

RESEARCH STATEMENT

Giorgia Piacentino

I study the effects of financial intermediaries in corporate finance, in corporate governance and in portfolio selection. I use Bayesian game theory and mechanism design to study delegated portfolio managers' agency frictions and credit rating agencies' information transmission.

Nowadays, delegated portfolio managers are the main holders of public equity and blocks of shares in the United States. They invest on behalf of others and thus respond to different incentives from individual investors—the usual actors in finance models. They do not care about portfolio returns alone, but also about their reputation: They must retain old clients and gain new ones to expand their assets under management.

My job market paper **“Do Institutional Investors Improve Capital Allocation?”** studies delegated portfolio managers in a corporate finance framework. Adverse selection in financial markets increases firms' cost of external finance and may be so severe as to hinder constrained firms' investment. Speculators can reduce firms' adverse selection problems associated to external financing by acquiring information and impounding it into prices via their trades. As information about good firms gets reflected by prices, firms' cost of funding decreases, allowing them to raise capital more cheaply. I show that the agency problem caused by delegated portfolio managers improves capital allocation: They have better incentives to provide information than individual investors. In fact, individual investors underprovide information generating an externality on firms' investment: They acquire information only when they can hide it, otherwise they cannot profit from it.

Heterogeneous delegated portfolio managers (funds) populate markets, some are skilled and some aren't, and only skilled funds can learn about firm quality. Skilled funds endogenously want to convey their information to attract clients and to grow their assets under management. But they can do so only when firms invest: When firms fail to obtain funding, they do not undertake their projects and the market learns neither about their true quality nor about funds' skills. To induce firms to invest, skilled speculators must acquire information and impound it into prices, and thereby reduce firms' financial constraints. But, on the other hand, unskilled funds trade in the hope of getting lucky, distorting order flows and potentially hampering the allocative role of prices. However, the unskilled speculator's equilibrium trading pattern complements the skilled speculator's transmission of information via prices and only augments the positive effects of delegated portfolio management on capital allocation.

While in my job market paper I unveil a positive side of delegated portfolio managers' agency frictions on firms' financing constraints, in my paper with Amil Dasgupta, **“The Wall Street Walk When Investors Compete for Flows”**, I show that they impede corporate governance. Dr Dasgupta and I re-examine the corporate governance problem—the potential for managers of public firms to act against the interests of shareholders—within the contemporary context in which the true stakeholders are not in fact the owners: Shareholders are typically institutional investors. Thus there is a two-layered agency problem, firstly between the firm and the fund and secondly between the fund and its investors.

Rather than look at blockholders' ability to exert influence over managers by direct monitoring or interference—so-called “voice”—we focus on their liquidating their blocks or credibly threatening to—termed their “exit”—as a means of disciplining management. Admati and Pfleider in their 2009 paper, model a dissatisfied

blockholder selling his shares and show that the manager's anticipation of the blockholder's liquidation combined with market-indexed performance pay, suffices to induce him to act in the interest of all shareholders.

We show that fund managers' concern for investor flows may prevent them from credibly threatening the manager by exit. When blockholding is delegated, exit may be informative about the ability of funds to generate value for investors and thus affects investor flows. The signalling role of exit impairs its disciplinary potential, undermining Admati and Pfleiderer's exit threat as a governance mechanism. Our result generates testable implications across different classes of funds: Only those funds who have relatively high powered incentives will be effective in using exit as a governance mechanism.

In my paper with Jason Roderick Donaldson, "**Investment Mandates and the Downside of Precise Credit Ratings**", I set aside the career-concerns of delegated portfolio managers, to study the optimal contract between competing risk-averse delegated portfolio managers and their risk-averse clients, when a public signal about the underlying risk of an asset is contractible. The optimal contract is affine in wealth and implements both efficient investment and optimal risk sharing for each realization of the public signal, but agents' competition drives them to write the public signal into their contracts and prevent risk sharing over it, a result reminiscent of Hirshleifer (1971). The public signal may be a rating from a credit rating agency and delegated portfolio managers often tie their hands making explicit reference to credit ratings in their investment mandates. This practice leads to inefficient risk sharing; the inefficiency is more severe when the precision of the public signal increases.

Since credit ratings are a primary example of public signals upon which delegated portfolio managers contract, we advocate regulation of credit rating agencies to prohibit their publishing information in forms conducive to their inclusion in rigid contracts. Our suggestion jives with regulators' assertions that institutions should quit responding robotically to ratings, as rigid contingent contracts fine-tuned to CRA announcements force them to.

The feedback from intermediaries' behaviour to real investment comes back to the forefront in my paper "**Overrating Agencies: Competition, Collusion, Information and Regulation**", also with Jason. We model firms issuing securities to fund projects in an opaque market in which investors cannot infer the value of assets. As a result, good firms, if unable to differentiate themselves, bypass profitable investment opportunities: Informational inefficiency leads to allocational inefficiency. A rating agency by providing certification for a fee, may mend the market. Unfortunately, it not only fails to inform investors and encourage investment, but also captures a share of firms' rents. With two agencies competing in fees and disclosure rules, though, problems disappear— information is complete and investment is efficient.

When agencies interact repeatedly they are prone to collusion. When investment opportunities are plentiful they rate honestly, but charge fees so high that some positive NPV projects go unfunded. On the other hand, when there are few investment opportunities in the economy they overrate and good firms don't invest. Regulatory prescriptions of bundling ratings with CDS issues and flooring fees solve the problem.