

# strategy+business

## Recent Research

by Des Dearlove and Stuart Crainer

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## Recent Research

On product piracy, CEO  
celebrity, me-too  
brands, and more.

by Des Dearlove and  
Stuart Crainer

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### Don't Kill the Pirate

Julio O. de Castro (Julio.Castro@ie.edu), David B. Balkin (David.Balkin@colorado.edu), and Dean A. Shepherd (shepherd@indiana.edu), "Can Entrepreneurial Firms Benefit from Product Piracy?" *Journal of Business Venturing*, available from the authors.

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Product piracy is a global phenomenon. Everything from fake Rolexes to unlicensed software is available for a fraction of the list price if you know where to look. In China and Russia, for instance, it is estimated that 90 percent of computer programs in use are pirated. And recently, U.S. officials complained that an entire automobile produced in China was stolen from a General Motors design.

As many corporate law firms can attest, piracy is expensive to combat. Global sales losses from unauthorized software distribution alone are placed conservatively at \$1.5 billion a year. Victims are pouring money into defending their wares. The Microsoft Corporation employs 250 people in its intellectual property protection department to police worldwide shipments of its

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products. And Cartier SA spends more than \$3 million a year defending its intellectual property rights.

Yet, despite the costs, three researchers contend that companies may be wise to limit their attempts to repel pirates. Julio O. de Castro, professor of entrepreneurship and strategy at the Spanish business school Instituto de Empresa; David B. Balkin, professor of management and chair of the management division at the University of Colorado's Leeds School of Business; and Dean A. Shepherd, associate professor of entrepreneurship at Indiana University's Kelley School of Business, argue that product piracy can actually be beneficial to the originator by boosting the value of intellectual property. This bump can happen in four ways.

The first involves "network effects," in which the value of a brand grows as more people use it. For example, over time many owners of pirated software acquire legal copies or convince others to do so. In 1995, U.K. researchers found that six out of seven spreadsheet and word processor users they studied chose pirated versions of the programs originally. But after becoming familiar with the programs, the

users either purchased the legitimate products or, through word of mouth, persuaded others to buy them, eventually generating 80 percent of the programs' unit sales. Thus, the more piracy increases network effects, the more it increases demand for legal versions of the product.

The second positive impact of piracy is from "signaling," in which consumers act on cues from others. For instance, a man shopping for an expensive handbag for his wife may be influenced to purchase a real Gucci merely because he has seen well-dressed women carrying these types of purses, even though they may have been counterfeit ones.

Third are "bandwagon effects," defined by the authors as "the desire to wear, buy, do, and consume like one's fellows." If a pirated video game is regarded as "cool" by leaders of a particular group of people, other members may, in turn, buy legal versions of the game.

Finally, there are "herding effects," in which individuals copy the choices and behavior of others simply because they don't want to be different. Unlike signaling and bandwagon effects, which are driven by the desire to be in the vanguard,

herding relates to an unwillingness to be left behind. Therefore, a successful new product that is pirated can quickly establish itself as the de facto standard. This phenomenon helps explain the existence, for example, of markets in Hong Kong where sellers of pirated copies coexist with stores selling legal copies of the same products, such as Gucci handbags or Rolex watches.

The authors conclude that before taking legal action, companies should consider the positive and negative ramifications of piracy on their products. Where a pirated product competes directly with the legal version, such as in more developed nations, some sales of the fake will be at the expense of the original. There could also be costs to the brand, in terms of image erosion, for example, if the imitation is of inferior quality. The negative effect could be more pronounced, too, in mature markets where a software product is already established as the sales leader. But where there is little or no overlap, as in markets where potential buyers cannot afford the original, or when a company is seeking to establish its new brand, then the originator might do better to ride the pirates' coattails.

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### Are Celebrity CEOs Worth It?

James B. Wade (jwade@rbsmail.rutgers.edu), Joseph F. Porac (jporac@stern.nyu.edu), Timothy G. Pollock (tpollock@psu.edu), and Scott D. Graffin (sgraffin@terry.uga.edu), “The Burden of Celebrity: The Impact of Certification Contests on CEO Pay and Performance,” *Academy of Management Journal*, vol. 49, no. 4 (2006): 643–60.  
[www.personal.psu.edu/faculty/t/x/txp14/pdfs/amj06.pdf](http://www.personal.psu.edu/faculty/t/x/txp14/pdfs/amj06.pdf)

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Jack Welch, Steve Jobs, Louis Gerstner, Bill Gates, Larry Ellison, Andrew Grove, and Carly Fiorina are just some of the CEOs (and former CEOs) on whom the media have conferred celebrity status. But does being identified as a “star” CEO have an impact on the organization, or on the individual? And if so, is it positive or negative?

These intriguing questions were the subject of extensive research by four academics: James B. Wade, professor of management and global business at Rutgers Business School; Joseph F. Porac, the George Daly Professor in Business Leadership at New York University’s Stern School of Business; Timothy

G. Pollock, associate professor in the management and organization department at Penn State University’s Smeal College of Business; and Scott D. Graffin, then a doctoral student at the University of Wisconsin–Madison School of Business (and currently an assistant professor in the department of management at the University of Georgia’s Terry College of Business).

The group collected data on 278 corporations in the S&P 500 to examine total CEO compensation and company stock market performance. They then probed whether companies led by CEOs who were the recipients of the *Financial World* CEO of the Year award between 1992 and 1997 fared better than those led by non-celebrity CEOs. The researchers compared company performance with average stock market returns as well as with market expectations.

The findings showed an initial gain for the organizations with the acclaimed CEOs. On the day after the announcement of the CEO contest winner, there was a slight rise — about 0.25 percent — in market return for these companies, against both the average for all companies and the expectations that existed for the companies with the celebrity CEOs.

But the CEO award also contributed to higher expectations for the companies. In the context of these elevated hopes, the results quickly turned negative. Within 30 days, actual return versus expected market return was marginally negative (negative 1.13 percent), and after eight months, significantly negative (negative 8.23 percent).

Meanwhile, honored CEOs benefit over the short and the long terms. “Winning a medal in the cur-

rent year increases a CEO’s pay by approximately 10 percent,” the authors note, “and each medal awarded in the previous five years adds almost 5 percent to his/her pay.”

The findings suggest that boards expect higher performance from their star CEOs and reward them accordingly. But this confidence is mostly wrongheaded. Paying over-the-odds compensation to attract star chief executives may be a losing strategy.

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### Stages of Citizenship

Bradley K. Googins (bradley.googins.1@bc.edu) and Philip H. Mirvis, “Stages of Corporate Citizenship: A Developmental Framework,” A Center for Corporate Citizenship at Boston College Monograph, May 17, 2006.  
<http://www.bcccc.net/>

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Implementing meaningful corporate citizenship initiatives is apparently no easy task. So says this monograph from Boston College’s Center for Corporate Citizenship, which argues that many organizations are confused by the social responsibility initiatives they are introducing. To provide a consistent framework for action, Bradley K. Googins and Philip H. Mirvis, executive director and research fellow at the center, respectively, offer five stages that companies should navigate to optimize the practice of corporate citizenship.

The center defines *corporate citizenship* as a company delivering on its core values in a way that minimizes harm, maximizes benefits, is accountable and responsive to key stakeholders, and supports strong financial results. The first step toward adopting this concept — the “elementary” stage — focuses on

# The emergence of the nanotechnology industry began with the futurists, who predicted goods manufactured atom by atom.

compliance, and is in line with Milton Friedman's observation that a company's obligation to society should be narrowly interpreted as "make a profit, pay taxes, and provide jobs." The authors say that in the early 1990s, Nike Inc. was at this stage — that is, satisfied with creating employment in low-cost nations — when it suddenly had to contend with complaints about its labor practices.

The second stage is termed "engaged." At this stage, budding leadership support helps the organization become more reactive to issues involving corporate values, and the company begins to improve its public relations. However, the organization lacks the infrastructure or capability to go much further. As an example of this, the authors cite Home Depot's decision to give preference to loggers who practice responsible harvesting.

At the next stage, "innovative," organizations embrace a more comprehensive concept of corporate citizenship by taking a "stewardship" role. The authors cite the example of the global health-care company Baxter International Inc., which faced a crisis in 2001 when six Spanish dialysis patients using equip-

ment that contained a Baxter filter died. The company immediately recalled the equipment and publicly apologized. The incident cost the company \$189 million. Baxter's CEO requested that his bonus be reduced to cover some of these costs.

Next comes an "integrated" stage, in which the emphasis within a company moves from coordination to collaboration. The authors use the petroleum company BP, which has a board-level ethics and environmental assurance committee, corporate directors of social policy and business ethics, oversight bodies at group level, corporation-wide and regional corporate values coordinators, and a variety of accountability measurements and audits, as an example. Additionally, the company's CEO, Lord John Browne, has repeatedly emphasized his personal commitment to corporate citizenship.

At the final stage, "transforming," the organization's leaders take on a visionary role and apply their corporate values as a means of creating new markets or achieving social change. The authors point to the examples of pharmaceutical companies donating drugs to African countries to treat river

blindness, leprosy, and diabetes, and Hewlett-Packard Company's investment in digital communities in Brazil, India, and South Africa.

Interestingly, the paper cites research showing that 92 percent of organizations are driven to embrace corporate citizenship only after their customers and end-customers demand it. The authors say that organizations should preempt these pressures by adopting corporate values as a strategic imperative. Those that do so will not only be doing the right thing, the paper claims, but also achieving greater financial success in the process.

## Nano Inc.

Stine Grodal (grodal@stanford.edu), "The Emergence of New Industries: Contestation and Negotiation Between Nanotechnology Communities," Danish Research Unit for Industrial Dynamics (DRUID), Summer 2006 conference. [www2.druid.dk/conferences/viewpaper.php?id=641&cf=8](http://www2.druid.dk/conferences/viewpaper.php?id=641&cf=8)

It is tempting to think that the industrial landscape is relatively unchanging. But it is actually in a never-ending state of flux, with new

industries constantly appearing and old ones falling away.

Rewind just 30 years, for example, and many of the products and industries that we take for granted today didn't exist in any meaningful way. (Consider computers, software, gas-fired electricity plants, and cell phones.) Yet, according to Stine Grodal, a Ph.D. student in the department of management science and engineering at Stanford University, management literature has largely ignored the process by which new industries emerge.

The conventional approach to analyzing the creation of a new industry uses the industry itself as the starting point. Yet this approach fails to consider precursors to the industry that helped lead to its development. In particular, the traditional approach overlooks three important points:

- Government officials, service providers, scientists, consumers, and other participants play an important role in the early development of an industry. For example, previous studies examining the development of the automobile industry focus on the manufacturers but largely ignore the impact of engineers who developed the combustion engine and the hobbyists who experimented with early prototypes.

- Industries are not isolated from other technologies. Witness the overlap between the telecommunications and television cable industries as they now compete to provide broadband Internet access.

- Interested parties such as scientists and journalists create rhetoric that defines a new industry. In the early days of nuclear power, for instance, nuclear scientists and government officials promoted the technology as a solution to air pollution.

But protests against nuclear energy created a competing rhetoric that eventually curtailed the sector.

Grodal, applying these factors to the nanotechnology industry, says that the emergence of the sector began with the futurists. In 1986, Eric Drexler coined the term *nanotechnology* in his famous book *Engines of Creation: The Coming Era of Nanotechnology*, which described a future of molecule-sized machines that manufacture goods from the “bottom up,” atom by atom.

Drexler's vision included such innovations as microscopic robots that would float in our blood and remove plaque. The media embraced his ideas. But at the time, the author was still a doctoral student, and mainstream scientists viewed his concepts as little more than science fiction.

Government officials, though, viewed nanotechnology as a way to increase federal funding for science and engineering and an opportunity to demonstrate political vision. In 2000, President Bill Clinton alluded to the potential benefits of advanced nanotech research in his State of the Union address, claiming that it could “revolutionize the 21st century in the same way that the transistor did the 20th.”

Out of this grew the National Nanotechnology Initiative (NNI), which assigned well over \$1 billion to nanotechnology research between 2001 and 2004. Since then, Congress has passed the 21st Century Nanotechnology Research and Development Act, providing even more funding. NNI predicted that nanotechnology would be a \$1 trillion market by 2015. That prediction, in turn, has attracted consultants, lawyers, and venture capitalists to the new field.

Meanwhile, the initially skeptical mainstream scientific community was won over by the promise of federal funding, the researchers note. This led to a widening of the definition of nanotechnology as scientists and entrepreneurs began to slide their research in all fields of molecular computing and machine design, including microfluids and microelectronic mechanical systems, under the nanotechnology umbrella. The boundaries of nanotech are still fuzzy today, but without a doubt, the industry has officially been born.

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## Me 2 Brands

Marco Bertini (mbertini@london.edu), John T. Gourville (jgourville@hbs.edu), and Elie Ofek (eofek@hbs.edu), “Branding Successive Product Generations,” London Business School Center for Marketing Working Paper Series, Working Paper No. 06-501. <http://facultyresearch.london.edu/docs/06-501.pdf>

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These words are being written on a computer using Windows 2000. We also own a Palm III, wear Air Jordans (2005 edition), and propel balls down fairways using Callaway’s Great Big Bertha. For successful brands, the name of the follow-up product is often as simple as A, B, C, or one, two, three. *The Godfather* begets *Godfathers Part II* and *III* as assuredly as one series of Mercedes S-Class follows another.

But how do consumers regard such changes, and how do they perceive more radical renaming? These questions are posed by Marco Bertini, assistant professor of marketing at London Business School; John T. Gourville, professor of business administration at Harvard Busi-

ness School; and Elie Ofek, associate professor of business administration at Harvard Business School.

They observe that there is a continuum of product naming. At one end is the repeated use of an existing name — they cite the Cadillac Coupe deVille as an example — and at the other end is the introduction of entirely new names, such as Sega’s Master, Genesis, and Saturn game consoles. More commonly, though, companies simply add a new descriptor (such as Apple’s Mac OS X Cheetah, Puma, and Jaguar), a new number to match each edition (Windows), or a new degree (Callaway’s family of big and bigger Bertha golf clubs).

In their research, the authors asked 78 business school students to consider the hypothetical case of a series of color printers produced by a consumer electronics company. In one case the name of the product was changed after its fourth generation. In another, the naming remained consistent from the beginning; model 2300W was followed by 2400W, and so on. The authors found that when a name change was introduced, people assumed that the product was more substantially changed than when model numbers

were altered according to a pattern.

In a second experiment, students were asked to select a digital camera to take photographs at a friend’s wedding. They were presented with three options: They could purchase the same model as their own camera, replace it with the next-generation version, or select a camera with a completely new brand name. The students’ reactions to these choices offered an interesting bit of feedback about how people respond to products: Changing a brand’s name increases expectations that the product will have greater benefits along with a higher price. There is also an element of ambiguity. Faced with a name change, consumers are more likely to be unsure that the product offers what they want at a price they are comfortable with. In contrast, consistent naming is associated with lower benefits and lower costs; it produces feelings of continuity, compatibility, and incremental progress. Thus, any name change must take into account the confusing effect it is likely to have on potential consumers.

The message? Name changes, large or small, have an impact on branding. Handle with care. +

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