

Top Price Doesn't Mean Top Value

Whether it's drafting an NFL player, ordering a bottle of wine, or hiring a new CEO to head your company, paying top dollar won't ensure getting top value, according to **Richard Thaler**, Robert P. Gwinn Distinguished Service Professor of Behavioral Science and Economics. "In a lot of markets, the price for buying the 'very best' goes up very steeply with small increases in quality," he said.

Looking at the last 17 years of draft picks in the National Football League, Thaler and **B. Cade Massey, MBA '03, PhD '03**, assistant professor of management at Duke University's Fuqua School of Business, concluded the first rookie chosen is likely to be overvalued and overpaid. "Teams put too high a value on picking early," Thaler said. "For every high draft pick who turns out to be a star, like Peyton Manning, who was taken with the first pick, there is another player like Ryan Leaf, who was taken with the second pick the same year." Leaf, drafted in 1998 with an \$11.25 million bonus, played poorly for several teams until he retired in 2002.

The culprit? Overconfidence, Thaler said. Teams that kept track of former predictions "would be shocked by

what they found, namely that their ability to predict is not as accurate as they think," he said. According to the study, comparing players who play the same position and were taken consecutively in the draft would show that the earlier pick has about a 53 percent chance of being better, in terms of games started. "But at the top of the draft, the first player taken might get paid twice as much as the second one. If you are told that player A costs twice as much as player B and has a 53 percent chance of being better, I think it's clear which one to take," Thaler said. According to the study, the most valuable player is around the 43rd pick.

Applying the research to the corporate world, he asked, "Are superstar CEOs who make hundreds of millions of dollars a year worth it? Would a company be better off promoting someone inside the organization with only a modest raise and using the money saved to buy more 'blockers and tacklers?'"

Or, Thaler noted, consider fine wine. It's possible to find good wine for \$20 a bottle, very good wine for \$50, and really excellent wine for \$100. But some wine sells for \$2,000 a bottle, he said. "It's very unlikely that many consumers could discriminate between the \$100 wine and the \$2,000 wine, much less think the \$2,000 wine was 20 times better.

"Still," Thaler quipped, "if any readers want to prove me wrong by opening one of those bottles to share, please call!"

The research drew the attention of the media last spring and was featured in the *New York Times* and the *Economist*.—P.H. with A.R.

ON THE WEB To read the paper "The Loser's Curse: Overconfidence vs. Market Efficiency in the National Football League Draft" or to learn more about Thaler's research, visit gsbwww.uchicago.edu/news/gsbchicago/facultylinks.html.



Price Hike: Top NFL draft picks are likely to be overvalued and overpaid, according to research by behavioral economist **Richard Thaler**.

IN THE NEWS

Chicago GSB Faculty Weigh In on Cops, Stock Prices, and Nuclear Energy

Accounting Adds Value



The more a company improves the accounting experience of its audit committee, the higher the firm's stock price, according to research by **Roman Weil**, V. Duane Rath Professor of Accounting. With fellow researchers **Douglas Coates, '05**, and M. Laurentius Marais, he examined the biographies of board members in proxy statements of about 300 companies and developed a ranking system to measure expertise. Accountants, controllers, and other executives with clear accounting experience received a score of four, the *New York Times* reported last April. "This is just a guess, but the marketplace believes that if you have a four on your committee, then it's more likely you won't let a bad thing continue," Weil told the paper.—P.H.

ON THE WEB To read the paper "Audit Committee Financial Literacy: A Work in Progress" or to learn more about Weil's research, visit gsbwww.uchicago.edu/news/gsbchicago/facultylinks.html.

Complaining about Cops



Soliciting customer feedback may work well for many companies, but it can backfire in the public sector, according to a study by **Canice Prendergast**, W. Allen Wallis Professor of Economics. In 1998, the Los Angeles Police Department made it easier for people to file complaints about police officers and vowed to investigate every report, not just the norm of 50 to 70 percent. The number of complaints shot up, and more officers were disciplined or fired. However, Prendergast told the *Times* (London) last April, the crime rate went up, as well. "The logic of these officers seems to be that if they don't arrest people, they won't get into trouble. As a result, arrests [are] way down and the crime rate has gone way up."—P.H.

ON THE WEB To read the paper "The Limits of Bureaucratic Efficiency" or to learn more about Prendergast's research, visit gsbwww.uchicago.edu/news/gsbchicago/facultylinks.html. To read an article about the paper that appeared in *Capital Ideas*, visit gsbwww.uchicago.edu/news/capideas/feb05/inefficiency.html.

New Nukes Needed



It's time to build new nuclear power plants in the United States, according to Nobel laureate **Gary Becker, PhD '55** (economics), University Professor of Economics and of Sociology. In an opinion article that appeared in the *Wall Street Journal* last May, Becker said, "The time has come for us to follow the example set by some other countries, and remove the many unnecessary regulatory obstacles to building additional nuclear power plants." He said the chance of industrial accidents is low; waste can be recycled or disposed of in large, safe, underground units; and the risk of radiation leak due to terrorist attacks is minimal. "Nuclear plants would reduce U.S. dependence on imports of natural gas and oil," Becker added.—P.H.

ON THE WEB To learn more about Becker's research, visit gsbwww.uchicago.edu/news/gsbchicago/facultylinks.html.

AWARDS

Faculty Honored for Research and Service

Last spring, Chicago GSB honored four faculty members for their individual contributions to the school with awards endowed by alumni and friends.

John Huizinga, Walter David “Bud” Fackler Distinguished Service Professor of Economics, received the Arthur L. Kelly Faculty Prize for Exceptional Service. Huizinga oversaw construction of the Hyde Park Center, ensuring that the building met the school’s needs and was completed on time and on budget. Established in 1999 and awarded once every two years, the Kelly award is made possible by **Arthur Kelly, ’64 (XP-20)**, managing partner of KEL Enterprises and a trustee of the university.

Ann McGill, MBA ’85, PhD ’86, Sears Roebuck Professor of General Management, Marketing, and Behavioral Science, received the McKinsey Award for Excellence in Teaching. “Ann sets high standards for herself and her students in the classroom, and the rigorous classroom experience is greatly appreciated by students,” said dean **Edward Snyder**. The award, established in 1979 by McKinsey & Company, is given every other year to a faculty member who has been teaching for at least two years.

Monika Piazzesi, associate professor of finance, received the Chookaszian Endowed Risk Management Prize for her paper “Bond Yields and the Federal Reserve.” In the paper, Piazzesi improves on macroeconomists’ previous understanding of the Fed’s behavior with a model that predicts the target interest rate better than the standard Taylor rules and shows that the Fed reacts to interest rates as well as to macroeconomic news. Given every other year, the award was created in 2003 by **Dennis Chookaszian, ’68**, retired chairman and CEO of CNA Insurance Companies and a member of the Council on the Graduate School of Business.



John Huizinga

Ann McGill

Monika Piazzesi

Haresh Sapra

All images by Dan Dry

Haresh Sapra, associate professor of accounting, received the Ernest R. Wish Accounting Research Award for his paper “Do Mandatory Hedge Disclosures Discourage or Encourage Excessive Speculation?” In the paper, Sapra shows that mandatory marking-to-market of derivatives induces firms to speculate excessively in the derivative markets. However, without any mandatory disclosures, even though firms may choose prudent risk-management strategies, their production decisions will be distorted. The award is given every other year by tenured accounting faculty for the best paper written by an untenured accounting faculty member. It was established in 2001 by **Ernest Wish, ’71 (XP-29)**, and PricewaterhouseCoopers, where Wish was formerly a managing partner.—A.R.

ON THE WEB To learn more about these faculty members or to read the papers by Piazzesi and Sapra, visit gsbwww.uchicago.edu/news/gsbchicago/facultylinks.html.

HONORS

Fama Wins Deutsche Bank Prize



Dan Dry

Eugene Fama, MBA ’63, PhD ’64, Robert R. McCormick Distinguished Service Professor of Finance, has been awarded the inaugural Deutsche Bank Prize in Financial Economics, established by the Center for Financial Studies in cooperation with the Goethe University of Frankfurt/Main. The international academic award honors a researcher who has made significant contributions to

research in finance and macroeconomics and whose work has influenced practice and policy. The jury chose Fama for his contributions to financial economics, particularly for developing the concept of market efficiency. “Fama has developed a conceptual basis and the analytical techniques that are now standard for financial economists in the academic world, management, and policy making,” the announcement said. As part of the prize, Fama will receive a cash award of \$50,000 and become a distinguished fellow of the Center for Financial Studies.—A.R.

TEACHING

Students Honor Faculty for Teaching

Last spring, students honored faculty members for excellence in teaching, including past winners **Scott Meadow** and **Haresh Sapra**.

Meadow, clinical professor of entrepreneurship, earned the Phoenix Award for the fourth year in a row. With this award, students in the Full-Time MBA Program annually recognize a faculty member who has enriched student life not only in the classroom, but also through involvement in extracurricular and community activities.

Sapra, associate professor of accounting, earned the Emory Williams Teaching Award for the third consecutive year. The award is given annually by Full-Time MBA Program students to a faculty member who demonstrates excellence in the classroom.

The Faculty Excellence Awards went to **Jean-Pierre Dubé**, associate professor of marketing, and to **Canice Prendergast**, W. Allen Wallis Professor of Economics, both first-time winners. Students in the Evening

and Weekend MBA Programs give the awards annually to faculty who have demonstrated an exceptional commitment to teaching.—A.R.

ON THE WEB To learn more about Meadow’s award, visit chronicle.uchicago.edu/050609/pst-meadow.shtml. To learn more about Sapra’s award, visit chronicle.uchicago.edu/050609/pst-sapra.shtml.

AWARDS

Tiao and Team Win EPA Award

George Tiao, W. Allen Wallis Professor Emeritus of Econometrics and Statistics, along with fellow members of the Ozone Science Tiger Team, received the Environmental Protection Agency’s 2005 Stratospheric Ozone Protection Award. Formed in 1982, the Tiger Team is made up of statisticians and atmospheric scientists and studies human impact on the ozone layer. The award recognizes exceptional leadership, personal dedication, and technical achievements in eliminating ozone-depleting substances.—A.R.

JOURNALS

Diamond, Guiso Join New Banking Journal

Douglas Diamond, Merton H. Miller Distinguished Service Professor of Finance, and **Luigi Guiso**, visiting professor of economics, have been named associate editors for the newly established *International Journal of Central Banking*. The journal, which is a joint project of the Bank for International Settlements, the European Central Bank, and the Group of Ten (G-10) central banks, focuses on research articles relating to monetary and financial stability.

Led by managing editor Ben S. Bernanke, chairman of President Bush’s Council of Economic Advisers, the journal’s editors will select the best policy-relevant articles to promote communication among researchers inside and outside central banks. The premier issue was published in May 2005.—L.M.

ON THE WEB For more information or to read the journal online, visit www.ijcb.org.

BOOKSHELF

From Hyde Park to Outer Space: What Faculty Are Reading

GSB faculty read more than research in their areas of expertise. Here's what two professors had on their bookshelves recently.



Philip Berger
Professor of Accounting,
Neubauer Family Faculty
Fellow

The Mercury 13: The Untold Story of Thirteen American Women and the Dream of Space Flight, Martha Ackmann (Random House, 2003)

"Prior to seeing this book, I had never heard of the Mercury 13, a group of female pilots who tested to become astronauts during the beginning of the U.S. space program. They underwent the same demanding tests and training as the famous Mercury 7 astronauts like John Glenn, who flew the first orbital space flights. The book describes the women's efforts to pursue their aspirations of space flight and details some of the political and bureaucratic decisions that ultimately prevented that from happening. The reader gets to know each of the potential astronauts in some detail. This is an interesting untold story about the early days of the space race."

Autobiography: The Story of My Experiments with Truth, Mohandas Karamchand Gandhi (Dover, 1983)

"Gandhi's autobiography focuses on his beliefs, not on his life. Instead of a description of the conflict he led against the British Empire, the book provides a simply told story of Gandhi's personal evolution toward a philosophy that emphasizes extreme humility and nonviolence. He shares experiences

from his life and the lessons he learned from each. This is not a quick read, and not all of these reflections grabbed my interest, but the book is remarkable in providing a very clear window into Gandhi's thinking."



Waverly Deutsch
Clinical Assistant
Professor of
Entrepreneurship

The Devil in the White City, Erik Larson (Crown, 2003)

"This is a fascinating history of the Chicago World's Columbian Exposition of 1893 combined with the compelling, real-life mystery of a serial killer who took advantage of it. The inventions associated with that fair, the Ferris wheel among them, speak to my entrepreneurial side, while the tales of building the fairgrounds here in Hyde Park appeal to my developing civic pride in Chicago. GSBers will see the Midway, the Museum of Science and Industry, and the statue of Winged Victory on Hayes Drive in a whole new light."

Bringing Down the House: The Inside Story of Six MIT Students Who Took Vegas for Millions, Ben Mezrich (Free Press, 2002)

"Statistics does not have to be boring. Take it from the MIT crews that used deep understanding of the math involved in blackjack to win millions

in Las Vegas. This page-turner details their exploits, which include smuggling large quantities of cash onto airplanes, using strippers to cash in their chips, and getting severely beaten up for their rashness. You will not be able to put it down."

Committed: Confessions of a Fantasy Football Junkie, Mark St. Amant (Scribner, 2004)

"As an NFL and fantasy football nut myself, I had to buy this one in hard-cover. Imagine quitting your job and devoting a year of your life to winning your fantasy football league. Then imagine that your significant other doesn't leave you in the process. That's what St. Amant did, and what he reveals about this underside of America's favorite sport is entertaining, to say the least. Warning: not recommended for those who aren't completely football obsessed."—A.R.



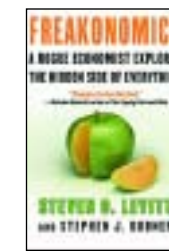
READINGS

Burt Publishes on Social Capital, Plus Levitt's *Freakonomics*



Brokerage and Closure: An Introduction to Social Capital (Oxford University Press, 2005)
Ronald Burt, Hobart W. Williams
Professor of Sociology and Strategy

Markets, organizations, and careers don't simply depend on formal reporting relationships. Informal relationships involving friendship, gossip, knowledge, or trust, for example, play a prominent role in business. In his new book, Ronald Burt shows how these relationships create advantage for some at the expense of others through brokerage and closure. Living at the intersection of social worlds, brokers see more and develop good ideas, while closers tighten their network and create trust and alignment. Burt explores how brokerage and closure define social capital, how reputation has replaced authority, and how reward has become associated with achieving competitive advantage in a social order of continuous disequilibrium.—A.R.



Freakonomics: A Rogue Economist Explores the Hidden Side of Everything (William Morrow, 2005)
Steven Levitt, Alvin H. Baum Professor of Economics and the College; Director, the University of Chicago Initiative on Chicago Price Theory

Steven Levitt isn't likely to tell you if the stock market will go up or if the economy will shrink. But ask him why drug dealers live with their moms, why crime rates *really* dropped in the last decade, or what makes a good parent, and he'll not only tell you the answer, but show you the data to back it up. In *Freakonomics*, Levitt and coauthor Stephen Dubner use Levitt's research to explore how people get what they want—especially when other people want the same thing. Written for a general audience, the book uncovers the economics in the everyday, from how schoolteachers cheat and real estate agents act like the Ku Klux Klan to how a child's name affects his or her chances for success. (Levitt argues that it's not the name, but rather the child's socioeconomic background, sometimes reflected in the name, that is the determinant.) The authors also contribute a monthly column of the same title to the *New York Times Magazine*.—A.R.

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