

Entrepreneurs' Diversification and Labor Income Risk

by Jan Bena, Andrew Ellul, Marco Pagano, and Valentina Rutigliano

Discussion by

Spyros Lagaras
University of Pittsburgh (Katz)

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Overview

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Excellent Paper - Great Contribution!

- Why?

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● Why?

- Provides Evidence on a **Central BUT Unexplored Prediction** from the Implicit Labor Contract Theory

Shareholders' Ability to Diversify Idiosyncratic Risk ⇒ Risk-Neutral Preferences

- Combines **Information** from **Multiple Administrative** Data Sources
- Introduces a **Well-Defined** and **Exogenous** Firm-Specific Measure of Idiosyncratic Shocks Based on Fluctuations in **Exchange Rates** for **Exporting** Firms

⇒ Shareholders' Diversification is Defined Relative to the Specific Shock

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● Discussion:

- Characteristics of Firms with **Diversified** Versus **Non-Diversified** Shareholders?
- Sample Focus on **Exporting Firms**
- Measure of **Diversification**

Firms with Diversified Vs. Non-Diversified Shareholders

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- ✗ Systematic Differences in Ownership Structure, Monitoring Capability, Labor Composition, Shareholders' Personal Wealth Affect Firms' Incentive to Provide Insurance

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Suggestions:

- Provide Descriptive Statistics of Firm-Level and Owner-Level Characteristics for Firms with Diversified and Non-Diversified Shareholders
 - ⇒ Critical to Inform the Degree and Direction of Any Bias in Estimates
- Provide Estimates from Non-Parametric Methods by Matching on Firm- and Owner-Level Characteristics?

Sample Selection

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- ✚ Well-Defined, Precisely Measured, Exogenous Source of Firm-Specific Risk
 - ⇒ Sample Firms Unable to Manipulate Currency Markets and Large Costs in Redirecting Exports Across Destination Countries
- ✚ Allows the Creation of a Measure of Shareholders' Diversification Specific to the Idiosyncratic Shock
 - ⇒ Relative to Exposure of Shareholders' Portfolio Firms

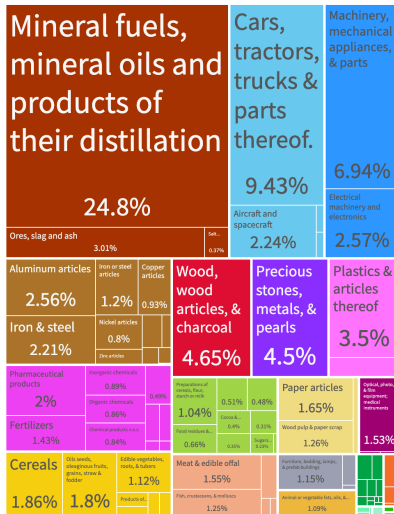
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 - ⇒ Relative to Exposure of Shareholders' Portfolio Firms
- ✗ How Representative are Estimates from Exporting Firms?
 - ⇒ Differences in Geographical and Sectoral Distribution, Productivity, Labor Composition (Melitz, 2003; Bustos, 2011)

Sample Selection

Canadian Exports in 2021: Certain sectors (e.g., Oil and Gas) or provinces (e.g., Alberta) are potentially overrepresented in the data



Sample Selection

How to Generalize Estimates?

- How do Baseline Estimates of Employment and Wage Insurance Compare Relative to Previous Literature?
⇒ In Canada, the Degree of Employment Insurance is 70% in Ellul et al. (2018)
- Provide Suggestive Estimates Including Non-Exporting Firms by Employing **Industry-Level Shocks** as in Ellul et al. (2018) or **Firm-Level Idiosyncratic Shocks** as in Guiso et al. (2005)
⇒ Feasible to Estimate Shocks at Portfolio Firms and Create the Respective Diversification Measures

Measure of Diversification

$$\text{DIV}_{ijt} = \text{VAR}(\hat{s}_{it}) - \text{VAR}(\hat{S}_{jt})$$

Shareholders' Diversification:

- Relies on **Firm Ownership** Information
- Captures Exposure of **Portfolio Firms** to Exchange-Rate Risk (\hat{S}_{jt}) Affecting the Exporting Firm (\hat{s}_{it})
- Estimates **Exchange-Rate Driven Sales Shocks** as $\Delta \hat{s}_{it} = \Delta e_{it} \text{Sales}_{it-1}$

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However:

- ✗ **Risk Management Practices** \Rightarrow Greater Use of **Hedging Instruments** by Shareholders Non-Diversified through Firm Ownership?
- ✗ **Liquid Assets in CAD as a Diversification Tool** \Rightarrow Higher Balances of **Liquid Assets** by Shareholders Non-Diversified through Firm Ownership?

Technicality: For Sales Shocks Focus Only on the **Share of Sales from Exporting Activity**? \Rightarrow Measure Potentially **Overstates** Sales Exposure to Exchange Rate Fluctuations

Alternative Mechanisms

- ✓ Differences in Shareholders' Skills?

⇒ **Owner Fixed Effects**

- ✓ Are Risk Preferences Time-Invariant?

⇒ **Attitude Towards Risk Changes with Age, or as a Result of Adverse Shocks**

- ✓ Differences in Funding Capacity?

⇒ **Controls for Wealth Using Earned Income and Total Assets of Portfolio Firms**

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⇒ **Controls for Wealth Using Earned Income and Total Assets of Portfolio Firms**
- ✗ Presence of "Internal Labor Markets" Within Portfolio Firms?
⇒ **Provide Estimates on the Probability or Level of Transfers Within Portfolio Firms**
- ✗ Heterogeneity in Monitoring or Agency Frictions?

Summary

- **Great paper with important contribution** by providing evidence on a **central prediction** of the implicit labor contract theory and by leveraging a **novel empirical strategy**
- Highlights the significant role of **shareholders' diversification** in providing employment and wage insurance
- **To further strengthen the paper's impact:**
 - Important to understand the **presence and direction** of any **bias** induced by **fundamental differences** between firms with diversified and non-diversified shareholders
 - Important to **generalize** and **expand** the paper's scope outside the set of **exporting firms**
- **Read the paper!**