2014 European Finance Association Annual Meeting in Lugano

Switzerland Becomes Platform for Leading Finance Researchers
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Dear friends of the Swiss Finance Institute

The Swiss Finance Institute (SFI) and the USI Università della Svizzera italiana (Lugano) were chosen to host the 41st Annual Meeting of the European Finance Association (EFA) from August 27 to 30, 2014 in Lugano. The conference, which was attended by 800 senior economists from around the world, was a unique opportunity to raise the profile of Switzerland as a center of leading financial research and practice. In this publication we present some of the highlights of these extraordinary three days.

With 1,800 submitted papers (of which only one out of seven was accepted for presentation) and 90 parallel sessions the 2014 Annual Meeting set new EFA records both in terms of quality and participation. The program comprised a total of 270 presentations, a plenary panel session on the role of finance in society, a doctoral tutorial, numerous networking opportunities, and last but not least, the keynote address by the 2013 Nobel Laureate, Professor Robert J. Shiller.

Bridging the gap between academia and practice in order to share knowledge is an important part of the mission of the Swiss Finance Institute. We therefore integrated a full one-day session for senior industry professionals into the EFA’s academic conference: the SFI Industry Forum. The event entirely focused on “Opportunities and Challenges in Asset Management” and gave insights into the latest academic research and the best business practices in this field. The 120 attendees were senior finance professionals from Switzerland and abroad.

We encourage you to explore the 270 presented academic papers (full-text PDF versions available at http://bit.ly/USI_efa2014) as well as the webcasts of the keynote address and the SFI Industry Forum talks.

We look forward to building on the success of the 2014 EFA Annual Meeting.

Prof. Francois Degeorge
EFA 2014 Conference Chair
Swiss Finance Institute Professor
Dean of the Faculty of Economics,
USI Università della Svizzera Italiana (Lugano)

Prof. Claudio Loderer
Managing Director
Swiss Finance Institute
University of Bern
In Brief

Location
Lugano

Date
August 27 - 30, 2014

Key figures
1800 papers submitted
15% acceptance rate
270 presentations
800 participants
40 Countries
157 Universities

Macro themes
Asset Pricing (Theoretical)
Asset Pricing (Empirical)
Banking, Central Banking, and Regulation
Behavioral Finance (Theoretical)
Behavioral Finance (Empirical)
Corporate Finance (Theoretical)
Corporate Finance (Empirical)
Corporate Governance
Financial Econometrics
Forwards, Futures, and Derivatives
Financial Intermediation (Theoretical)
Financial Intermediation (Empirical)
Household Finance
International Finance
Market Microstructure
Real Estate Finance

EFA Annual Meetings

2016 BI Norwegian Business School (Norway)
2011 Stockholm School of Economics (Sweden)
2012 Copenhagen Business School (Denmark)
2013 University of Cambridge – Judge Business School (United Kingdom)
2010 Goethe-University Frankfurt (Germany)
2015 WU Vienna University of Economics and Business (Austria)
2014 USI Università della Svizzera Italiana (Switzerland)
Nobel Laureate Prof. Robert Shiller is welcomed by EFA Conference Chair Prof. François Degeorge.
Keynote Speech by 2013 Nobel Laureate Robert J. Shiller
Views on Market Efficiency and the Role of Finance in Society

In his keynote speech, Nobel Laureate Robert J. Shiller, Professor of Economics at Yale University, argued that financial markets are neither as efficient nor as socially effective as they need to be.

“It often seems that the efficient markets hypothesis, which says that financial markets work perfectly, is essential to the whole idea that our financial markets are contributors to society,” Prof. Shiller began. “The view I want to express here is that they don’t work perfectly. But nonetheless, financial markets are central to our civilization and to our quality of life.” The imperfections in these markets, Prof. Shiller said, should be taken as a challenge to those working in them to improve them.

Prof. Shiller received the 2013 Nobel Prize in Economic Sciences jointly with Professors Lars Peter Hansen and Eugene Fama of the University of Chicago. Recalling the week spent in the company of his two co-laureates, Prof. Shiller noted that the debate among the three of them was vigorous though friendly. One key point of difference was that Professors Fama and Hansen see financial markets as being more efficient in reflecting all available information. Prof. Shiller, on the other hand, believes market irregularities are better explained by psychologists and sociologists than by the efficient market theory. Asset prices, said Prof. Shiller, “are unpredictable – like people.”

Referring to Prof. Fama’s research, as well as to his own and to that of many others over the years, Prof. Shiller described the landscape of debate around financial market efficiencies before returning to his theme of the role of finance in society.

Financial services are good for society, he pointed out, in that they perform roles without which we would be disadvantaged. Insurance protects us from particular risks to which we otherwise would be exposed. We cannot rely on institutions and other forces to rescue us in case of disaster; governments, agencies, religious organizations, and charities can do only so much.

However, just as people are flawed, so are markets. Financial markets can and have been manipulated, and problems do arise in regulating them. These imperfections have yet to be fully overcome.

While crowd funding and other innovations and experiments, Prof. Shiller noted, have begun to make interesting and valuable contributions to the democratization of markets, he placed greater faith in information technology (IT).

Concluding his presentation, Shiller explained how IT – with its increasing power and capabilities – could make financial markets more efficient. With these improvements, markets would be better able to meet the financial needs of society. Yet, “Any experimentation in financial markets has to have a sense of reality about the way they function and should include what engineers call ‘human factors engineering,’” he cautioned, “that is, engineering devices that will work with real people and their real frailties.”

For this reason, therefore, Prof. Shiller believes markets still “have a long way to go” before they can serve society efficiently and realistically in the ways they should.

Robert J. Shiller is known as the founder of behavioral finance, which investigates how psychological and sociological phenomena influence financial markets. His pioneering books include “Irrational Exuberance” (2000) and “Finance and the Good Society” (2012). In addition to his academic work, Robert Shiller has had a deep impact on financial practice. Together with Karl Case Robert Shiller developed the Case-Shiller Home price indices. In 2013 Robert J. Shiller shared the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel for his work on the empirical analysis of asset prices.

“Views on Market Efficiency and the Role of Finance in Society”
The EFA Annual Meeting in Lugano combined academic sessions with the practitioner-oriented SFI Industry Forum on Opportunities and Challenges in Asset Management.

Panel discussion on passive vs. active asset management at the SFI Industry Forum. From the left: Francesco Sandrini (Pioneer), Haig Simonian (moderator), Anne Richard (Aberdeen) and Andreas Schlatter (UBS).
The 800 conference participants and presenters came from all over the world.

With a total of 90 parallel sessions and 270 papers presented, the EFA Annual Meeting set records both in terms of quality and participation.

Dr. Frank Hatheway (NASDAQ OMX Group)
Summary of Selected Papers

The 2014 European Finance Association Annual Meeting included the presentation of 270 academic papers, six of which are summarized here to provide you with a brief introduction to the range of research projects shared. We also encourage you to explore the many other presented papers (full text available) at http://bit.ly/USI_efa2014.

Sticky Prices and Stock Valuation

Rigid or “sticky” product pricing predicts risk and stock returns.

These are among the conclusions drawn from this latest research into the effects of the use of “sticky” pricing, instead of a more flexible approach to selling products, on a firm’s stock market valuation.

The researcher developed a multi-sector production-based asset-pricing model, in which firms differed in their frequency of price adjustment; he then measured “price stickiness” as the average frequency of price adjustments. The data he used covers the period 1994 to 2009, with 13,810 observations; it focuses on major U.S. S&P500 companies worth more than USD 3 billion.

The use of standard Capital Asset Pricing Model (CAPM) regressions yielded two findings. First, CAPM cannot fully explain the portfolio returns, as alphas are positive; second, the “sticky price” companies had betas higher than one, while the flexible price companies had betas lower than one. The difference in annual returns between stocks with high and low frequencies of price adjustments was approximately 4%, suggesting that “sticky price” firms bear a higher systemic risk and consequently yield higher returns. Different specifications that controlled for firm size, turnover, or industry heterogeneity yielded similar effects.

A firm’s price rigidities, he concluded, are a strong predictor of systemic risk and, subsequently, of stock returns. Price stickiness, therefore, has real costs for firms; it increases the cost of capital, and firms might forgo profitable investment projects.

Author
Michael Weber (University of Chicago Booth School of Business)

Paper
“Nominal Rigidities and Asset Pricing”

“Price rigidities explain both business-cycle dynamics in aggregate quantities and cross-sectional variation in stock returns.”

1 Winner of the UBS Best Conference Paper award and of the Best Ph.D. Student Paper Award.
Positional Portfolio Strategies

Positional portfolio strategies, which account for managers’ goal to be well-ranked compared to their peers, can outperform traditional allocation strategies.

The authors’ conclusions are based upon a wide-ranging research into data gathered from the NYSE, AMEX and NASDAQ stock markets between 1990 and 2012. The researchers found that understanding the implications of positional portfolio management is of prime importance, as it can create new types of allocation strategies; these, in turn, may further lead to different patterns of risk-returns trade-offs.

Their results suggest that positional portfolio strategies can outperform traditional approaches, such as mean-variance, momentum, and reversal strategies, in terms of most performance criteria. For criteria based on position, these strategies even outperformed 1/n portfolios.

Authors
Patrick Gagliardini (Università della Svizzera italiana and Swiss Finance Institute), Christian Gourieroux (CREST and University of Toronto), and Mirco Rubin (Università della Svizzera italiana and Swiss Finance Institute)

Paper

“Positional strategies outperform the equally weighted portfolio for criteria based on position.”
Venture Capital Success and Monitoring Costs

Close involvement by venture capital (VC) firms in the companies they own leads to increased innovation and greater success.

This was the authors’ conclusion from research they conducted into the external factors affecting venture capital’s involvement with U.S. investee companies.

Using data from 22,986 U.S. companies that received funds from 3,158 VC firms between 1977 and 2006, the authors analyzed a natural experiment: the impact of the introduction of a new airline route between the VC firm and the portfolio company. The authors found that the consequent reduction in monitoring costs resulted in more innovation and a higher likelihood that the company went public.

The introduction of the new airline route led to an increase in the number of patents that the portfolio company produced and in the number of citations per patent that it received. It also increased the probability of the company’s going public or being acquired. Reduction in travel times between nonlead VC firms and the portfolio companies, on the other hand, did not result in greater company success, suggesting that the positive effect of monitoring on companies came from the lead VC firm.

The paper offers strong evidence that a VC firm’s involvement is an important determinant of innovation and company success.

Authors
Shai Bernstein (Stanford), Xavier Giroud (MIT), and Richard Townsend (Dartmouth)

Paper
“The Impact of Venture Capital Monitoring: Evidence from a Natural Experiment”

“Closer monitoring results in more innovation and financial success in venture-backed companies.”

Runner-up for the UBS Best Conference Paper Award.
Honesty and Social Norms

Two forces influence a CEO’s honesty when announcing earnings statements: situational pressure and the sense that acting truthfully provides the CEO with an opportunity to signal his or her identity as a virtuous individual.

This paper reports the results of a laboratory experiment that offered monetary incentives to participants who acted as CEOs. These “CEOs” were each asked to make a statement that they knew to be false regarding their company’s earnings. Although the statement was false, the participants were informed that it is legal to exaggerate earnings. In addition, by inflating the earnings figures, the participants themselves would receive a higher monetary compensation. The innovation in the study’s experimental design was to skew the social norm environment by letting the participants know that the market was observing their actions. There was no possibility, the researchers noted, for the participants to behave in a strategic manner.

The authors found, first, that subjects with higher values for honesty and truthful behavior showed a higher propensity to announce truthful corporate earnings. Second, changes in the behavior of their peers and in the environment in which they operated did influence their behavior. Third, subjects with a relatively higher level of honesty and truthful behavior were considerably less prone to be influenced by social pressure.

Authors
Rajna Gibson (University of Geneva and Swiss Finance Institute), Carmen Tanner (University of Zurich and Swiss Finance Institute), and Alexander Wagner (University of Zurich and Swiss Finance Institute)

Paper
“Understanding Honesty: An Experiment Regarding Heterogeneous Responses to Situational Social Norms”
Downside Risk and Executive Incentives

Companies protect their top managers from risks associated with short-selling by offering them more options.

The authors of this paper examined the consequences of the SEC’s 2004 Reg SHO decision – which removed short-selling restrictions – on a random set of U.S. firms (pilot firms versus control firms); they focused on the impact of the SEC decision on the design of executive incentive contracts.

Short-selling activities have been shown to increase the sensitivity of stock returns to negative news and, as a consequence, to increase the exposure of CEOs’ wealth, via their equity-based compensation packages, to their firms’ idiosyncratic risk. Based on this observation, the authors asked whether firms changed their executives’ compensation packages to offset their increased exposure to downside risk.

Looking at firms in the Russell 3000 index (representing 98% of the investable U.S. equity market), they found, first, that firms in the pilot group increased the proportion of stock option grants relative to equity grants by approximately 8%, on average, compared to the control firms. Second, the increase in the proportion of stock options was larger for pilot firms that showed the highest increase in their sensitivity to negative news. Third, these same firms – those highly sensitive to negative news – responded to the change in downside risk by increasing expenses in research and development.

These findings offer strong evidence that firms protect their top managers from the increase in downside risk by offering them more stock options. Interestingly, the overall total equity compensation remained constant across both types of firms.

Authors
David De Angelis, Gustavo Grullon, and Sébastien Michenaud (Rice University)

Paper
“Downside Risk and the Design of Executive Incentives: Evidence from the Removal of Short-Selling Constraints”

“Firms decrease managerial exposure to risks associated with short-selling by shifting executive compensation toward stock options and away from restricted stocks.”

Runner-up for the UBS Best Conference Paper Award.
Bankruptcy Codes, Financial Distress, and Investment Decisions

Bankruptcy laws that encourage debt renegotiation tend to reduce investment distortions. The authors reached this conclusion after investigating the effects of risky debt and shareholder vs. debt holder conflicts on firms’ decisions.

Using a panel of 19,466 firms across 41 countries, each with different bankruptcy codes, the authors sought to determine whether laws that favor debt renegotiation in situations of near insolvency influence firms’ decisions with respect to investment, asset selling, and risk taking.

Previous work suggests that high debt overhang (defined as the product of the company’s leverage times its default probability times recovery rate) is the key driver in explaining disinvestment, increases in asset sales, and increases in risk taking. The present paper found that, in fact, it is the combined effect of debt overhang and renegotiation failure that actually explains the decisions that shareholders make.

Two seemingly identical firms approaching financial distress, but located in countries with radically different approaches to debt renegotiation, differed by as much as 19% in average investment growth rate, by 74% in the growth rate of asset sales, and by 11% in the growth rate of risk taking.

These findings strongly suggest that the prospect of a successful debt renegotiation induces the shareholders to underinvest less, to sell fewer assets, and to take on less risk.

Authors
Giovanni Favara (Federal Reserve Board), Erwan Morellec (EPFL and Swiss Finance Institute), Enrique Schroth (Cass Business School), and Philip Valta (HEC Paris)

Paper
“Debt Renegotiation and Investment Decisions Across Countries”

“Weaker debt enforcement decreases the underinvestment and asset substitution distortions caused by debt overhang.”
The UBS Best Conference Paper Award was won by Michael Weber (middle) who was congratulated by Sergio Ermotti, Group CEO UBS, and Prof. François Degeorge, EFA 2014 Conference Chair.
The three days in Lugano offered plenty of opportunities for networking not just among colleagues from academia, but also between researchers and industry experts from around the world.
SFI Industry Forum
Bridging the Gap between Academia and Financial Practice

The Swiss Finance Institute (SFI) Industry Forum, “Opportunities and Challenges in Asset Management,” was specifically designed for senior managers to gain new insights into academic research and best business practices. On August 29, 2014, 120 Swiss and international practitioners came to Lugano for a day of thought-provoking talks by leading experts in the field. The day concluded with a keynote speech by the 2013 Nobel Laureate, Professor Robert Shiller.

Opportunities and Challenges in Asset Management
After Professor Claudio Loderer, SFI Managing Director, welcomed the participants, the forum began with four inspiring talks on the challenges, opportunities, and uncertainties that are currently dominant in the field of asset management.

Dr. Burkhard Varnholt, Chief Investment Officer at Julius Baer, highlighted the structural, demographic, and technological changes of the 21st century in his talk, “The Rise of a New World Order.” Recently observed non-linear changes, he argued, challenge our common, linear way of thinking about how to deal with the present in order to shape the future. Dr. Varnholt emphasized the power behind ideas and concluded by stating that only those countries that understand and appreciate the notion of sustainable development will prosper in the longer term.

Tim Jenkinson, Professor of Finance at Said Business School, University of Oxford, aimed to solve a mystery in his talk, “Why Are There So Many Asset Managers?” Academic research shows that active management does not, on average, add any value. Yet, Prof. Jenkinson noted, investment consultants currently advise on the investing of USD 25 trillion in assets. When Prof. Jenkinson conducted a survey on how investment consultants make product recommendations, and on how those products performed, he found that investment consultants do not simply chase past performance. Their recommendations are also influenced by soft factors, such as investor communication. His most sobering finding: recommended funds tend to underperform non-recommended ones.

Narayan Naik, Professor of Finance at the London Business School, spoke on the “Hit Rates and Win-Loss Ratios of Long-Only Active Managers.” People speculate on the source of success of fund managers, he explained, yet lack sufficient information on what these managers actually do. Prof. Naik and his colleagues collected data on hundreds of thousands of individual investment decisions. They then computed trade-based estimates of skill; these estimates prove to be a more robust signal of alpha than does past alpha. Prof. Naik and his colleagues’ analysis reveals that managers’ decisions to buy do add significant value, but their decisions to sell do not. Professional managers also seem to suffer from the same behavioral biases as retail investors: they sell winner stocks too early and hold on to loser stocks too long.

“The Rise of a New World Order”
Dr. Burkhard Varnholt,
Chief Investment Officer at Julius Baer, CH

“Do Investment Consultants Add Value?”
Prof. Tim Jenkinson,
Said Business School, Oxford University, UK

“Hit Rates and Win-Loss Ratios of Long-Only Active Managers”
Prof. Narayan Naik,
London Business School, UK
Dr. Frank Hatheway, Chief Economist at Nasdaq OMX Group, titled his presentation “Blurring of the Lines: Convergence between Private and Public Equity.” He discussed the important role of private equity in completing the market, thus allowing for a more efficient allocation of assets. Yet, he noted, several forces are driving private equity to act more like public equity. Dr. Hatheway cited, as examples, the elimination of tax benefits by the government and poor monitoring by clients. In conclusion, Dr. Hatheway outlined forces that can allow private equity to maintain its market-completing role.

Active versus Passive Management
In the afternoon, a panel discussion addressed “The Risk-Adjusted Price of Delegation in Asset Management,” with the participation of three international experts: Dr. Andreas Schlatter, Head of Global Asset Management Switzerland at UBS; Anne Richards, Chief Investment Officer at Aberdeen Asset Management; and Dr. Francesco Sandrini, Head of Multi Asset Securities Solutions at Pioneer Investments. Their discussion focused on the active versus passive management debate and considered how asset managers could in fact provide value to their investors, in spite of the evidence for successful passive management. The panel members agreed that there was a place for both active and passive management in investors’ portfolios, but that managers needed to better justify their work. The participants also shared their insights on the future of the industry, including the effects of regulatory changes and the pressure on fee structures.

Keynote Speech by Nobel Laureate Robert Shiller
The closing session of the SFI Industry Forum was the keynote speech by Robert J. Shiller, Professor of Economics at Yale University and winner of the Nobel Prize in Economic Sciences in 2013 for his pioneering contribution to the empirical analysis of asset prices. Prof. Shiller highlighted evidence of bubbles in the U.S. real estate market and pointed out the importance of sociological and psychological explanations in understanding investors’ irrational behavior. Prof. Shiller signed copies of his latest book, Finance and the Good Society, in which he challenges readers to rethink the role of finance in society and argues that finance should play a larger role in helping society achieve its goals.

The SFI Industry Forum focused on “Opportunities and Challenges in Asset Management” and gave insights into the latest academic research and the best business practices in this field.
Media Coverage

The 2014 European Finance Association’s Annual Meeting received major media coverage in print, online and on television. Here a selection of some of the coverage.
Ticino All’USi il Nobel Shiller

A fianaragio la 61. adunazione dell’European Finance Association.

Lugano, una calamita per la finanza mondiale

L’Academia dei manager dell’European Institute of Finance Lugano, dichiarata il 2019, come il più attrezzato in Europa in campagna di formazione, ha aperto le sue porte a tutti i professionisti della finanza di tutto il mondo. La città svizzera si dimostra una vera e propria calamita per i manager, con una crescita esponenziale di invitati e partecipanti. L’AIF Lugano è diventato un punto di riferimento per tutta la comunità finanziaria, offrendo opportunità di apprendimento e networking preziose.
About

Swiss Finance Institute
The Swiss Finance Institute (SFI) is a high-level think tank in banking and finance. As befits Switzerland’s international reputation as a leading financial center, SFI strives for excellence in research and doctoral training, knowledge transfer, and continuing education in the fields of banking and finance.

Created in 2006 as a public-private partnership, SFI is a joint initiative of the Swiss finance industry, leading Swiss universities, and the Swiss Confederation. The institute is organized across three centers: the SFI Léman Center at the universities of Geneva and Lausanne and the Ecole Polytechnique Fédérale de Lausanne (EPFL); the SFI Lugano Center at the Università della Svizzera italiana; and the SFI Zurich Center at the University of Zurich and ETHZ.

SFI’s global academic network and its proximity to the industry place it in a unique position from which to combine intellectual leadership and industry experience:

– SFI attracts leading minds in finance research to Swiss universities, uniting outstanding professors and doctoral students to form Switzerland’s largest finance research group and making top research easily accessible to the industry.
– Through its variety of educational programs, SFI nurtures a highly qualified talent pool in banking and finance. Ranging from programs for industry “high-potentials” and senior executives to doctoral training, SFI raises the overall level of financial competence in Switzerland.
– By encouraging an ongoing dialogue between experienced practitioners and researchers, SFI fosters interaction and stimulates intellectual leadership, directly impacting the future of finance.

www.sfi.ch

USI Università della Svizzera italiana (Lugano)
The USI Università della Svizzera italiana is one of the ten cantonal universities and two federal institutes of technology in Switzerland. Established in 1999, the Institute of Finance at USI (Ifin) coordinates the research and training activities in financial disciplines of the Faculty of Economic Sciences. www.usi.ch

European Finance Association (EFA)
The European Finance Association (EFA), founded in 1974, is the leading finance association in Europe. Its flagship journal is the Review of Finance, a peer-reviewed journal that publishes high-quality papers in all areas of financial economics. Its annual meeting attracts over 800 finance researchers from around the world, hosts 90 sessions over two-and-a-half days, and includes a doctoral tutorial, as well as a variety of social events that provide excellent opportunities for networking. The annual meetings are hosted by a different university each year. www.efa-online.org
The Swiss Finance Institute gratefully acknowledges the invaluable support of its founding members:

Special thanks go to the institutions and individuals who made the 2014 EFA Annual Meeting and the SFI Industry Forum in Lugano possible:

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