



Swiss Finance Institute Practitioner Roundups



Prof. Laurent Frésard

Laurent Frésard is Professor of Finance at the Università della Svizzera italiana and holds an SFI Senior Chair. He received his PhD in Finance from the University of Neuchâtel. Before joining the faculty in Lugano, he was a member of the faculty at the University of Maryland and at HEC Paris. His research interests lie in the area of empirical corporate finance.

The Finance Wage Premium and the Reallocation of Skilled Workers

The size of the financial sector, like the compensation of its workers, has been growing considerably over the past 40 years. Since the 2008 financial crisis, academics, policy makers, and the press have been concerned that excessive compensation in the sector might be distorting the economy, as talented workers reallocate from occupations that generate high social returns to more lucrative jobs in finance.

SFI Professor Laurent Frésard and fellow researcher Francesco D'Acunto (University of Maryland) study the effect of growing finance wages on worker reallocation and economic growth in their research paper *Finance, Talent Allocation, and Growth*. They contribute to the literature, whose focus has been on the rising finance wage premium, by focusing on the consequences of the rise in that premium for talent allocation across the job market and the economy. Their results show that growing finance wages are associated with a modest reallocation of skilled workers from non-finance sectors to finance, but that such a reallocation carries no consequences for the overall economy.

What do higher salaries mean?

Although it is quite clear that higher salaries attract talented individuals, this does not mean that higher salaries induce a harmful misallocation of talent in the economy. One could indeed argue that the increase in salaries and skills in a given sector reflects an improvement of the services provided by that sector to the overall economy. One must not forget that the financial sector helps talented individuals start and develop new companies, which affect our everyday lives.

The adjusted growth of finance wages

To determine whether the increase in finance salaries leads to an increase in the value added the financial sector provides to the economy one must compare one to the other. To do so, the authors develop the finance wage premium (the wage of skilled workers in finance relative to the wage of skilled workers in the rest of the economy) and the finance value added premium (the value added per skilled worker in finance relative to the value added per skilled

worker in the rest of the economy). The difference between the two equals the adjusted growth of finance wages (AGFW). If, for example, this difference equals zero, then the private return of working in finance is equal to the social return that finance provides to the economy.

What does data reveal regarding the AGFW?

Data covering 24 countries in North America, Europe, Asia, and Oceania for 35 years show that the AGFW yields a positive value, suggesting that the relative wages in the financial sectors have grown faster than the contributions of the financial sectors of these countries' respective economies. Further analysis reveals that the AGFW has decreased over time and is now close to zero. Data also reveal that the share of skilled workers in the economy increased by 30 percent between 1970 and 2005, that skilled workers have benefited from a largely time-consistent wage premium of 74 percent in comparison to medium- and low-skilled workers, and that workers in the financial sector have a largely time-consistent wage premium of close to 60 percent over the other sectors of the economy.

Does the workforce reallocate when the AGFW changes? And does this affect the overall economy?

Analysis reveals that skilled workers shift away from non-financial sectors and into financial sectors when the AGFW increases. Further estimates show that this effect was particularly strong in the early nineties and is not concentrated in either high- or low-income economies. Data show that sectors in which workers have skills that are easier to transfer to finance jobs are the most affected by reallocations induced by changes in the AGFW and that sectors that rely heavily on finance in order to grow are the least affected. Although reallocation between non-finance and finance sectors due to changes in the AGFW is significant, it exerts little overall impact as it affects less than 1 percent of the overall skilled workforce. The researchers find no impact of changes in the AGFW and of workforce reallocation on usual economic performance measures such as output, value added, total factor productivity, or GDP.





John Hucker, CFA, MBA

John Hucker is CEO of Elliott Capital, a venture builder and deconstructed accelerator, and the founder and President of the Swiss Finance + Technology Association. He holds an MBA from Saïd Business School (Oxford) and is a CFA charterholder. His previous roles were in wealth and asset management at Credit Suisse, UBS, and TD Bank.

Rethinking the «Golden Cage»

The research by SFI Professor Frésard and Professor D'Acunto examines whether high salaries in finance hurt society by pulling individuals away from jobs that would make better use of their talents. A similar issue, known as the «Golden Cage» is often cited as being among the top challenges for entrepreneurship in Switzerland, particularly in the area of Fintech. It refers to the effect that the high salaries available in finance have on would-be entrepreneurs and the pool of talent available to start-ups. Whether talking about the opportunity costs of leaving a job in finance or the high cost of hiring talent, there is no doubt that money is a major factor. That said, my experience on both sides of the issue has led me to believe that the Golden Cage is not a real roadblock. Why? Because entrepreneurs find a way to pursue their vision in all conditions, and the high salaries in Swiss finance actually offer a number of advantages.

Valuable experience

Working in finance provides experience not available outside the industry, which can be valuable in Fintech and in all areas of entrepreneurship—it includes negotiating financing and managing risks. Also, unlike in many other areas of start-up activity, where youth has a clear advantage, experience still counts for a lot in Fintech. Attracting talent to work for a number of years in a well-paid finance job creates a great foundation for a career in Fintech or entrepreneurship, specifically by training people to better understand risk and reward.

Stockpiling cash

The ability to save money to support entrepreneurial endeavors is an obvious advantage to working in finance. While gaining experience, it makes sense to start putting money aside and working on your business plans. The costs of launching a start-up may continue to drop, but well-paid financial professionals still have an advantage when it comes to being financially prepared for entrepreneurship. It should also be possible to develop networks that allow access to more funds with which to finance future ventures.

Extreme conditions

Much like running in the mountains can push the body to new levels of performance, dealing with the high salaries in Switzerland makes Fintech entrepreneurs more adaptive, innovative, and internationally competitive. Teams learn to become more efficient with manpower and to leverage technology; they become more effective by working virtually; they develop international supply networks. Extreme conditions also have the benefit of discouraging amateurs or lifestyle entrepreneurs, simply because they cannot afford the high cost environment of the Swiss financial center. Anyone choosing to become a Fintech entrepreneur in Switzerland knows that the high cost of industry talent requires them to make full use of its productivity.

Fintech offers the best of finance and tech industries

The data by SFI Professor Frésard and Professor D'Acunto shows that sectors in which workers have skills that are easier to transfer into finance jobs and innovative sectors are the most affected by reallocations induced by changes in the adjusted growth of finance wages, or AGFW. This is consistent with the strong interest from financial professionals to enter Fintech, where company valuations have risen to high levels, versus bank salaries which have become more modest in recent years.

It is no fluke that many talented people pursue well-paid careers in finance. The jobs are demanding and rewarding for those who can obtain them. At the same time, the experience, financial resources, and competitive experiences developed by working in finance also put talented people in an excellent position to evaluate the potential risks and rewards of leaving the Golden Cage to pursue Fintech and entrepreneurship. When entrepreneurs find a great opportunity, there is no holding them back until it has been realized.

