Discussion

Career Risk and Market Discipline in Asset Management

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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 losing their 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