CONVERSABLE ECONOMIST

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Campbell Harvey: Interview on Topics in Finance

An interview of Campbell Harvey by David A. Price appears in Econ Focus, published by the Federal Reserve Bank of Richmond (2015 First Quarter, pp. 26-30). Here are some comments that especially caught my eye, but the rest of the interview contains many additional nuggets like Harvey's comments on Bitcoin, a countercyclical risk premium, CEO overconfidence, and why people keep buying actively managed investment funds although they don't seem to beat the market on average.

Concerning the differences between doing work in practical finance inside a company and doing academic finance

> To be published in academic finance or economics, the idea must be unique; it's the same in the practice of finance — you're looking to do something that your competitors haven't thought of.
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> There are differences, though. The actual problems that are worked on by practitioners are more applied than the general problems we work on in financial economics.
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> The second difference is that in academic financial economics, you have the luxury of presenting your paper to colleagues from all over the world. You get feedback, which is really useful. And then you send it in for review and you get even more feedback. In business, it's different; you cannot share trade secrets. You really have to lean on your company colleagues for feedback.
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> The third thing that's different is access to data for empirical finance. When I was a doctoral student, academia had the best data. For years after that, the pioneering academic research in empirical finance relied on having this leading-edge data. That is no longer the case. The best data available today is unaffordable for any academic institution. It is incredibly expensive and that's a serious limitation in terms of what we can do in our research. Sometimes you see collaborations with companies that allow the academic researchers to access to data that they can't afford to buy. Of course, this induces other issues such as conflicts of interest. ...
>
> The fourth difference is the assistance that's available. Somebody in academia might work on a paper for months with a research assistant who might be able to offer five to 10 hours per week. In

Timothy Taylor
conversableeconomist@gmail.com

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the practice of management, you give the task to a junior researcher and he or she will work around the clock until the task is completed. What takes months in academic research could be just a few days.

The fifth difference is computing power. Academics once had the best computing power. We have access to supercomputing arrays, but those resources are difficult to access. In the practice of management, companies have massive computer power available at their fingertips. For certain types of studies, those using higher frequency data, companies have a considerable advantage.

Concerning some major open questions in finance

One is how you measure the cost of capital. We had the capital asset pricing model in 1964, but the research showed very weak support for it. We have many new models, but we are still not sure. That's on the investment side. On the corporate finance side, it would certainly be nice to know what the optimal leverage for a firm should be. We still do not know that. In banking, is it appropriate that banks have vastly more leverage than regular corporations? Again, we need a model for that. Hopefully these research advances are forthcoming. Some people have made progress, but we just don't know.

Concerning the importance of looking for big research ideas

One thing that was pretty important for me in my development was an office visit with Eugene Fama, my dissertation adviser, where I had a couple of ideas to pitch for a dissertation. I pitched the first idea, and he barely looked up from whatever paper he was reading and shook his head, saying, "That's a small idea. I wouldn't pursue it." Then I hit him with the second idea, which I thought was way better than the first one. And he kind of looked up and said, "Ehh, it's OK. It's an OK idea." He added, "Maybe you can get a publication out of it, but not in a top journal." He indicated I should come back when I had another. Even though he had shot down both of my ideas, I left feeling energized. The message from him was that I had a chance of hitting a big idea. That interaction, which I am sure he doesn't remember, was very influential — it pushed me to search for big ideas and not settle on the small ones.

Posted by Timothy Taylor at 7:00 AM

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