Discussion of “Persistent Blessing of Luck”

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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?
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
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 l-contracts
  - For $t$ period: $R_t = Y_t^l \rho X_l$ where $Y_t^l$ is an indicator of success
  - For $t + 1$ period: $R_{t+1} = Y_t^l Y_{t+1}^l \rho X_l + (1 - Y_t^l) Y_{t+1}^C \rho X_C$

- Autocovariance:

\[
\text{Cov}(R_t, R_{t+1}) = E_t[\text{Cov}_t(R_t, R_{t+1})] + \text{Cov}(R_t, E_t[R_{t+1}])
\]
\[
= (1 + \triangle) \rho^2 X_l (p_l X_l - p_C X_C) \text{Var}(Y_t^l)
\]

- 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
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