

Abstract

I try to give honest statistical background to the CUPED method. This allows us to correctly include multiple predictors and use heteroscedasticity robust standard errors.

CUPED: statistician viewpoint

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1 Déjà vu

On the third page Deng writes ‘the linear model makes strong assumptions that are usually not satisfied in practice, i.e., the conditional expectation of the outcome metric is linear in the treatment assignment and covariates. In addition, it also requires all residuals to have a common variance’.

As I am teaching statistics and econometrics I was eager to read further. But then I encounter $\theta = \text{Cov}(Y, X) / \text{Var}(X)$ in equation 4 which is a theoretical counterpart of slope estimate in simple regression. And later t-test is applied to Δ_{cv} that is again equivalent to a second simple regression. Regression is replaced by something similar to two regressions. Déjà vu.

So I decided to expose the CUPED method using old boring regression language. Let’s see what will happen!

2 Old regression friend

To simplify the use of regression language I will start with one dataset of n observations with three variables:

- w_i the indicator of treatment: $w_i = 1$ for the treated group and $w_i = 0$ for the untreated group.
- x_i any covariate that is a-priori independent with treatment indicator w_i .
- y_i the target variable that is probably dependent both with w_i and x_i .

Using regression language CUPED is a two step procedure:

Step 1a. Estimate the following regression using OLS:

$$\hat{y}_i = \hat{\gamma}_1 + \hat{\gamma}_2 w_i + \hat{\theta} x_i.$$

Step 1b. Calculate the semiresidual $r_i = y_i - \hat{\theta} x_i$.

I call this r_i ‘semiresidual’ as classic residual in econometrics is

$$\hat{u}_i = y_i - \hat{y}_i = y_i - (\hat{\gamma}_1 + \hat{\gamma}_2 w_i + \hat{\theta} x_i).$$

Step 2a. Estimate the second regression using OLS:

$$\hat{r}_i = \hat{\beta}_1 + \hat{\beta}_2 w_i.$$

Step 2b. Use classical standard errors to build confidence interval for β_2 .

Why this two-step procedure is better than just plain old multivariate regression

$$\hat{y}_i = \hat{\gamma}_1 + \hat{\gamma}_2 w_i + \hat{\theta} x_i$$

with confidence interval for γ_2 build with classic standard errors?

Honestly speaking Deng is not very explicit which regression should be used in the first step. On the page three the theoretical unknown θ is used.

So one may also consider a simpler alternative regression

$$\hat{y}_i = \hat{\gamma}_1 + \hat{\theta} x_i.$$

I will discuss why I prefer the inclusion of w_i as regressor in the first step.

3 Comparison with multivariate regression

Let's talk about numeric estimates without assumptions at all.

[the proof of equality]

Let's start easy first. No heteroscedasticity and no interaction between treatment w_i and covariate x_i . Correctly specified linear model.

Assume that the true model is

$$y_i = \gamma_1 + \gamma_2 w_i + \theta x_i + u_i.$$

The observations are independent and identically distributed with finite fourth moments. The error term u_i satisfies $\mathbb{E}(u_i | X) = 0$, $\text{Var}(u_i | X) = \sigma^2$.

[here goes the picture]

It is well known in econometrics that OLS estimator $\hat{\gamma}_2$ is unbiased and consistent in this case. As $\hat{\beta}_2$ estimate from second step is exactly equal to $\hat{\gamma}_2$ the same result applies.

And what about standard errors?

4 Toy problem to understand the difference

5 Heteroscedasticity case

6 Unanswered questions