Linear Regression Analysis on Team Task Orientation

	R	R^2	R^2 *Change*	*F*
Predictor				
Model 1: Team Avg. Interpersonal EI	.37	.14*	.14	F(1,31)=4.91
Model 2: Team Avg. General Mood EI	.40	.16*	.04	F(2,30)=3.32
Predictors entered as a set				
Model 3 Team Avg. Interpersonal EI and Team Avg. General Mood EI	.43	.18		

Note: N = 33 teams
* p< .05

Functions" (α= .93). Items include: "team resolved conflict among members," "members were friendly and cooperative..." and "members helped members beyond what was required."

Results

Our analyses were divided into two parts. First, we conducted correlational analysis on the data collected with the EQ- i® and team process measures to identify the significant correlations between team averaged EI scores and Team Task Orientation and Team Maintenance functions. Table 1 reports the means, standard deviations, Cronbach alphas and zero-order correlations for all measures included in this study. Second, we conducted hierarchical linear regression analyses to examine the relationship between multiple dimensions of team averaged EI and two central components of team process: Team Task Orientation and Team Maintenance Function. Analysis of the data revealed a positive although nonsignificant correlation between total (overall) team averaged EI and Team Task Orientation and Team Maintenance Function, however, the two EI composites, team averaged interpersonal EI and team averaged general mood EI, were positively and significantly correlated with Team Task Orientation and Team Maintenance Function. Based on these findings, the two EI composites were investigated further and included in the hierarchical linear regression analyses conducted (see Table 3). Team averaged interpersonal EI explained variance in both Team Task Orientation (r = .37) and Team Maintenance Function (r = .31). Hierarchical linear regression analyses reported in Table 3 shows that in step 1, the team averaged interpersonal EI composite predicted 14 percent of the variance in Team Task Orientation. In step 2, the addition of team average general mood EI contributed slightly (2%), but significantly to predicting Team Task Orientation beyond the variance accounted for by Team Average EI. Thus, taken together, the team averaged interpersonal EI and general mood composite scales predicted 16 percent of the variance in Team Task Orientation in the present study.

Table 4 shows the results of the hierarchical linear regression on Team Maintenance Function. In step 1, team averaged interpersonal EI was predictive of Team Maintenance Function; team average interpersonal EI accounted for 10 percent of the variance in Team Maintenance Function. In contrast to our expectations, when the team averaged General Mood EI composite scale was added in step 2, it did not contribute significantly to the prediction of Team Maintenance Function.

Discussion

The current exploratory study examined the relationship between specific dimensions of team averaged emotional intelligence and two dimensions of team interpersonal process. The basic premise of the present study was that the interpersonal and general mood dimensions of EI were particularly relevant in predicting Team Task Orientation and Team Maintenance Function, two components of team interpersonal process that affect team performance. Empirical findings presented in this study provide evidence that two EI composite scales, interpersonal EI and general mood EI, were both significant predictors of the Team Task Orientation and that team averaged interpersonal EI was also a

Table 4
Results of Hierarchical Linear Regression Analysis on Team Maintenance Function

Predictor	*R*	R^2	R^2 *Change*	*F*
Step 1: Team Avg. Interpersonal EI	.31	.10*	.10	F(1,31)=5.29
Step 2: Team Avg. General Mood EI	.32	.10	.01	F(2,30)=1.73
Predictors entered as a set				
Team Avg. Interpersonal EI and Team Avg. General Mood EI	.32	.10		

Note: N = 33 teams
* p< .05

valid predictor of the Team Maintenance Function dimension of team interpersonal process.

The findings of this study provide evidence that emotional intelligence assessed with a multidimensional process-oriented measure demonstrates positive and significant relationships to team process. The results presented here suggest that team averaged interpersonal EI is useful in predicting the Team Task Function component of team process. More specifically, the data suggests that teams comprised of members who on average are dependable, responsible, have good social skills (behaviors consistent with high interpersonal EI) and who have a positive outlook on life (an attitude that reflects high general mood EI) may engage in more effective team interpersonal processes in terms of Team Task Orientation than teams with lower team averaged interpersonal and general mood EI scores. Previous research on team process identifies the quality of interpersonal interactions between team members as a critical precursor to team functioning and team performance (Baker and Salas 1992; Brannick, Salas and Prince 1997). This study contributes to the understanding of team interpersonal process effectiveness by providing evidence that two specific dimensions of emotional intelligence, team averaged interpersonal EI and team averaged general mood EI, are relatively useful tools in predicting Team Task Orientation and Team Maintenance Functions. These findings are also consistent with the Van Rooy and Viswesveran (2004) meta-analysis that reports differential predictive validity for the five dimensions of emotional intelligence measured with the BarOn EQ-i® (1997, 2000). The fact that the present research was conducted in the context of an actual organization with intact organizational teams extends previous research using college students assigned to work together in teams on short-term class projects. As noted previously, emotional intelligence measures have been found to have higher predictive validities of performance in employment settings (.24) as compared to performance in academic settings (.10) (Van Rooy and Viswesveran 2004).

One potential limitation of the study is that all of the measures were collected via self-report. Hence, the correlations may be at least partly due to common method bias rather than a significant relationship between the factors. Bar-On (1997; 2000), however, includes correction factors to reduce self report bias in the emotional intelligence scores reported to researchers. An additional limitation on the generalizability of the findings is that the sample was mostly middle aged caucasian, American females. Future research should attempt to replicate these findings in a more diverse sample. Our belief is that diversity in terms of gender, age, and race within teams will make emotional intelligence even more critically necessary for team performance. Moreover, while it is accepted practice to use team process as a surrogate for team outcomes in research (Prince et al. 1997), objective measures of team performance should be assessed by future research to further elucidate the relationship between team averaged EI scores, team interpersonal processes, and team performance. MAJB

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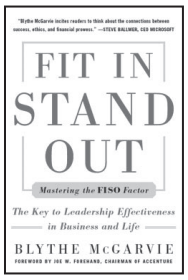
Fit In, Stand Out: Mastering the FISO Factor for Success in Business and Life

By: *Blythe McGarvie*
Reviewer: *JoAnn K. Linrud, Central Michigan University*



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McGarvie opens with this ad for readers of the book. While the book offers advice for business professionals and aspirants from someone who has "walked the talk," it could be equally helpful for business educators. McGarvie offers credible, concrete help to those of us advising and directing college students with minds directed toward management.

Blythe McGarvie's credentials are unimpeachable. She is a CPA with an MBA from the Kellogg School of Management; has served as CFO for Kraft Foods, Sara Lee Corporation, and BIC Group, Paris; was EVP and CFO for Hannaford Bros. Co., a *Fortune* 500 food retailer; and has served on the boards of directors of Accenture Ltd., Pepsi Bottling Group, St. Paul Travelers, Lafarge North America, and Wawa Inc. As well, she was appointed Senior Fellow at the Kellogg Innovation Network at Northwestern. In 1994, when she achieved her first CFO role in a *Fortune* 500 firm, she was one of only ten women to hold such a position. She has excelled at fitting in and standing out.

The book's premise appears to be a contradiction: How can one both fit in and stand out? McGarvie maintains that the two imperatives must not only coexist but are essential for successful leadership. In two chapters, she establishes the book's foundation for corporate leadership and career success.

The precepts that inform success as a leader ("*Leadership success is synonymous with organizational success*," and "*Corporate success, and thus leadership success, is measured financially.*") are driven by two forces: integration and transformation. Integration is "the force behind standardization, stability, and economy.... [It] enables all of the disparate elements of a company to fit together, work efficiently, and maximize profit." Transformation is "the force behind differentiation and change.... [It] enables a company to set itself apart from its competitors and create new growth engines." Successful companies are dependent on the systemic, dynamic interplay of the two forces.

Corporate success, however, is also a function of the effectiveness of the personal platform of its leader. "A leadership platform is anchored through the integrative process and its visibility is established through the transformation process. To put this in terms of your career path,..." McGarvie writes, "*[f]itting-in* is the process of integrating oneself into the culture and structure of the company.... *Standing-out* is the process of developing the visibility one needs to advance within the system."

The remaining chapters present each of the FISO Factor catalysts, the six essential building blocks, the tools leaders can use to move their organizations, and their outcomes:

- Financial acuity yields confidence,
- Integrity yields trust,
- Linkages yield access,
- Learning yields innovation,
- Perspective yields balanced judgment, and
- Global citizenship yields agility.

Discussion of each catalyst culminates in practical suggestions for fitting in and standing out through attitude, behavior, and characteristics. Finally, McGarvie offers advice on career choice selection with respect to corporate culture and career stage, and provides three questions for evaluating options: "Can I contribute to the success of the company?", "Will I learn something from this?", and "Is the company ready to do what needs to be done?"

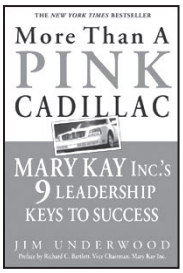
This relatively small tome (184 text pages) compacts years of high-

level experience into a primer for careful thinking about career planning. It engages theory and elucidates relevant practice. While the examples cited are those of very high-profile individuals in major corporations, the lessons could be applicable to career-planning circumstances at any level, college student to experienced professional. Can one have too much financial fluency? integrity? For most leaders, the point at which having more, rather than fewer, linkages, social capital, or return on relationships (ROR) creates decreased efficiency is far in the distance.Who can't grow in perspective by learning from others' thoughts and experiences, those both similar and diverse?

So is this book just another leadership manual? Engaged leaders face dichotomies, paradoxes, contradictions every day. McGarvie has put into context several important dichotomies: fitting in and standing out, integration and transformation, corporate leadership and career accomplishment. As well, she's drawn a framework for bringing them into alignment—a substantial strength of the work. If the book has a failing, it is that it merely scratches the surface of her insight into some important concepts; the corporate culture future-values matrix is one. But that is, perhaps, another book. MAJB

More Than a Pink Cadillac:
Mary Kay Inc.'s 9 Leadership Keys to Success

By: *Jim Underwood*
Reviewer: *Lisa R. Lopiccolo Gallagher, Western Michigan University*



"*This is about much more than selling lipstick. We are changing lives.*"
—Mary Kay Ash, founder of Mary Kay Incorporated (Underwood, 55)

Jim Underwood's best seller, *More Than a Pink Cadillac,* is a reflection on the success of Mary Kay Incorporated. This book enthusiastically promotes and shares the Mary Kay experience with readers. It also describes the leadership style of company founder Mary Kay Ash. The primary intent of this work is to detail the nine leadership principles used at Mary Kay Inc. The author contends that these principles can be applied in any business setting and, if followed, will ultimately lead to successful leadership. Overall, this book emphasizes that great leadership is a function of how people are treated.

Variations in phrasing aside, support for Mary Kay's Nine Keys to Leadership Success can be found in other texts. The third and fourth keys, for instance, encompass the concepts of motivation, appreciation and recognition. The views of Alex Hiam, author of *Making Horses Drink,* support these two keys. Hiam's book is similarly structured, providing leaders and managers with tips and techniques for success. Titled *Encouragement*, his essential tip creatively reads, "Encourage your horse to believe it is a winner. It won't run its hardest until it does" (Hiam 2002, 181). He discusses the importance of appreciating employees by recognizing and rewarding their efforts. He also advocates the need to find something nice to say about everyone. Hiam's entire segment on this topic directly coincides with the third and fourth keys Underwood identifies as essential for leadership success.

The inclusion of motivation as a leadership key is appropriate because high performance is likely to result if employees are motivated. Three primary factors affecting motivation are expectancy, instrumentality and valence. Employees must believe if they exert effort, they will be able to perform at a high level (expectancy). If employees believe they are likely to be rewarded for their efforts, they will have high instrumentality. It is also necessary for employees to view potential rewards as having great value, or valence. These three factors are components of the Expectancy Theory (Vroom 1964), and directly correspond to the level of effort, type of performance and overall outcomes leaders can expect from employees. While not described in *More Than a Pink Cadillac*, an understanding of this process theory provides further backing as to why successful leaders must be conscious of the fourth key.

Making Horses Drink also provides support for Mary Kay's sixth key: Innovate or Evaporate. Underwood advocates that the best innovation occurs when it is done across all levels. Of course, he points to Mary Kay as effectively demonstrating this concept (Underwood, 119-121). Hiam's book emphasizes the need for leaders and employees to explore together—which is exactly what Mary Kay proposes with the sixth key.

This book includes several letters and inspirational stories from Mary Kay employees. Underwood's credibility is enhanced not only by these inspirational stories, but also by the contributions of Mary Kay Inc.'s Vice Chairman, Dick Bartlett, and Chief Operating Officer David Holl. Their reflections on a variety of topics appear throughout the text (Underwood, 194). All of these lend support to the concepts that Underwood presents throughout this book and show why the "Mary Kay way" has earned such great success (41).

While many sources lend support to the Mary Kay leadership philosophy, discrepancy exists surrounding one of the company's core values and leadership practices: the Golden Rule. Mary Kay Ash believed if she treated others as she would want to be treated, the organization would flourish. She felt the Golden Rule should be applied to every business decision. Even today, Mary Kay Inc. continues to use Golden Rule management (Underwood, 14). While doing business based on the Golden

Rule seems to have paid off for Mary Kay, authors Marcus Buckingham and Curt Coffman disagree. In their popular leadership book, *First, Break All the Rules*, Buckingham and Coffman (1999) state that great managers actually *break* the Golden Rule. They insist this rule is "well intended but overly simplistic" (151-152). This is certainly an opposing view of the Golden Rule, though one that is neither explored—nor defended—in *More Than a Pink Cadillac.*

Beyond the nine keys and Golden Rule management, additional concepts of great importance appear in this book, such as the value of leading by example. Underwood emphasizes how Mary Kay never asked of her employees that which she couldn't (or wouldn't) do herself (Underwood, 144-145). Though not defined as one of the nine keys, leading by example adds great value to a reader's comprehension of what is necessary to be an extraordinary leader. Underwood's effort to explore issues beyond the nine keys is noteworthy as it extends the usefulness of *More Than a Pink Cadillac* as a reference guide for leaders.

Another strength of this book is honesty. The author openly admits he is positively biased toward Mary Kay Inc. (Underwood, 7). It is not surprising to find the overwhelming majority of *More Than a Pink Cadillac* to be positive and inspirational. Underwood does, however, expose some of Mary Kay's mistakes and stumbling blocks. Readers further benefit from learning strategies the company used to solve their problems. In light of his bias, Underwood's choice to include the organization's struggles should be applauded, as they are a necessary reminder of the challenges leaders face.

Mary Kay operates in 33 countries worldwide (Underwood, 1). Differing customs, work ethic, principles, and management style are just a few aspects of international diversity corporations are likely to encounter in foreign markets. While *More Than a Pink Cadillac* includes a substantial amount of information, it fails to point out any challenges the company encountered in their overseas expansion. In fact, Mary Kay has faced challenges overseas. The Chinese government, for example, implemented an embargo that banned direct selling for five months in 1998 (Booe 2005, 24). In short, commentary on Mary Kay's struggles as a multinational corporation is one improvement I would suggest in a revised or expanded edition of this book.

Unfortunately, *More Than a Pink Cadillac* falls short in its description of what seems to be a rather essential concept. Underwood devotes no more than one half of a page toward the end of his book to "Theory MK Leadership." He points out that most theories fail because they talk a lot *about* leadership, but not about *how* to lead. He then advocates that the business world adopt Theory MK Leadership. Underwood's elaboration on this theory spans no more than a few sentences, contradicting his prior view of other theories as lacking in their explanations. Perhaps he is referring to the 100 plus pages prior to this point as being the "how" of Theory MK. Still, Theory MK Leadership deserves further attention and expansion at this point in the book (Underwood, 185).

In *More Than a Pink Cadillac*, Underwood skillfully uses the Mary Kay organization to illustrate factors of critical importance and teach valuable lessons on leadership. Despite a few omissions, I would recommend this book to others. Its solid format includes visual aids, charts, and bulleted lists, as well as inspiring stories that keep readers' attention and enhance their understanding. I am in agreement with the nine keys to successful leadership identified in this book, but I contend that there are more than just these nine. Valuing diversity, for example, is imperative for leaders today. While it is mentioned in this book, it is not identified as a key to successful leadership. On the whole, *More Than a Pink Cadillac* is a readable reference guide that provides realistic perspective and solid approaches. Leaders looking to sharpen their skills, reach their potential and enhance their contributions will find this book is well worth the read. MAJB

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