

LSF Lunchtime Seminar:

Risk-Adjusted Capital Allocation and Misallocation

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Abstract

We develop a theory linking “misallocation,” i.e., dispersion in static marginal products of capital (MPK), to systematic investment risks. In our setup, firms differ in their exposure to these risks, which we show leads naturally to heterogeneity in firm-level risk premia and, more importantly, MPK. The theory predicts that cross-sectional dispersion in MPK (i) depends on cross-sectional dispersion in risk exposures and (ii) fluctuates with the price of risk, and thus is countercyclical. We document strong empirical support for these predictions. We devise a strategy to quantify variation in firm-level risk exposures using data on the dispersion of expected stock market returns. Our estimates imply that risk considerations explain almost 40% of observed MPK dispersion among US firms and in particular, can rationalize a large persistent component in firm-level MPK deviations. Our framework provides a sharp link between aggregate volatility, cross-sectional asset pricing and long-run economic performance – MPK dispersion induced by risk premium effects, although not *prima facie* inefficient, lowers the average level of aggregate TFP by as much as 7%, suggesting large “productivity costs” of business cycles.

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Thursday 20 December 2018

12:30 – 13:45pm

Location

Faculty of Law, Economics and Finance
JFK Building
29, avenue Kennedy
L-1855 Luxembourg
Ground Floor, Nancy-Metz Room

Langue

English

Registration

- Free seminar
 - Registration by e-mail to lsf-events@uni.lu
(please specify full name and institution)
- Before 13th December 2018**

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