Discussion of

"The Effects of Experience on Investor Behavior: Evidence from India's IPO Lotteries"

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July 17, 2015

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Big Picture

- **Fundamental tradeoff:**

  The more important a research question, the less likely we are to find variation that is both economically significant and exogenous.

- This paper revisits an established research question with a remarkably clean identification strategy...

  ... but treatments that are economically insignificant.

- Authors conclude that investment experiences have a **causal effect** on (some forms of) future investment behavior.

- Authors favor behavioral interpretations precisely because of the small treatments.

Summary of Paper

- **Empirical Strategy:** Compare future behavior of investors who win shares in IPO to losers who bid for same number of shares.
- **Sample:** **40** IPOs with return > 0; **14** IPOs with return < 0
- **Investors:** **469,288** treatment and **1,093,422** control accounts.
- **No differences in investor characteristics before treatment.**
- **Treatment:** Median gain of **$30**. Median portfolio of **$1630**.
- **Winners in IPOs with positive (and less volatile) returns are:**
  - More likely to participant in future IPOs.
  - More likely to trade non-IPO stocks, exhibit disposition effect, increase weight in industry of IPO, increase number of stocks.
- Opposite effects for "winners" in IPOs with negative returns.
- Largest effects for winners in largest IPOs.
- **Sophistication:** Effects shrink as account size and age increase.
- *"experienced gains have strong effects on investor psychology."*

Summary of Discussion

- **I have nothing insightful to say about the authors' empirical strategy.**
  - It is well executed and the authors are well aware that their treatment effects are economically small.
  - Papers that use clean identification strategies and confirm existing findings are just as valuable as those that fail to confirm existing findings.
- **I have three minor suggestions based on my (limited) knowledge of the institutional details.**
- **I'm still puzzling over the economic significance of the authors' findings in terms of investor welfare.**

Institutional Details

- The authors intentionally ignore 31 IPOs where retail shares are allocated without any use of a lottery.
  - What do the authors find if they naively relate the return properties of these IPOs to future investment behavior?
  - Provides a benchmark for actual empirical strategy.
- In addition to retail investors, there are non-institutional and qualified institutional buyers (QIBs).
  - QIBs should be less prone to behavioral effects.
  - Possible to exploit variation in IPO allocations to QIBs?
- In 2011, the SEBI accused six IPOs of market manipulation due to collusion between underwriters and retail investors (Neupane, Rhee, Veeraraghavan (2014))
  - Effect of winning fraudulent IPO on future behavior?

Research Question

- **“What is the causal effect of investment experiences on future investment behavior?”**
- **Answer may reveal something interesting about investor learning or heterogeneity in investor learning**
  - Neat that effects vary with account size and age.
  - Do the effects shrink when investor wins second or third IPO lottery?
  - Could differential salience of IPO returns lead to differential “learning” about expected returns of Indian IPOs or efficiency of Indian stock market? When are allocations announced?
- **Aside:** I am more comfortable extrapolating from sample of Indian investors that participate in IPO lotteries (where direct ownership of stocks is the norm) than from sample of U.S. investors with accounts at a discount brokerage house.

Research Question (2)

- **Answer may help us better understand why investors trade and how they make asset allocation decisions**
  - Authors emphasize that they are the first to link exogenous gains and losses with future trading activity.
    - **Potential welfare implications if investors respond to gains by incurring additional trading costs and/or reducing diversification.**
    - How much trading volume can be explained by past gains and losses in individual holdings?
    - **Caveat:** I'm not sure how to think about elasticities estimated from such small treatments.
  - Overweighting of IPO sector is better-identified version of qualitative finding in Huang (2012).
  - Unlike Malmendier and Nagel (2011), authors do not find that positive IPO returns lead to larger future equity holdings.

Investor Welfare?

- **"What is the causal effect of investment experiences on investor welfare?"**
  - *Likely dominated by effect on level of wealth (e.g., Enron).*
- I'm not sure how much the paper speaks to this question, or how concerned I am that unobserved investor heterogeneity contaminates studies asking how equity **realizations** effect.
  - *401(k) plan savings rates (Choi, Laibson, Madrian, Metrick (2009)).*
  - *Participation in equity markets (Calvet, Campbell, Sodini (2007)).*
  - *Retirement timing (Chalmers, Johnson, Reuter (2013)).*
- Treatments in this paper are arguably too small to effect decisions along these important margins (especially when compared to Briggs, Cesarini, Lindqvist, Ostling (2015)).

Investment Experiences?

- **How do investors in different settings perceive their investment experiences?**
- Choi et al. (2009) show that larger, less volatile returns *within* year and plan associated with higher savings rates; conclude “investors follow a naive reinforcement learning heuristic.”
- Nature of experience may depend on the menu and default option.
- Preliminary tabulations from TIAA-CREF reveal those defaulted into TDFs before the financial crisis are much more likely to remain fully invested in TDFs than those defaulted into MMFs.

2007 New Participants Who Had Been PP thru 2014 and Remained in The Same Default Funds		
Year	MM Defaulters	LC Defaulters
2007	100.0%	100.0%
2008	97.3%	97.9%
2009	88.6%	96.4%
2010	77.4%	95.4%
2011	65.9%	94.7%
2012	52.1%	93.9%
2013	45.8%	93.2%
2014	38.9%	91.8%

Conclusion

- **The paper does everything that its empirical strategy allows it to do and no more.**
- It convinced me that gains and losses have a causal effect on the likelihood of trading... at least within the sample of investors who actively trade individual stocks.
- I do not know whether the effects will generalize to other samples of investors or how to think about the welfare consequences of these effects on the sample studied in this paper...
- ... But those are inherent limitations of the experiment rather than of the paper.