Strong Effects of Regression to the Mean Can Lead to Rank Reversals in Performance Associations: Empirical Evidence from Entertainment, Innovation, Auto Racing, and Business

Seminar Series 2018 - 19
Dr Chengwei Liu
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Performance metrics are all around us and being highly ranked brings many benefits. However, prior studies have demonstrated that performances are not necessarily a reliable indicator of underlying quality and future performances tend to regress to the mean. We formally demonstrate when top-ranked performances can regress disproportionately more to the mean than less extreme performances. This possibility of non-monotonicity and rank reversals between current and future performances is surveyed using data from four domains, with two datasets each and 6.2 million actor-performances in total. All datasets show strong regression effects. Four of them show significant rank reversals but the contexts determine where they occur. We discuss how performance non-monotonicity challenges existing theory and method in strategy and how the ignorance of rank reversals creates an alternative source of strategic opportunities.

Chengwei Liu (Ph.D., Cambridge) is Associate Professor of Strategy and Behavioural Science and Director of Executive MBA at Warwick Business School (London Shard). His research on luck and contrarian strategy is published in leading academic journals, including Academy of Management Review, PNAS, Organization Science, and he serves on the editorial boards of Organization Science and Strategy Science. Thinkers50 name Chengwei as a next-generation management guru and Poets&Quants name Chengwei a Top 40 under 40 MBA Professor.

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SEMINAR VENUE:
4.013, AMBS Building
Oxford Road, Manchester
M13 9PL

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