

Labor Adjustment Costs and Expected Equity Returns

Discussion

Paper by J. Marcelo Ochoa

Discussant: Oleksandr Zhylyevskyy

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Summary

Paper studies connection between firm's expected return and fraction of high-skilled workers among firm's employees

Empirical evidence suggests that labor adjustment costs (e.g., costs of hiring employee) increase with skill level of worker

Author constructs dynamic labor demand model and draws two implications from it:

- Higher fraction of high-skilled employees \Rightarrow higher expected return
- Higher aggregate uncertainty \Rightarrow expected returns rise relatively more among firms with higher fraction of high-skilled employees

Presented evidence from portfolio sorts and regression analyses is consistent with these implications

Comments and Suggestions: Overall Content

Topic is very interesting and relevant

Some improvements are needed to make paper more compelling:

- Expand and clarify Appendix B on numerical solution algorithm
- Substantially expand and clarify regression analysis on p. 26 (regarding “skill premium” as risk factor)
- More carefully interpret regression results reported in Sections 3.3 and 3.4: dependent variable is return, rather than expected return; also, data in regressions have *both* time and cross-section dimensions, data are not purely cross-sectional
- Standardize and use same terminology throughout paper: e.g., always use “worker’s skill index,” rather than also “worker’s preparation index”
- Standardize and use same math notation throughout paper

Comments and Suggestions: Theory

Consider equation (4): $C^j(n_t^j, n_{t-1}^j) = \chi^j |n_t^j - n_{t-1}^j| + F^j n_{t-1}^j$

Here, $n_t^j = n_{t-1}^j + 1$ and $n_t^j = n_{t-1}^j - 1$ imply same $C^j(n_t^j, n_{t-1}^j)$

Why is cost of hiring same as cost of firing? Is this realistic?

Some disconnect between theory and empirical analysis:

- Model considers firms that produce homogeneous product, have same production functions, and face same aggregate productivity and volatility shocks
- How would such model produce heterogeneity across firms in cross-section at given point in time in terms of fraction of high-skilled workers employed, and therefore, expected returns?
- Model has implications for time-series of expected return, but no obvious implications for *cross-section* of expected returns

Comments and Suggestions: Empirical Work

In regressions underlying Table 2, “schooling index” is *categorical*
⇒ perhaps create and use educational attainment dummies

Workers’ skill index, $WSKILL_j$, is weighted average of *categorical* variables

⇒ perhaps create and use 5×1 vector: fraction of employees from skill zone 1, fraction of employees from skill zone 2, etc.

Regression analyses in Sections 3.3 and 3.4 do *not* control for firm’s beta (i.e., loading on market risk)

⇒ perhaps include firms’ betas as regressors when explaining cross-section of returns

⇒ perhaps perform Fama & MacBeth-type of analysis throughout

Minor Issues (I)

Some editing is needed to “polish” the language. Here is a list of issues I noticed in the Abstract and in the Introduction:

- abstract: "Macroeconomic risk..."—incomplete sentence
- abstract: "its cautiousness"—unclear "its" → "the firm's cautiousness"
- abstract: "evidence based on" → "evidence from"
- abstract: "sorts conclude" → "sorts suggests"
- abstract: "more relevant leading" → "more relevant, leading"
- abstract: "employees with high-skilled workers" → "high-skilled employees"
- p. 1: "in 1998 emphasizes Perhaps"—correct punctuation/capitalization/citation
- p. 2: "uncertainty hikes" → "uncertainty rises"
- p. 2: "the following, firms" → "as follows. Firms"
- p. 2: "adjusting its labor stock" → "adjusting their labor stock"
- p. 2: "since their labor stock"—unclear "their"—rephrase

Minor Issues (II)

- p. 3, footnote 2: "index, engineering" → "index are engineering"
- p. 4: "between a firm relies" → "between a firm that relies"
- p. 4: "workers' preparation index" → "workers' skill index"
- p. 4: "the workers' skill premium"—rephrase: the premium arising from...
- p. 4: "thus contains" → "therefore, it contains"
- p. 4: "can explain much better"—rephrase: has a much higher explanatory power than...
- p. 5: "to the demand of labor" → "for labor demand"
- p. 5: "therefore have no implications..."—I couldn't understand this sentence as a whole; rephrase it

Page 6 and beyond: if possible, hire a professional editor; or
"bribe" a colleague to help you identify and fix all other editorial
issues