Discussion of Heaton and Lucas (2009)

"Capital Structure, Hurdle Rates and Portfolio Choice – Interaction in an Entrepreneurial Firm"

Paul Willen

Federal Reserve Bank of Boston

Bank of Spain Conference, October 15, 2009

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  - Steve Davis and I were working on a paper called, "Occupation-Level Income Shocks and Asset Returns: Covariance Structure and Portfolio Choice Implications

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  - and play baseball

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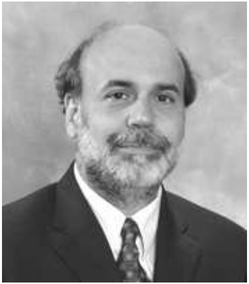

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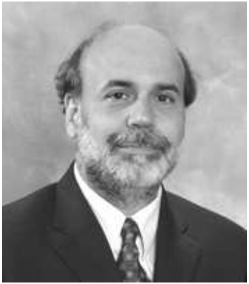

- When I say "we", I don't mean Ben and me.

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> *No one who cannot rejoice in the discovery of his own mistakes deserves to be called a scholar.*
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> –Donald Foster

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- Findings:
  - Investors will use "risky debt" to finance entrepreneurial projects to the fullest extent, conditional on investing in such a project.
  - But the "hurdle" rate to get them to do the project may be quite high and is well above their apparent cost of funds.

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- It's easy to understand classical portfolio choice.
- Borrowing constraints, short sale, etc. wreak havoc.

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  - Risk adjusted return = expected return.

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  - Wealth – lower wealth means that consumption more highly correlated with investment outcome for given size of investment – risk-adjusted return lower.

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- The end.