Discussion

Career Risk and Market Discipline in Asset Management

Andrew Ellul, Marco Pagano and Annalisa Scognamiglio

Discussion by: Cláudia Custódio (Imperial College, CEPR and ECGI)

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Imperial College
Business School

▸ Summary and main findings:

- The paper studies labor market incentives for asset managers
- It estimates the career impact of fund liquidations for fund managers
- The paper finds an average loss in compensation of $664,000
- This penalty is mostly associated with poor relative performance
- No compensation penalty when fund liquidations occur after *bad luck*
- Model: providing insights on how job market penalty affects effort choice and adverse selection

▸ Can labor markets act as incentive mechanism?

-The answer to the question, as much as quantifying by how much, is **very important** to design optimal incentive contracts

-The paper is mostly focused on career penalties type of discipline, but there are also incentives associated with the upside potential of career moves

▸ The asset management/finance industry

-Is asset management a good "lab"?

-Or is this particularly important for asset management/finance? This seems to be the motivation

-The first approach implies a discussion about the external validity of these estimates. The second implies some comparison with other industries.

1. Empirical Strategy

1.1. Identification

Goal: Quantify the penalty (our upside) for managers loosing theirs fund manager jobs due to poor performance caused by low/no effort/low talent (?)

Challenge: establish a link between low effort of manager and poor performance, and then from poor performance to pay cut;

- Effort is not observable
- Performance is observable but might be driven by other factors (fund, manager, or fund-manager specific)
- There might be unobservable characteristics of fund manager (unrelated to talent or effort) that drive both performance and pay cut – for instance risk aversion (or lack of it) drives poor performance despite high effort and drives manager accepting lower pay salary with high future upside

1. Empirical Strategy

1.2. Measurement and empirical specifications

- Manager fixed effects “**control for unobserved talent**” to estimate career penalty
    - i) not sure if one should ‘control for talent’ if the disciplinary mechanism is also through adverse selection (eventually scare away poor quality managers)
    - Ii) assuming we do, I am not 100% sure manager fixed effect does the trick here. Assume assortative matching between manager talent (unobservable) and fund quality/performance - all good (bad) managers run good (bad) funds and only bad managers end up being liquidated. Unless there are multiple liquidation events for the same manager?
- Risk preferences or overconfident managers: can they explain both performance and penalty? An overconfident manager gets liquidated and accepts a lower paid job because expecting an uncertain upside?

1. Empirical Strategy

1.2. Measurement and empirical specifications (cnt'd)

- Not clear what **job level changes** mean: for instance going from 1 to 2 might not be the same (in terms of compensation or other job conditions) than to go from 2 to 3 or 4 to 5; Compensation obviously does not have this issue

- Because the dependent variable in this case is ordinal, use a ordered probit?

2. Implications of the labor market penalty mechanism

Risk taking and self selection

– **Risk choices**: the magnitude of the penalty changes the convexity of managers payoff and risk incentives (which will eventually also affect performance); check if there are differences in this magnitude for different sectors, and see if this affects risk taking behavior

- **Self selection into sectors:** the magnitude of the penalty might scare away/attract some types – what is the matching between sectors are manager types in terms of education quality for instance?

3. Career background

- The paper shows evidence that some managers move industries

- Fund managers with more general human capital and can switch industries should be less sensitive to pay cut in financial industry, because they have other outside options unlike specialists.

3. Minor comments

- Sample period (2007-2017) – is it really ‘bad luck’ underperforming during the crisis?

- Year entered the job market instead of cohort to better capture initial job market conditions (enough observations?)

- Year entered financial/asset management industry

- Number of obs. In table 4 (with female as control) > Table 2 sum stats with male dummy

- Robustness with log(compensation)

▸ Conclusions:

- Great paper!

- Contributes to an **Important topic: understanding job market discipline and incentives is key to design optimal contracts**

- New evidence on career penalties of poor performance

- Next step? Maybe show more direct evidence that the mechanism is effective