

Discussion of “Persistent Blessing of Luck”

Lin William Cong Yizhou Xiao

Discussion by Byeong-Je An (NTU)

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Introduction

- Great paper! I really enjoyed reading.
- Overview
 - Motivation
 - Result
 - Comments

Motivation

- Performance persistence exits in the PE industry
 - Is it due to differential innate manager skills?
 - Or simply due to luck?

Result

- This paper's answer:
 - “The rich get richer and the poor get poorer”
 - Identical PE funds can generate performance persistence simply due to initial luck
 - Mechanism
 - Complementarity between endogenous capital and deal flows
 - Successful PE fund due to luck will get better contract terms from LP and in turn find better deals

Short-term or long-term persistence?

- The model successfully predicts short-term persistence
- However, the model can't generate long-term persistence
 - Some funds might generate **consistently** higher return
 - But, the mass of these funds is zero in the steady-state
 - Conditional on survival, in the long run all GPs have the same expected return
- Then, the question becomes what kind of persistence is observed empirically?
 - Evidence is mixed
 - Most of papers regress returns on lagged returns and find positive coefficient
 - Korteweg and Sorensen (2017) use a new variance decomposition model and find long-term persistence

Autocovariance

- It might be better to relate the results to empirical measure of persistence, such as autocovariance
- For example, performance from funds under I-contracts
 - For t period: $R_t = Y_t^I \rho X_I$ where Y_t^I is an indicator of success
 - For $t + 1$ period: $R_{t+1} = Y_t^I Y_{t+1}^I \rho X_I + (1 - Y_t^I) Y_{t+1}^C \rho X_C$
 - Autocovariance:

$$\begin{aligned} \text{Cov}(R_t, R_{t+1}) &= E_t[\text{Cov}_t(R_t, R_{t+1})] + \text{Cov}(R_t, E_t[R_{t+1}]) \\ &= (1 + \Delta) \rho^2 X_I (p_I X_I - p_C X_C) \text{Var}(Y_t^I) \end{aligned}$$

- The authors can also show that autocovariance of net-of-fee return is positive

Contract between EN and GP

- EN's share $(1 - \rho)$ is fixed and same for I- and C-technology
 - The authors claim that endogenizing it through Nash Bargaining would not alter the results
 - This assumption is crucial in a sense that EN with innovative idea strictly prefers funds under I-contracts so that in equilibrium only assortative matching exist
 - However, if EN observes only the offer GP makes, then GP under C-contracts might have incentives to mimic the offer of GP under I-contract
 - In that case, EN with I-project is not necessarily matched with GP under I-contracts
 - By anticipating this, LP might not reward previously successful GP with incurring additional cost for innovative nurturing technology

Unicorn Scarcity

- Assumption 2: in any period there are more recently successful funds than innovative ideas
 - Some of successful funds under C-contracts might not get I-contracts
 - What if it's opposite?
 - Success is more difficult no matter a project is innovative or conventional than creating innovative idea
 - Some of EN with innovative idea might not get I-contracts
 - Or Some of GP who fails under I-contract recently will get I-contracts in the next period

Other Comments

- Same discount rate for EN, GP, LP: Often, LP is less time-patient than EN or GP
- The purpose of section “Equilibrium with fixed technology” is unclear to me
 - The authors might move this section to Appendix so that readers can follow the authors’ logic more easily