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# HKMetrics-Seminar@Heidelberg

Research Seminar in Econometrics and Statistics

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## Optimal Peers

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**November 04, 13:30 – 14:30**

**Alfred-Weber-Institute, Bergheimer Str. 58, Room 00.010**

**Abstract:** This paper provides a theoretical foundation for constructing optimal benchmarks via machine learning (ML). For a broad class of performance models, the optimal benchmark is given by an appropriately weighted portfolio of peers. I show that Ordinary Least Squares (OLS) provides the theoretically optimal portfolio weights in the population. In finite samples, machine learning methods, notably the lasso, can provide a robust, implementable solution. In an application to a large sample of U.S. public firms, ML-based benchmarks strongly outperform traditional industry benchmarks in out-of-sample explanatory power. This suggests that ML-based benchmarks can substantially improve outcomes in a wide range of applications, such as incentive contracts or relative performance evaluation.