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Directional Distance Estimators**

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# Fast and Efficient Computation of Directional Distance Estimators

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## Abstract

Directional distances provide useful, flexible measures of technical efficiency of production units relative to the efficient frontier of the attainable set in input-output space. In addition, the additive nature of directional distances permits negative input or outputs quantities. The choice of the direction allows analysis of different strategies for the units attempting to reach the efficient frontier. Simar et al. (2012) and Simar and Vanhems (2012) develop asymptotic properties of full-envelopment, FDH and DEA estimators of directional distances as well as robust order- $m$  and order- $\alpha$  directional distance estimators. Extensions of these estimators to measures conditioned on environmental variables  $Z$  are also available (e.g., see Daraio and Simar, 2014). The resulting estimators have been shown to share the properties of their corresponding radial measures. However, to date the algorithms proposed for computing the directional distance estimates suffer from various numerical drawbacks (Daraio and Simar, 2014). In particular, for the order- $m$  versions (conditional and unconditional) only approximations, based on Monte-Carlo methods, have been suggested, involving additional computational burden. In this paper we propose a new fast and efficient method to compute exact values of the directional distance estimates for all the cases (full and partial frontier cases, unconditional or conditional to external factors), that overcome all previous difficulties. This new method is illustrated on simulated and real data sets. Matlab code for computation is provided in an appendix.

**Keywords:** directional distances, conditional efficiency, robust frontiers, environmental factors, nonparametric methods.

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# 1 Introduction

Production theory and efficiency analysis examine how production units (i.e., Decision Making Units or DMUs) transform quantities of inputs (e.g., labor, energy and capital) into quantities of outputs (e.g., goods and services). The technical efficiency of a particular unit is then measured by distance in some direction from the unit’s location in input-output space to the technology, i.e., the frontier of the production set.

Traditional nonparametric efficiency estimators based on radial contractions of inputs or radial expansions of outputs to reach the frontier have been proposed by Farrell (1957), Charnes et al. (1978) and Deprins et al. (1984).<sup>1</sup> More recently, estimators of directional distance efficiency have been proposed by Chambers et al. (1996). The directional measures of efficiency and their corresponding estimators nest the input and output-oriented versions of the original DEA and FDH estimators, but also permit estimation of efficiency along other paths to the frontier. In addition, the directional estimators permit negative values of input or output quantities, unlike the earlier radial estimators. This enhanced flexibility has made directional measures and their estimators popular in recent years.

The conditional efficiency estimators based on FDH and DEA have been extended to robust order- $m$  and order- $\alpha$  type estimators; see Daraio and Simar (2007) for an introduction and Simar and Wilson (2013, 2015) for comprehensive summaries. These robust estimators are based on the idea of estimating distance from a given DMU’s position in input-output space to a *partial frontier* lying “close” to the full frontier (i.e., the boundary of the production set). Partial frontiers provide an alternative benchmark, and provide advantages over the full-envelopment FDH and DEA estimators in terms of the resulting statistical properties. Inclusion of environmental variables may reflect heterogeneity of the DMUs and their operating environments. Environmental variables are neither inputs nor outputs, but instead are external (to the DMU) factors that may affect the performance of the units. Efficiency estimates are *conditioned* on these variables in the sense that efficiency is estimated *given the environment described by the environmental variables*. Bădin et al. (2014) provide an overview.

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<sup>1</sup> The Data Envelopment Analysis (DEA) estimators proposed by Farrell (1957) and Charnes et al. (1978) impose convexity on the production set, while the Free Disposal Hull (FDH) estimator proposed by Deprins et al. (1984) does not.

The statistical properties of both conditional and unconditional directional distance estimators have been derived by Simar and Vanhems (2012) and Simar et al. (2012) for both the full-envelopment and robust, partial frontier cases. However, as observed by Daraio and Simar (2014), computation of directional distance estimates is problematic due to numerical issues as well as a substantial computational burden due to reliance on Monte-Carlo approximations required to compute the estimates.

This paper provides a new, fast and efficient method to compute exact values of the directional distance estimates for all the cases (i.e., both the full frontier case as well as the robust, partial-frontier cases, and both conditional or unconditional cases). The new method eliminates the need for Monte-Carlo approximations and provides exact solutions. This avoids the substantial computational burden that has been incurred until now. In addition, the new method avoids numerical problems that can arise in applications when the previous computational methods are used in applications. This new method is illustrated on both simulated and real data, and Matlab code is provided for use by practitioners.

The results provided in this paper are relevant to practitioners, in particular because the robust directional distance estimators (both conditional and unconditional) are widely used. Conditional efficiency analyses have been applied to carry out innovation studies at regional level (Broekel, 2012) and environmental analyses at both national (Halkos and Tzeremes, 2014; Halkos et al., 2016; Halkos and Managi, 2017; Manello, 2017) as well as regional levels accounting for governance issues (Halkos et al., 2015) and growth (Halkos et al., 2016; Halkos and Tzeremes, 2013a). Applications in agriculture (Serra and Lansink, 2014) include the efficiency of family firms (Baležentis and De Witte, 2015) and the analysis of the effect of public subsidies on farm efficiency (Minviel and De Witte, 2017). Examples of applications in the financial sector include Mallick et al. (2016), Matousek and Tzeremes (2016) and Tzeremes (2015). Other interesting applications examine libraries (De Witte and Geys, 2011), primary schools (Cordero et al., 2017b), secondary schools (Haelermans and De Witte, 2012), municipalities (Cordero et al., 2017a), the health care sector (Varabyova et al., 2017; Varabyova and Schreyögg, 2017; Ferreira et al., 2018), water utilities (Zschille, 2015), waste management (Fuentes et al., 2015; Guerrini et al., 2016), culture and eco-efficiency (Halkos and Tzeremes, 2013b) and local police departments (Vershelde and Rogge, 2012).

The paper is organized as follows. The next section introduces the basic concepts and

notation and provides an outline of the issues addressed by the paper. Section 3 presents the full frontier cases distinguishing between unconditional and conditional analyses, Sections 4 and 5 analyze the partial frontier approaches, presenting again for each of them the unconditional and conditional cases. Section 6 reports the outcome of the application of the new proposed method for computing directional distances to simulated as well as real data. Section 7 provides conclusions and a brief summary of the main results. Matlab code implementing the new computational method is provided in Appendix A.

## 2 Statistical Framework and Notation

This section introduces the basic concepts and notation needed to present the new computational methods for directional distances in the various cases of interest. We first summarize the concepts of directional distance functions and their conditional versions which allow analysis of possible heterogeneity due to some environmental factors. We then give the intuition behind the robust partial frontiers (order- $\alpha$  and order- $m$ ) in the context of directional distances. Finally, we discuss the drawbacks of the existing algorithms for computing these various directional distances and the need for the new computational methods provided later in this paper.

### 2.1 Directional Distances and Their Probabilistic Formulation

Consider a production process in which  $p$  inputs are used to produce  $q$  outputs. The production set

$$\Psi = \{(x, y) \in \mathbb{R}^{p+q} \mid x \text{ can produce } y\} \quad (2.1)$$

is the set of technically feasible combinations of inputs and outputs. The efficient frontier of  $\Psi$  is defined by

$$\Psi^\partial = \{(x, y) \in \Psi \mid (\gamma^{-1}x, \gamma y) \notin \Psi \forall \gamma > 1\}. \quad (2.2)$$

Traditional approaches to efficiency measurement based on the ideas of Farrell (1957), Debreu (1951) and Shephard (1970) involve measuring the distance from a production plan  $(x, y)$  to the efficient frontier  $\Psi^\partial$  in either the input or output direction by considering either the maximum feasible, proportionate reduction in input quantities (holding output fixed) or the maximum feasible, proportionate increase in output quantities (holding input fixed). With

these *radial* measures of efficiency, only non-negative values of input and output quantities can be accommodated.

Nonparametric estimators of the attainable set  $\Psi$  are often based on envelopment of the cloud of observed points  $\mathcal{X}_n = \{(X_i, Y_i)\}_{i=1}^n$ . The Free Disposal Hull (FDH), suggested by Deprins et al. (1984), only assumes free disposability of both inputs and outputs, whereas the Data Envelopment Analysis (DEA) estimators proposed by Farrell (1957) and popularized by Charnes et al. (1978) assume convexity of  $\Psi$  as well as free disposability of inputs and outputs. The properties of the resulting estimators of efficiency measures, in the radial cases, have been derived in Park et al. (2000) for the FDH case and in Kneip et al. (2008) for the DEA with varying returns to scale and Park et al. (2010) for the DEA with constant returns to scale. It is now well-known that these estimators suffers from the “curse of dimensionality.” When the dimension  $p + q$  increases, the rates of convergence become slower. For individual efficiency measures, bootstrap techniques are required to make inference, estimate bias and estimate confidence intervals. For more details, see the recent surveys by Simar and Wilson (2013, 2015) and the references therein.

Directional distances introduced by Chambers et al. (1996, 1996) and discussed by Färe and Grosskopf (2004) provide useful and flexible ways to measure technical efficiency of units relative to the efficient frontier. The directional distance function

$$\beta(x, y \mid d_x, d_y) = \sup\{\beta > 0 \mid (x - \beta d_x, y + \beta d_y) \in \Psi\} \quad (2.3)$$

projects the input-output vector  $(x, y)$  onto the technology in a direction specified by a vector  $d = (d_x, d_y) \geq 0$ . The choice of the directions  $d_x$  and  $d_y$  for measuring the distance from the unit operating at  $(x, y) \in \Psi$  to the frontier allows analysis of different strategies for the units to reach the efficient frontier. Note that some directions (but not all) can be set equal to zero, indicating the components of  $X$  and  $Y$  that are “inactive” in the optimization described in (2.3). For instance is the vector  $d_x = 0$ , and if all the outputs take positive values, then the Farrell-Debreu radial output efficiency measure is given by  $1 + \beta(x, y \mid 0, y)$ . Alternatively, in the input orientation, if all the inputs take positive values, the Farrell-Debreu radial efficiency is given by  $1 - \beta(x, y \mid x, 0)$ . Note that the additive nature of directional distances allows to treat negative inputs and outputs, which is not the case for radial distances.

In practice all these quantities are unknown and must be estimated from a sample of observations  $\mathcal{X}_n = \{(X_i, Y_i)\}_{i=1}^n$ . Therefore, in order to evaluate the properties of the resulting

estimates, and to make inference, a statistical model is required. We adopt the probabilistic formulation of Cazals et al. (2002) and extended by Daraio and Simar (2005). The production process is characterized by the process that generates a vector of inputs and outputs defined over an appropriate probability space. Let  $X \in \mathbb{R}^p$  denote a  $p$ -vector of inputs and  $Y \in \mathbb{R}^q$  denote a  $q$ -vector of outputs. The joint distribution of  $(X, Y)$  has support over  $\Psi$ . Now consider the joint probability  $H_{XY}(x, y) = \Pr(X \leq x, Y \geq y)$ , which is the probability of finding a unit  $(X, Y)$  dominating the point  $(x, y)$ . As shown by Cazals et al. (2002), under the free disposability assumption<sup>2</sup>

$$\Psi = \{(x, y) \in \mathbb{R}^{p+q} \mid H_{XY}(x, y) > 0\}. \quad (2.4)$$

Simar and Vanhems (2012) show that under free disposability,

$$\beta(x, y \mid d_x, d_y) = \sup\{\beta > 0 \mid H_{XY}(x - \beta d_x, y + \beta d_y) > 0\}. \quad (2.5)$$

Nonparametric estimators of the attainable set are typically obtained by envelopment techniques. Simar and Vanhems (2012) and Simar et al. (2012) show that the resulting estimators of the directional distances share properties similar to those of the radial measures.

In this paper we will focus on the FDH family of estimators, without imposing convexity of the attainable set. In this case, it can be shown that the FDH estimator of  $\beta(x, y \mid d_x, d_y)$  can also be obtained by plugging (2.5) into the empirical version of  $H_{XY}$  given by

$$\widehat{H}_{n,XY}(x, y) = \frac{1}{n} \sum_{i=1}^n \mathbb{1}(X_i \leq x, Y_i \geq y), \quad (2.6)$$

where  $\mathbb{1}(\cdot)$  is the indicator function ( $\mathbb{1}(a) = 1$  if  $a$  is true and 0 otherwise). We will see below how to implement this in practice, in particular when some (but not all) elements of  $(d_x, d_y)$  are set at zero.

## 2.2 Introducing Environmental Variables

The probabilistic characterization of the production process defined above allows quite naturally introduction of environmental factors into the process. Consider the case where external environmental variables  $Z \in \mathcal{Z} \subset \mathbb{R}^r$  represent heterogeneity factors that may influence the

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<sup>2</sup> The free disposability of inputs and outputs assumes that if  $(x, y) \in \Psi$ , then  $(\tilde{x}, \tilde{y}) \in \Psi$  for all  $(\tilde{x}, \tilde{y})$  such that  $\tilde{x} \geq x$  and  $\tilde{y} \leq y$ . In a sense, it assumes the possibility of wasting resources.

production process. To accommodate these variables, the probability space considered so far has to be augmented. We consider the probability space  $(\Omega, \mathcal{F}, \mathbb{P})$  on which the random variables  $X, Y, Z$  are defined and we denote by  $\mathcal{P}$  the support of the joint distribution of  $(X, Y, Z)$ . Let  $\Psi^z$  denote the support of  $(X, Y)$  given  $Z = z$ . Thus the attainable set for firms facing external conditions  $Z = z$  is given by

$$\begin{aligned}\Psi^z &= \{(x, y) \in \mathbb{R}^{p+q} \mid x \text{ can produce } y \text{ if } Z = z\} \\ &= \{(x, y) \in \mathbb{R}^{p+q} \mid H_{XY|Z}(x, y \mid z) > 0\},\end{aligned}\tag{2.7}$$

where  $H_{XY|Z}(x, y \mid z) = \Pr(X \leq x, Y \geq y \mid Z = z)$ . The variables in  $Z$  can affect the production process either (i) through  $\Psi^z$  the support of  $(X, Y)$ , (ii) through the conditional distribution of  $(X, Y)$  given  $Z$ , affecting e.g. only the probability of a firm to reach its optimal boundary, or (iii) through both (i) and (ii).

It is easy to see that  $\Psi = \bigcup_{z \in \mathcal{Z}} \Psi^z$ , so that  $\Psi^z \subseteq \Psi$ , for all  $z \in \mathcal{Z}$ . In the very particular case where the joint support of  $(X, Y, Z)$  can be written as the Cartesian product  $\mathcal{P} = \Psi \times \mathcal{Z}$ ,  $Z$  has no impact on the boundaries of  $\Psi$  and  $\Psi^z = \Psi$  for all  $z \in \mathcal{Z}$  (this is called the “separability condition” in the literature; e.g., see Simar and Wilson, 2007, 2011). In the latter case,  $Z$  may eventually influence the production process only through the probability of reaching its optimal boundary. Daraio et al. (2018) provide a procedure for testing this separability condition.

Now we can define the conditional directional distance function

$$\beta(x, y \mid d_x, d_y, z) = \sup\{\beta > 0 \mid H_{XY|Z}(x - \beta d_x, y + \beta d_y \mid z) > 0\}.\tag{2.8}$$

Here again, we can recover the conditional version of the radial Farrell-Debreu measures by the appropriate choice of the distance vector. A nonparametric estimator of  $\beta(x, y \mid d_x, d_y, z)$  is obtained from a sample  $\mathcal{X}_n = \{(X_i, Y_i, Z_i)\}_{i=1}^n$  by plugging a nonparametric estimator of  $H_{XY|Z}(x, y \mid z)$  into (2.8). This conditional version requires smoothing over the values of  $Z_i$  in a neighborhood of  $z$  since observations with exact values  $Z_i = z$  are typically not available. We use the empirical, localized analog of  $H_{XY|Z}(x, y \mid z)$  given by

$$\widehat{H}_{n,XY|Z}(x, y \mid Z = z) = \frac{\sum_{i=1}^n \mathbb{1}(X_i \leq x, Y_i \geq y) K_h(Z_i, z)}{\sum_{i=1}^n K_h(Z_i, z)},\tag{2.9}$$

where  $K_h(Z_i, z)$  are appropriate kernel functions (with compact support) and  $h$  is a vector of  $r$  bandwidths, one for each component of  $z$ . In fact, it can be shown that the conditional

FDH estimator is a localized version of the unconditional case, where the localization is tuned by the bandwidths  $h$ . The estimator is the FDH estimator computed over the subsample of observations  $i = 1, \dots, n$  such that  $\|Z_i - z\| \leq h$  (see Cazals et al., 2002 and Daraio and Simar, 2005 for details).<sup>3</sup> The asymptotic properties of the resulting estimators of the radial conditional measures have been established in Jeong et al. (2010) and adapted to directional distances in Simar and Vanhems (2012). To summarize, we keep similar properties as in the unconditional case but with a reduced number of observations:  $n$  is replaced by  $n \prod_{j=1}^r h^{(j)}$ .

Conditioning on  $Z$  requires the determination of an  $r$ -vector of bandwidths. For the radial oriented efficiency scores, Bădin et al. (2010) suggest adapting least squares cross validation techniques from the literature. However, Simar et al. (2016) show (see their Appendix B) that better monotonicity properties of the resulting efficiency estimates are achieved by searching for the optimal bandwidth when estimating the joint probability  $H_{XY|Z}(x, y | z)$ .<sup>4</sup> Here direct methods suggested by Li et al. (2013) can be used (Matlab code for this purpose is provided by Bădin et al., 2018). A detailed methodology on how to analyze the effect of  $Z$  on the production process has been proposed by Bădin et al. (2012, 2014). Simar et al. (2016) show how to adapt the approach when  $Z$  is latent and hence unobserved. This requires an additional model and an instrument to identify  $Z$ .

### 2.3 Partial Frontiers: Robust Approaches

Nonparametric FDH and DEA estimators are envelopment estimators in the sense that the corresponding estimate of  $\Psi$  (or of  $\Psi^z$ ) envelops the cloud of observed data points. Consequently, these estimators are highly sensitive to extreme data points and outliers. This provides the major interest in the robust version of these estimators developed for radial measures by Cazals et al. (2002), Aragon et al. (2005) and Daouia and Simar (2007). Simar and Vanhems (2012) extend these concepts to directional distances. In all cases, the idea is to define a less-extreme boundary to use as a benchmark, i.e. to define a *partial frontier* in contrast to the full frontier used above. By construction, some data points may lie outside the partial-frontier, but nonetheless the partial frontier provides a useful benchmark for evaluating efficiency. Two classes of partial frontiers have been suggested in the literature:

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<sup>3</sup> The inequality  $\|Z_i - z\| \leq h$  has to be understood component by component  $|Z_i^{(j)} - z^{(j)}| \leq h^{(j)}$ .

<sup>4</sup> See the discussion in Footnote 6 below.

the order- $\alpha$  quantile frontier and the order- $m$  partial frontier. In this summary we give only some intuitive definitions for the case of one output and with the output orientation (e.g.  $d_x = 0$  and  $d_y = 1$ ) for the unconditional case where  $Z$  does not play a role. In the remaining sections of the paper we will derive expressions for the most general cases.

For any  $\alpha \in (0, 1]$  the directional distance of order- $\alpha$  is given by

$$\beta_\alpha(x, y | 0, 1) = \sup\{\beta \mid S_{Y|X}(y + \beta \mid x) > 1 - \alpha\}, \quad (2.10)$$

where  $S_{Y|X}(y \mid x) = \Pr(Y \geq y \mid X \leq x) = H_{XY}(x, y)/F_X(x)$  is the conditional survival function of  $Y$  given  $X \leq x$ . Note that if  $\alpha \rightarrow 1$ , we are back the usual full frontier measure (for  $d = (0, 1)$ ). So for  $\alpha < 1$ , the benchmark frontier for the unit  $(x, y)$  (i.e. where  $\beta_\alpha(x, y | 0, 1) = 0$ ) corresponds to the  $\alpha$ -quantile of the conditional distribution of the output among the population of units using less inputs than  $x$ .

Then the partial order- $\alpha$  frontier (or the “order- $\alpha$  quantile frontier”) is given by

$$\varphi_\alpha(x) = y + \beta_\alpha(x, y | 0, 1), \quad (2.11)$$

where  $y$  can be any value in the support of  $S_{Y|X}(\cdot \mid x)$ . Note that  $\beta_\alpha(x, y | 0, 1)$  can takes negative values if  $y$  is large and hence this unit lies above the conditional quantile frontier of order- $\alpha$ .

The order- $m$  frontier in the same (output) orientation can be defined for any integer  $m$  as

$$\varphi_m(x) = \mathbb{E} [\max(Y_1, \dots, Y_m) \mid X \leq x], \quad (2.12)$$

where the  $Y_j$  are independent, identically distributed (iid) realization of the output  $Y$ , conditionally on  $X \leq x$ . Here, as  $m \rightarrow \infty$ , we are back to the usual full-frontier measure. So the benchmark frontier is the expected value of the maximum output among  $m$  peers drawn from the population of units using less inputs than  $x$ . It can be shown that when  $Y$  takes only positive values,

$$\varphi_m(x, y) = \int_0^\infty [1 - (1 - S_{Y|X}(y \mid x))^m] dy. \quad (2.13)$$

Note again that  $\beta_m(x, y | 0, 1) = \varphi_m(x) - y$  can take negative values for large values of  $y$ .

Nonparametric estimators are obtained by plugging in the empirical versions of the conditional survival function. They share interesting properties, in particular, and by contrast

to the full frontier estimates, they achieve the parametric  $\sqrt{n}$ -rate of convergence independently of the dimension of the problem ( $p + q$ ). The statistical properties of the order- $m$  estimators have been established by Cazals et al. (2002) and for the order- $\alpha$  cases by Daouia and Simar (2007). These include the conditional to  $Z$  cases. Simar and Vanhems (2012) extend these to the directional distances cases.

We will provide below general expressions for evaluating the directional distance to these partial frontiers (conditional and unconditional to  $Z$ ) and their estimators. Recall that their robustness properties rely on the fact that for large  $\alpha$  (or  $m$ ) we estimate a partial frontier not far from the full frontier, but for  $\alpha < 1$  and finite  $m$ , the estimators will not envelop all the data points and so are robust to extreme data points and outliers. Comparisons of the two concepts from a robustness point of view can be found in Daouia and Ruiz-Gazen (2006) and Daouia and Gijbels (2011b). Daouia et al. (2010, 2012) show how these partial frontiers can be used for estimating the full frontier, letting  $\alpha \rightarrow 1$  and  $m \rightarrow \infty$  when  $n \rightarrow \infty$  but at an appropriate rate.

## 2.4 Aim of the Paper

After the summary in the preceding sections, we next focus on the computational issues of directional distance functions. Simar and Vanhems (2012) show the equivalence between directional distances and hyperbolic radial distances after a monotonic transformation of the coordinate space of the inputs and the outputs. To summarize, for the “active” variables (those with components in  $d$  being  $> 0$ ), the transformation is defined as

$$X^* = \exp(X \oslash d_x) \text{ and } Y^* = \exp(Y \oslash d_y), \quad (2.14)$$

where  $\oslash$  is the Hadamard component-wise division of vectors. The “non-active” variables can remain as they are.

This transformation is useful for obtaining the theoretical properties of the resulting estimators but may create some numerical problems for their practical computations (Daraio and Simar, 2014). The exponential transformation may provide huge numbers that have to be carefully handled to avoid numerical problems when handling ratios (which is typical in FDH approaches).<sup>5</sup> Also the log transformation at the end, for coming back to original units,

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<sup>5</sup> Note e.g. that  $\exp(50)$  is already of the order  $5 \times 10^{21}$ . So without rescaling the variables we may have

may create other problems. Simar and Vanhems (2012) observe that this is particularly the case for the order- $m$  estimators where the  $\log(w)$  comes in an integral starting at  $w = 0$ . The integral is well defined but its numerical treatment can be difficult. So for the order- $m$  estimators (either conditional on  $Z$  or unconditional on  $Z$ ), only approximate solutions based on Monte-Carlo simulations have been proposed so far. These Monte-Carlo approximations are not easy to implement (especially for the conditional-on- $Z$  case; see Daraio and Simar, 2014 for discussion), and may involve substantial computational burden to achieve reasonable precision. In this paper we propose an alternative, but equivalent, formulation of the directional distances which avoids *all* of these drawbacks. In the same set up and for the different nonparametric robust conditional and unconditional cases covered by Simar and Vanhems (2012) and by Daraio and Simar (2014) we propose a fast and efficient formula for computing the directional distances, also in the most general cases where some components of  $d_x$  and of  $d_y$  might be equal to zero. In addition, we provide simple expressions for the exact computation of the order- $m$  directional distances (both unconditional and conditional). The main difficulty is to provide a formulation capable of handling cases where some of the inputs or outputs are inactive (i.e., with  $d$ -elements equal to zero). This is important since it reflects one of the most interesting flexibility properties of the directional distance functions.

In the next sections we detail how our method can be applied in various scenarios, cases. Appendix A provides the Matlab code implementing our methods.

## 3 Full Frontier Cases

### 3.1 Unconditional Case

To fix the notation, and without loss of generality, let us partition  $d_x = (d_{x_1}, d_{x_2})$ , where  $d_{x_2} = 0$  is of dimension  $p_2 \geq 0$ . Then  $d_{x_1} > 0$  is of dimension  $p_1 = p - p_2$ . Note that  $d_{x_2}$  could be an empty vector with  $p_2 = 0$ . We use similar notational convention for the elements of  $d_y = (d_{y_1}, d_{y_2})$  with  $d_{y_2} = 0$  of dimension  $q_2 \geq 0$ . We partition all the inputs and outputs analogously, noting that  $X_2$  and/or  $Y_2$  could be empty vectors. So  $X_1$  and  $Y_1$  are the active variables in the optimization equations above.

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numerical imprecision and overflow conditions on digital computers. Note that the corresponding elements of the direction vector have to be rescaled accordingly, to avoid misinterpretation of the resulting  $\beta$ . This creates additional potential for confusion or errors.

Following Appendix B in Simar and Vanhems (2012), in the presence of inactive directions, the directional distance is defined as

$$\beta(x, y \mid d_x, d_y) = \sup\{\beta > 0 \mid H_{X_1 Y_1 \mid X_2 Y_2}(x_1 - \beta d_{x_1}, y_1 + \beta d_{y_1} \mid x_2, y_2) > 0\}, \quad (3.1)$$

where  $H_{X_1 Y_1 \mid X_2 Y_2}(x_1, y_1 \mid x_2, y_2) = \Pr(X_1 \leq x_1, Y_1 \geq y_1 \mid X_2 \leq x_2, Y_2 \geq y_2)$  is the conditional probability of dominating  $(x_1, y_1)$  given that  $X_2 \leq x_2, Y_2 \geq y_2$ . This is in the spirit of the probabilistic characterization of the Farrell-Debreu concept of efficiency introduced by Cazals et al. (2002). For instance, in the pure output orientation  $d_x = 0$  and  $d_y > 0$ , the efficient frontier for a unit  $(x, y)$  is given by the upper support of the conditional distribution of  $Y$  given  $X \leq x$ . Note also that for units where  $H_{X_2 Y_2}(x_2, y_2) > 0$ , for the full frontier case, the directional distance may also be computed as

$$\beta(x, y \mid d_x, d_y) = \sup\{\beta > 0 \mid H_{XY}(x_1 - \beta d_{x_1}, x_2, y_1 + \beta d_{y_1}, y_2) > 0\}. \quad (3.2)$$

As explained below, the latter equivalence will not be valid for the robust versions of the frontiers where the conditioning on  $X_2 \leq x_2, Y_2 \geq y_2$  has to be used, as in (3.1).

Directional distances are independent of the units of measurement as described in Färe et al. (2008) and formally proven in Appendix A in Simar and Vanhems (2012). The property can be stated as follows:

$$\beta(\theta \circ x, \lambda \circ y \mid \theta \circ d_x, \lambda \circ d_y) = \beta(x, y \mid d_x, d_y) \text{ for } \theta \in \mathbb{R}_+^p, \text{ and } \lambda \in \mathbb{R}_+^q, \quad (3.3)$$

where  $\circ$  indicates the Hadamard product or component-wise multiplication of vectors. This property inspires the transformation of the variables that will make easy the characterization of directional distances and will facilitate the computation of their estimators. Consider first the case where all components of  $d$  are  $> 0$ . We have indeed as a consequence of (3.3) the following identity:

$$\beta(x, y \mid d_x, d_y) = \beta(x^*, y^* \mid i_p, i_q), \quad (3.4)$$

where  $i_k$  is a vector of ones of length  $k$ ,  $x^* = x \circ d_x$  and  $y^* = y \circ d_y$ . More generally, when some elements of  $d$  are zero, we consider the transformation

$$\begin{aligned} X_1^* &= X_1 \circ d_{x_1} \text{ and } X_2^* = X_2 \\ Y_1^* &= Y_1 \circ d_{y_1} \text{ and } Y_2^* = Y_2, \end{aligned} \quad (3.5)$$

which leads to

$$\beta(x, y \mid d_x, d_y) = \sup\{\beta > 0 \mid H_{X_1^* Y_1^* | X_2^* Y_2^*}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} \mid x_2^*, y_2^*) > 0\}, \quad (3.6)$$

where  $H_{X_1^* Y_1^* | X_2^* Y_2^*}$  is the version of  $H_{X_1 Y_1 | X_2 Y_2}$  in the new coordinate system.

Now the nonparametric estimator of the distance is obtained by plugging in the empirical version of  $H_{X_1^* Y_1^* | X_2^* Y_2^*}$  in (3.6). This yields

$$\begin{aligned} \widehat{H}_{n, X_1^* Y_1^* | X_2^* Y_2^*}(x_1^*, y_1^* \mid x_2^*, y_2^*) &= \frac{\widehat{H}_{n, X_1^*, X_2^* Y_1^*, Y_2^*}(x_1^*, x_2^*, y_1^*, y_2^*)}{\widehat{H}_{n, X_2^* Y_2^*}(x_2^*, y_2^*)} \\ &= \frac{\sum_{i=1}^n \mathbb{1}(X_{1,i}^* \leq x_1^*, X_{2,i}^* \leq x_2^*, Y_{1,i}^* \geq y_1^*, Y_{2,i}^* \geq y_2^*)}{\sum_{i=1}^n \mathbb{1}(X_{2,i}^* \leq x_2^*, Y_{2,i}^* \geq y_2^*)}. \end{aligned} \quad (3.7)$$

Some algebra leads to the following explicit formula for the FDH estimator of  $\beta(x, y \mid d_x, d_y)$ , namely

$$\begin{aligned} \widehat{\beta}(x, y \mid d_x, d_y) &= \sup\{\beta > 0 \mid \widehat{H}_{n, X_1^* Y_1^* | X_2^* Y_2^*}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} \mid x_2^*, y_2^*) > 0\}, \\ &= \max_{\{i \mid X_{2,i}^* \leq x_2, Y_{2,i}^* \geq y_2\}} \left[ \min_{\substack{k=1, \dots, p_1 \\ \ell=1, \dots, q_1}} \left\{ x_1^{*,k} - X_{1,i}^{*,k}, Y_{1,i}^{*,\ell} - y_1^{*,\ell} \right\} \right], \end{aligned} \quad (3.8)$$

where for a vector  $a$ ,  $a^j$  represents its  $j^{\text{th}}$  component. The formulation (3.8) is easy to program in modern high-level languages like R or Matlab. The call of the Matlab function `FDH_dirdist_new(x,y,dx,dy,X,Y)` in Appendix A computes  $\widehat{\beta}(x, y \mid d_x, d_y)$  using the expression in (3.8).

## 3.2 Conditioning on Environmental Factors $Z$

Simar and Vanhems (2012) provide the conditional (on environmental factors  $Z \in \mathbb{R}^r$ ), directional measure

$$\beta(x, y \mid d_x, d_y, z) = \sup\{\beta > 0 \mid H_{X_1 Y_1 | X_2 Y_2 Z}(x_1 - \beta d_{x_1}, y_1 + \beta d_{y_1} \mid x_2, y_2, z) > 0\}, \quad (3.9)$$

where  $H_{X_1 Y_1 | X_2 Y_2 Z}(x_1, y_1 \mid x_2, y_2, z) = \Pr(X_1 \leq x_1, Y_1 \geq y_1 \mid X_2 \leq x_2, Y_2 \geq y_2, Z = z)$  is the conditional probability of dominating  $(x_1, y_1)$  given that  $X_2 \leq x_2, Y_2 \geq y_2$  and  $Z = z$ , noting the difference in conditioning between the inactive inputs, the inactive outputs and the factors  $Z$ . This distribution is given by

$$H_{X_1 Y_1 | X_2 Y_2 Z}(x_1, y_1 \mid x_2, y_2, z) = \frac{H_{X_1, X_2, Y_1, Y_2 | Z}(x_1, x_2, y_1, y_2 \mid z)}{H_{X_1, X_2, Y_1, Y_2 | Z}(\infty, x_2, -\infty, y_2 \mid z)}. \quad (3.10)$$

The nonparametric estimator of the distribution in 3.10 requires smoothing in  $z$  using a kernel with compact support (see Daraio and Simar, 2005). Following Simar et al. (2016), the optimal bandwidths  $h_z$  can be obtained through leave-one out cross validation for estimating the conditional distribution  $H_{X_1, X_2, Y_1, Y_2 | Z}$ .<sup>6</sup> Then we have

$$\widehat{H}_{n, X_1 Y_1 | X_2 Y_2 Z}(x_1, y_1 | x_2, y_2, z) = \frac{\sum_{i=1}^n \mathbb{1}(X_{1,i} \leq x_1, X_{2,i} \leq x_2, Y_{1,i} \geq y_1, Y_{2,i} \geq y_2) K((Z_i - z) \odot h_z)}{\sum_{i=1}^n \mathbb{1}(X_{2,i} \leq x_2, Y_{2,i} \geq y_2) K((Z_i - z) \odot h_z)}, \quad (3.11)$$

where, with some abuse of notations when  $Z$  is multivariate,  $K(\cdot)$  is the chosen kernel function (for multivariate  $Z$  we use a product kernel,  $h_z = (h_z^1, \dots, h_z^r)$  and the division by  $h_z$  is component-wise). The version for the transformed variables  $(X^*, Y^*)$  is the same after adapting the notation. This estimator will be useful for the robust frontiers below. For the conditional full frontier, only the knowledge of the bandwidth  $h_z$  is needed. We know from Daraio and Simar (2005) and Jeong et al. (2010) that the conditional FDH estimator is a localized version of the FDH estimator, where “localizing” means using only observations  $(X_i, Y_i)$  such that  $|Z_i - z| \leq h_z$  (component-wise). So the expression in (3.8) transforms as follows:

$$\begin{aligned} \widehat{\beta}(x, y | d_x, d_y, z) &= \sup\{\beta > 0 | \widehat{H}_{n, X_1^* Y_1^* | X_2^* Y_2^* Z}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} | x_2^*, y_2^*, z) > 0\}, \\ &= \max_{\{i | X_{2,i} \leq x_2, Y_{2,i} \geq y_2, |Z_i - z| \leq h_z\}} \left[ \min_{\substack{k=1, \dots, p_1 \\ \ell=1, \dots, q_1}} \left\{ x_1^{*,k} - X_{1,i}^{*,k}, Y_{1,i}^{*,\ell} - y_1^{*,\ell} \right\} \right], \end{aligned} \quad (3.12)$$

where we see clearly after comparing with (3.8) that under the max operator, that conditional directional distance are localized versions of the unconditional FDH estimator.

The Matlab function `ZFDH_dirdist_new(hz, x, y, z, dx, dy, X, Y, Z)` in Appendix A computes  $\widehat{\beta}(x, y | d_x, d_y, z)$  as described in (3.12), where  $h_z$  has been determined in advance.

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<sup>6</sup> Note that when some elements of the direction vector  $d$  are zero, we condition on the inactive variables ( $X_2 \leq x_2$ ) and ( $Y_2 \geq y_2$ ), but for bandwidths selection, the argument from the Appendix A of Simar et al. (2016) remains valid. We select the optimal bandwidth (by cross-validation) for estimating  $H_{XY|Z}(x, y | Z = z)$  rather the ones for estimating the conditional distributions  $H_{X_1 Y_1 | X_2 Y_2 Z}(x_1, y_1 | X_2 \leq x_2, Y_2 \geq y_2, Z = z)$ . It is easy to see that for fixed  $(x_1, y_1, z)$ , the resulting  $\widehat{H}_{n, X_1 Y_1 | X_2 Y_2 Z}(x_1, y_1 | X_2 \leq x_2, Y_2 \geq y_2, Z = z)$  defined in (3.10) cannot decrease with  $x_2$  and cannot increase with  $y_2$ , and so for  $\widehat{\beta}(x, y | d_x, d_y, z)$  which is required by the same economic reasoning. Everything else constant (i.e., producing the same level of outputs  $y_1$  with the same level of inputs  $x_1$  and under conditions  $z$ ), the efficiency should increase when decreasing some of the inputs in  $x_2$  or by increasing some of the outputs in  $y_2$ . This property is not guaranteed by using bandwidths  $h_z(x_2, y_2)$  changing with the levels of the inactive variables  $(x_2, y_2)$ .

## 4 Robust Version: Order- $\alpha$ Quantile Frontiers

### 4.1 Unconditional Case

Daouia and Simar (2007) introduced order- $\alpha$  quantile frontiers for radial measures in the multivariate case. These have been adapted to directional distances in Simar and Vanhems (2012). Their definition in the more general case where some elements of  $d_x$  and/or of  $d_y$  may be equal to zero can be presented as follows. For any  $\alpha \in (0, 1]$ , and for any  $(x_2, y_2)$  such that  $H_{X_2 Y_2}(x_2, y_2) > 0$ ,

$$\begin{aligned}\beta_\alpha(x, y \mid d_x, d_y) &= \sup\{\beta \mid H_{X_1 Y_1 \mid X_2 Y_2}(x_1 - \beta d_{x_1}, y_1 + \beta d_{y_1} \mid x_2, y_2) > 1 - \alpha\}, \\ &= \sup\{\beta \mid H_{X_1 X_2 Y_1 Y_2}(x_1 - \beta d_{x_1}, x_2, y_1 + \beta d_{y_1}, y_2) > (1 - \alpha)H_{X_2 Y_2}(x_2, y_2)\},\end{aligned}\quad (4.1)$$

noting that using the quantile of the complete joint distribution  $H_{X_1 X_2 Y_1 Y_2}$  (unconditional to  $(X_2, Y_2)$ ) would give different objects unless both  $X_2$  and  $Y_2$  are empty and so  $H_{X_2 Y_2}(x_2, y_2) = 1$ .<sup>7</sup> Note also that a negative value of  $\beta_\alpha(x, y \mid d_x, d_y)$  indicates a unit  $(x, y)$  lying above the order- $\alpha$  frontier. In the transformed coordinate system this gives

$$\beta_\alpha(x, y \mid d_x, d_y) = \sup\{\beta \mid H_{X_1^* Y_1^* \mid X_2^* Y_2^*}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} \mid x_2^*, y_2^*) > 1 - \alpha\}.\quad (4.2)$$

Now Consider the random variable

$$W^{x,y}(X_1^*, Y_1^*) = \min_{\substack{k=1, \dots, p_1 \\ \ell=1, \dots, q_1}} \left\{ x_1^{*,k} - X_1^{*,k}, Y_1^{*,\ell} - y_1^{*,\ell} \right\}\quad (4.3)$$

Clearly, the conditional survival function of  $W^{x,y}(X_1^*, Y_1^*)$  is given by

$$\begin{aligned}S_W(w \mid x_2, y_2) &= \text{Prob}(W^{x,y}(X_1^*, Y_1^*) \geq w \mid X_2 \leq x_2, Y_2 \geq y_2) \\ &= H_{X_1^* Y_1^* \mid X_2^* Y_2^*}(x_1^* - w i_{p_1}, y_1^* + w i_{q_1} \mid x_2^*, y_2^*),\end{aligned}\quad (4.4)$$

which allows definition of  $\beta_\alpha(x, y \mid d_x, d_y)$  through the quantiles of  $W^{x,y}(X_1^*, Y_1^*)$ . The nonparametric estimator is obtained by plugging the empirical version of  $H_{X_1^* Y_1^* \mid X_2^* Y_2^*}$  into the last equation. Consider the sequence  $W^{x,y}(X_{1,i}^*, Y_{1,i}^*)$  for  $i = 1, \dots, n$ . Define  $N_2^{x,y} =$

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<sup>7</sup> This would be more in the vein of the quantile frontier introduced by Daouia et al. (2017) and adapted to directional distances in Daraio and Simar (2014). This approach has the drawback of being defined only for quantiles  $(1 - \gamma)$  where  $\gamma > 1 - H_{X_2 Y_2}(x_2, y_2)$  ( $\gamma = 1 - (1 - \alpha)H_{X_2 Y_2}(x_2, y_2)$ , with  $\alpha > 0$ ), so if the point  $(x_2, y_2)$  is on the edge of their possible values, only quantiles with very large values of  $\gamma$  would be available.

$n\widehat{H}_{n,X_2^*Y_2^*}(x_2^*, y_2^*)$ , the number of observations in the original sample with  $X_{2,i} \leq x_2$  and  $Y_{2,i} \geq y_2$  (note that  $N_2^{x,y} = n$  if both  $X_2$  and  $Y_2$  are empty, with all the directions in  $d$  being  $> 0$ ).

Next, define the order statistics

$$W_{(1)}^{x,y} \leq W_{(2)}^{x,y} \leq \dots W_{(N_2^{x,y})}^{x,y} \quad (4.5)$$

of the variables  $W^{x,y}(X_{1,i}^*, Y_{1,i}^*)$  only for the  $N_2^{x,y}$  observations with  $X_{2,i} \leq x_2$  and  $Y_{2,i} \geq y_2$ : It immediately follows that

$$\widehat{\beta}_\alpha(x, y \mid d_x, d_y) = \begin{cases} W_{(\alpha N_2^{x,y})}^{x,y} & \text{if } \alpha N_2^{x,y} \in \mathbb{N} \\ W_{([\alpha N_2^{x,y}] + 1)}^{x,y} & \text{otherwise,} \end{cases} \quad (4.6)$$

where  $[a]$  denotes the integer part of  $a$ . Note that if  $\alpha = 1$  we recover the full frontier estimate  $\widehat{\beta}(x, y \mid d_x, d_y)$ .

The Matlab function `OrderAlpha_dirdist_new(x,y,dx,dy,X,Y,alpha)` in Appendix A computes  $\widehat{\beta}_\alpha(x, y \mid d_x, d_y)$  using the expression in (4.6), where  $\alpha \in (0, 1]$  is selected a priori.

## 4.2 Conditioning on Environmental Factors $Z$

The conditional (on  $Z = z$ ) version of the order- $\alpha$  directional distance estimator is rather easy to derive using the conditional distribution and its nonparametric estimator described above in (3.10) and (3.11). The definition of the order- $\alpha$  conditional directional distance, for any  $\alpha \in (0, 1]$ , is given by

$$\beta_\alpha(x, y \mid d_x, d_y, z) = \sup\{\beta \mid H_{X_1Y_1|X_2Y_2Z}(x_1 - \beta d_{x_1}, y_1 + \beta d_{y_1} \mid x_2, y_2, z) > 1 - \alpha\}, \quad (4.7)$$

$$= \sup\{\beta \mid H_{X_1^*Y_1^*|X_2^*Y_2^*Z}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} \mid x_2^*, y_2^*, z) > 1 - \alpha\}. \quad (4.8)$$

The conditional (on  $Z$ ) survival function of  $W^{x,y}(X_1^*, Y_1^*)$  is given by

$$\begin{aligned} S_{W|Z}(w \mid x_2, y_2, z) &= \text{Prob}(W^{x,y}(X_1^*, Y_1^*) \geq w \mid X_2 \leq x_2, Y_2 \geq y_2, Z = z) \\ &= H_{X_1^*Y_1^*|X_2^*Y_2^*Z}(x_1^* - w i_{p_1}, y_1^* + w i_{q_1} \mid x_2^*, y_2^*, z). \end{aligned} \quad (4.9)$$

Its nonparametric estimator can be written as

$$\widehat{S}_{n,W|Z}(w \mid x_2, y_2, z) = \frac{\sum_{i=1}^n \mathbb{1}(W_i \geq w, X_{2,i} \leq x_2, Y_{2,i} \geq y_2) K((Z_i - z) \otimes h_z)}{\sum_{i=1}^n \mathbb{1}(X_{2,i} \leq x_2, Y_{2,i} \geq y_2) K((Z_i - z) \otimes h_z)}, \quad (4.10)$$

$$= \frac{\sum_{j=1}^{N_2^{x,y}} \mathbb{1}(W_{(j)}^{x,y} \geq w) K((Z_{[j]}^{x,y} - z) \otimes h_z)}{\sum_{i=1}^n \mathbb{1}(X_{2,i} \leq x_2, Y_{2,i} \geq y_2) K((Z_i - z) \otimes h_z)}, \quad (4.11)$$

where  $Z_{[j]}^{x,y}$  is the observation  $Z_i$  corresponding to the  $j$ -th order statistic  $W_{(j)}^{x,y}$ . Therefore

$$\widehat{S}_{n,W|Z}(w \mid x_2, y_2, z) = \begin{cases} 1 & \text{if } w \leq W_{(1)}^{x,y} \\ L_{k+1} & \text{if } W_{(k)}^{x,y} < w \leq W_{(k+1)}^{x,y}, k = 1, \dots, N_2^{x,y} - 1 \\ 0 & \text{if } w > W_{(N_2^{x,y})}^{x,y}, \end{cases} \quad (4.12)$$

where for  $k = 1, \dots, N_2^{x,y} - 1$ ,

$$L_{k+1} = \frac{\sum_{j=k+1}^{N_2^{x,y}} K((Z_{[j]}^{x,y} - z) \odot h_z)}{\sum_{i=1}^n \mathbb{1}(X_{2,i} \leq x_2, Y_{2,i} \geq y_2) K((Z_i - z) \odot h_z)}. \quad (4.13)$$

Finally, the explicit expression of the conditional order- $\alpha$  directional distance is given by

$$\widehat{\beta}_\alpha(x, y \mid d_x, d_y, z) = \begin{cases} W_{(k)}^{x,y} & \text{if } L_{k+1} \leq 1 - \alpha < L_k, k = 1, \dots, N_2^{x,y} - 1 \\ W_{(N_2^{x,y})}^{x,y} & \text{if } 0 \leq 1 - \alpha < L_{N_2^{x,y}}. \end{cases} \quad (4.14)$$

These formulae extend to the general directional distance case allowing some elements of  $d$  to equal zero, and hence include the expressions derived in Daouia and Simar (2007) for output radial distances as special cases.

The Matlab function `ZorderAlpha_dirdist_new(kernelz,hz,x,y,z,dx,dy,X,Y,Z,alpha)` in Appendix A computes  $\widehat{\beta}_\alpha(x, y \mid d_x, d_y, z)$  using (4.14), where a value  $\alpha \in (0, 1]$  is passed to the function as an argument. The kernels for the components of  $Z$  can be Gaussian, Quartic, Epanechnikov or Uniform. The bandwidths  $h_z$  must be determined before this call.

## 5 Robust Version: Order- $m$ Partial Frontiers

### 5.1 Unconditional case

Cazals et al. (2002) introduce order- $m$  partial frontiers and corresponding radial efficiency measures, while Simar and Vanhems (2012) extend these to directional distances. Cazals et al. give an explicit, exact expression for computing the nonparametric estimator in the univariate case (e.g.,  $q = 1$  in the output orientation or  $p = 1$  in the input orientation), but so far only Monte-Carlo approximations are available for more general cases (see Simar and Vanhems, 2012 or Daraio and Simar, 2014 for discussion). Below, we provide an exact expression for the estimators which is easy and fast to compute for any  $p \geq 1$  or  $q \geq 1$ . The method also allows some elements of the direction vector  $d$  to be zero, and includes both the unconditional as well as the conditional-on- $Z$  cases.

The order- $m$  directional distance is defined as follows (see Simar and Vanhems, 2012). For any integer  $m \geq 1$  and for any  $(x_2, y_2)$  such that  $H_{X_2 Y_2}(x_2, y_2) > 0$ , consider  $m$  iid variables  $(X_{1,j}, Y_{1,j})$ ,  $j = 1, \dots, m$  drawn from the conditional distribution  $H_{X_1 Y_1 | X_2 Y_2}(x_1, y_1 | x_2, y_2)$  and define the random set  $\tilde{\Psi}_m^{x,y} = \bigcup_{j=1}^m \{(x_1, u, y_1, v) \in \Psi \mid x_1 \geq X_{1,j}, u \leq x_2, y_1 \leq Y_{1,j}, v \geq y_2\}$ . Next, define the random measure

$$\tilde{\beta}_m(x, y \mid d_x, d_y) = \sup\{\beta \mid (x_1 - \beta d_{x_1}, x_2, y_1 + \beta d_{y_1}, y_2) \in \tilde{\Psi}_m^{x,y}\}. \quad (5.1)$$

Then the order- $m$  directional distance is given by

$$\beta_m(x, y \mid d_x, d_y) = \mathbb{E}(\tilde{\beta}_m(x, y \mid d_x, d_y) \mid X_2 \leq x_2, Y_2 \geq y_2). \quad (5.2)$$

Similar to the interpretation in Cazals et al. (2002),  $\beta_m(x, y \mid d_x, d_y)$  in (5.2) benchmarks the unit  $(x, y)$  against the expectation of the “best” among  $m$  peers using less inactive inputs  $X_2$  and producing more inactive outputs  $Y_2$ . A negative value of  $\beta_m(x, y \mid d_x, d_y)$  indicates a unit at  $(x, y)$  operating above the order- $m$  frontier.

We can now see what happens in the transformed coordinate system  $(X^*, Y^*)$  defined above. We have

$$\tilde{\beta}_m(x, y \mid d_x, d_y) = \sup\{\beta \mid \tilde{H}_{m, X_1^* Y_1^* | X_2^* Y_2^*}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} \mid x_2^*, y_2^*) > 0\}, \quad (5.3)$$

where  $\tilde{H}_{m, X_1^* Y_1^* | X_2^* Y_2^*}$  is the empirical version (in the new coordinate system) of  $H_{X_1^* Y_1^* | X_2^* Y_2^*}$  obtained from the random sample  $\{(X_{1,j}, Y_{1,j})\}_{j=1}^m$ . Hence by defining  $W^{x,y}(X_1^*, Y_1^*)$ , as above in (4.3), but now for the  $m$  transformed observations  $\{(X_{1,j}^*, Y_{1,j}^*)\}_{j=1}^m$ , it is clear that

$$\tilde{\beta}_m(x, y \mid d_x, d_y) = \max_{j=1, \dots, m} \{W^{x,y}(X_{1,j}^*, Y_{1,j}^*)\} \quad (5.4)$$

where the  $(X_{1,j}^*, Y_{1,j}^*)$  are distributed according  $H_{X_1^* Y_1^* | X_2^* Y_2^*}$ .

The survival function of  $W^{x,y}(X_1^*, Y_1^*)$  is given by

$$\begin{aligned} S_W(w \mid x_2, y_2) &= \Pr(W^{x,y}(X_1^*, Y_1^*) \geq w \mid X_2 \leq x_2, Y_2 \geq y_2) \\ &= H_{X_1^* Y_1^* | X_2^* Y_2^*}(x_1^* - w i_{p_1}, y_1^* + w i_{q_1} \mid x_2^*, y_2^*). \end{aligned} \quad (5.5)$$

Consequently, the distribution function of  $\tilde{\beta}_m(x, y \mid d_x, d_y)$  is given by

$$G_m^{x,y}(w) = \Pr(\tilde{\beta}_m(x, y \mid d_x, d_y) \leq w) = [1 - S_W(w \mid x_2, y_2)]^m. \quad (5.6)$$

This leads to an equivalent expression for  $\beta_m(x, y | d_x, d_y)$ , namely

$$\beta_m(x, y | d_x, d_y) = \int_0^{\beta(x, y | d_x, d_y)} w dG_m^{x, y}(w). \quad (5.7)$$

It is straightforward to confirm that  $G_m^{x, y}(0) = [1 - S_W(0 | x_2, y_2)]^m = 0$  and that  $G_m^{x, y}(w) = 1$  for all  $w \geq \beta(x, y | d_x, d_y)$ . Integration by parts then gives the desired result,

$$\beta_m(x, y | d_x, d_y) = \beta(x, y | d_x, d_y) - \int_0^{\beta(x, y | d_x, d_y)} G_m^{x, y}(w) dw. \quad (5.8)$$

Nonparametric estimation is now easy. Plugging the empirical version  $\widehat{H}_{n, X_1^* Y_1^* | X_2^* Y_2^*}$  into (5.5) leads to

$$\widehat{\beta}_m(x, y | d_x, d_y) = \widehat{\beta}(x, y | d_x, d_y) - \int_0^{\widehat{\beta}(x, y | d_x, d_y)} \widehat{G}_m^{x, y}(w) dw, \quad (5.9)$$

where  $\widehat{G}_m^{x, y}(w) = \left[1 - \widehat{S}_{n, W}(w | x_2, y_2)\right]^m$ . As shown above,  $\widehat{S}_{n, W}(w | x_2, y_2)$  is easily obtained from the order statistics of the  $N_2^{x, y}$  variables  $W^{x, y}(X_{1, i}^*, Y_{1, i}^*)$  defined in (4.3) such that  $X_2 \leq x_2, Y_2 \geq y_2$ , i.e.,  $W_{(1)}^{x, y} \leq \dots \leq W_{(N_2^{x, y})}^{x, y}$ . Then an explicit expression for the order- $m$  directional distance estimator is given by

$$\widehat{\beta}_m(x, y | d_x, d_y) = \sum_{j=1}^{N_2^{x, y}} W_{(j)}^{x, y} \left[ \left( \frac{j}{N_2^{x, y}} \right)^m - \left( \frac{j-1}{N_2^{x, y}} \right)^m \right]. \quad (5.10)$$

The Matlab function `Orderm_dirdist_new(x, y, dx, dy, X, Y, m)` in Appendix A organizes the computations for evaluating  $\widehat{\beta}_m(x, y | d_x, d_y)$  as described in (5.10), where  $m$  is an integer  $\geq 1$  chosen a priori.

## 5.2 Conditioning on Environmental Factors $Z$

The conditional-on- $Z$  case follows similar arguments. The definition of the conditional order- $m$  directional distance is now based on the conditional (on  $Z$ ) versions of the various distributions used above in Section 5.1.

For any integer  $m \geq 1$  and for any  $(x_2, y_2)$  such that  $H_{X_2 Y_2 | Z}(x_2, y_2 | z) > 0$ , consider  $m$  iid variables  $(X_{1, j}, Y_{1, j})$ ,  $j = 1, \dots, m$  drawn from the conditional distribution  $H_{X_1 Y_1 | X_2 Y_2 Z}(x_1, y_1 | x_2, y_2, z)$  and define the random set  $\widetilde{\Psi}_m^{x, y, z} = \bigcup_{j=1}^m \{(x_1, u, y_1, v) \in \Psi | x_1 \geq X_{1, j}, u \leq x_2, y_1 \leq Y_{1, j}, v \geq y_2, Z = z\}$ . Define the random measure

$$\widetilde{\beta}_m(x, y | d_x, d_y, z) = \sup\{\beta | (x_1 - \beta d_{x_1}, x_2, y_1 + \beta d_{y_1}, y_2) \in \widetilde{\Psi}_m^{x, y, z}\}. \quad (5.11)$$

Then the conditional order- $m$  directional distance is defined by

$$\beta_m(x, y \mid d_x, d_y, z) = \mathbb{E}(\tilde{\beta}_m(x, y \mid d_x, d_y) \mid X_2 \leq x_2, Y_2 \geq y_2, Z = z). \quad (5.12)$$

Following the arguments used in Section 5.1 for the unconditional case, we have

$$\begin{aligned} \tilde{\beta}_m(x, y \mid d_x, d_y, z) &= \sup\{\beta \mid \tilde{H}_{m, X_1^* Y_1^* | X_2^* Y_2^* Z}(x_1^* - \beta i_{p_1}, y_1^* + \beta i_{q_1} \mid x_2^*, y_2^*, z) > 0\}, \\ &= \max_{j=1, \dots, m} \{W^{x, y}(X_{1, j}^*, Y_{1, j}^*)\}, \end{aligned} \quad (5.13)$$

where now the  $(X_{1, j}^*, Y_{1, j}^*)$  are distributed according to  $H_{X_1^* Y_1^* | X_2^* Y_2^* Z}$ . The conditional (on  $Z$ ) survival function of  $W^{x, y}(X_1^*, Y_1^*)$  is given by

$$\begin{aligned} S_{W|Z}(w \mid x_2, y_2, z) &= \Pr(W^{x, y}(X_1^*, Y_1^*) \geq w \mid X_2 \leq x_2, Y_2 \geq y_2, Z = z) \\ &= H_{X_1^* Y_1^* | X_2^* Y_2^* Z}(x_1^* - w i_{p_1}, y_1^* + w i_{q_1} \mid x_2^*, y_2^*, z). \end{aligned} \quad (5.14)$$

Finally, using reasoning analogous to that in Section 5.1, we have

$$\beta_m(x, y \mid d_x, d_y, z) = \beta(x, y \mid d_x, d_y, z) - \int_0^{\beta(x, y \mid d_x, d_y, z)} G_m^{x, y, z}(w) dw, \quad (5.15)$$

where  $G_m^{x, y, z}(w) = [1 - S_{W|Z}(w \mid x_2, y_2, z)]^m$ .

The nonparametric estimator is obtained by plugging the estimator of the survival function  $S_{W|Z}$  described in (4.12) into (5.15), yielding

$$\hat{\beta}_m(x, y \mid d_x, d_y, z) = \hat{\beta}(x, y \mid d_x, d_y, z) - \int_0^{\hat{\beta}(x, y \mid d_x, d_y, z)} \hat{G}_m^{x, y, z}(w) dw, \quad (5.16)$$

where  $\hat{G}_m^{x, y, z}(w) = [1 - \hat{S}_{n, W|Z}(w \mid x_2, y_2, z)]^m$ . Simple analytical derivations reveal that the estimator can be computed by the explicit formula

$$\hat{\beta}_m(x, y \mid d_x, d_y, z) = \sum_{k=1}^{N_2^{x, y}} W_{(k)}^{x, y} ([1 - L_{k+1}]^m - [1 - L_k]^m), \quad (5.17)$$

where the  $L_{k+1}$  are defined in (4.13) for  $k = 1, \dots, N_2^{x, y} - 1$ , noting that  $L_1 = 1$  in (4.13), and defining  $L_{N_2^{x, y} + 1} = 0$ .

The Matlab function `Zorderm_dirdist_new(kernelz, hz, x, y, z, dx, dy, X, YZ, , m)` given in Appendix A computes values for  $\hat{\beta}_m(x, y \mid d_x, d_y, z)$  using (5.17), where  $m \geq 1$  is an integer, `kernelz` is the kernel chosen for  $Z$  and  $h_z$  is the vector of bandwidths.

## 6 Numerical Illustrations

In this section we demonstrate how much is gained by the new computational methods introduced above, relative to the existing algorithms involving Monte Carlo methods proposed by Simar and Vanhems (2012) and Daraio and Simar (2014). For the full frontier estimates and the order- $\alpha$  (both unconditional and conditional) the gain in computing speed is negligible. Nonetheless, the new methods avoid potential numerical problems related to ratios of exponentials and logarithms (recall footnote 5).

The new methods proposed for computing order- $m$  directional distances (either unconditional or conditional) are remarkably faster than the existing Monte Carlo methods that have been used until now. The results presented above provide exact expressions that are easy to implement in practical applications. The results presented below indicate that even if one is willing to accept precision to only two decimal places, the existing Monte Carlo-based algorithms require roughly 200 times the CPU time required by the new methods presented above. To obtain precision to 3 decimal places, the old methods require roughly 1,000 times the CPU time required by the new methods.

It is important to note that implementation of the older Monte-Carlo algorithm is complicated when some elements of the direction vector  $d$  are zero. We used the algorithms suggested by Daraio and Simar (2014).<sup>8</sup> For the conditional-on- $Z$  case, some complications arise due to step (1) of the algorithm where the data points have to be sampled according to the weights given by the kernel function. These complications are avoided by the new methods developed above.

### 6.1 Simulated Data

We simulate  $p = 2$  inputs  $X_{j,i} \sim \text{Unif}(0, 1)$ , independently for  $j = 1, 2$  and for  $i = 1, \dots, n$ . Then the two efficient outputs are defined by

$$Y_{1,i}^\partial = X_{1,i}^{0.5} \times X_{2,i}^{0.5}$$

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<sup>8</sup> There is an unfortunate typo in Appendix B Daraio and Simar (2014). The last line before step (1) of the algorithm appears as  $D_{x,y}^* \neq \{(X_i^*, Y_i^*) \mid X_i^* \leq x^*, Y_i^* \geq y^*\}$  but should instead be  $D_{x,y}^* = \{(X_i^*, Y_i^*) \mid X_{2,i}^* \leq x_2^*, Y_{2,i}^* \geq y_2^*\}$ , where only the inactive variables are concerned here.

and

$$Y_{2,i}^\partial = X_{1,i}^{0.4} \times X_{2,i}^{0.3}.$$

Then the observed outputs are computed as

$$\begin{aligned} Y_{1,i} &= Y_{1,i}^\partial \times \exp(-U_i), \\ Y_{2,i} &= Y_{2,i}^\partial \times \exp(-U_i) \end{aligned}$$

where  $U_i \sim N^+(0, 0.75^2)$  is the inefficiency term. We then simulate independent  $Z \sim N(1, 3^2)$ . In this illustration, we are not interested interpreting the results, but rather in investigating how much computing time is saved by our new approach over the existing, previous method. Hence we choose the bandwidth  $h_z = 0.8111$  given by the usual rule of thumb (i.e., normal reference rule) for estimating the density of  $Z$ .

We have  $p = q = 2$  and  $r = 1$ . For the numerical illustration we choose  $n = 1000$  and  $m = 100$  and  $\alpha = 0.99$  (in the next example using real data we discuss how one should choose these robustness parameters in practice). With these two values the percentage of points above the partial frontiers are comparable (0.55 percent for order- $\alpha$  and 0.50 percent for order- $m$ ). We also fix the direction vector by setting  $d_x = \text{Med}(X_i)$  and  $d_y = \text{Med}(Y_i)$ , i.e., we use the sample medians of the input and output vectors, respectively.

The computing time required for computing the full frontier, the conditional full frontier, the order- $\alpha$ , the conditional order- $\alpha$ , the order- $m$  and the conditional order- $m$  for the  $n = 1000$  units using the new methods presented above was only 2.11 seconds running on a 2.6 Ghz MacBook-Pro laptop computer running MacOS 10.13 with 8GB of memory and using Matlab version R2015a. Using the Monte-Carlo algorithms for the order- $m$  and conditional order- $m$  with limited precision ( $MC = 200$  replications for both cases as often recommended in the literature) the required 418.18 seconds of CPU time for producing the same full table of results (an increase in computation time by a factor of 198.2). Table 1 merges the two approaches for the first 10 units, with subscripts ‘‘MC’’ identifying the order- $m$  estimates computed via Monte Carlo methods. Comparing the MC estimates with the exact estimates gives an idea of the loss of precision due to the Monte-Carlo approximations.

Table 1: The first 10 units from the sample  $n = 1000$ , in the simulated example. We fixed  $\alpha = 0.99$  and  $m = 100$ . Here  $MC = 200$  have been used for the Monte-Carlo approximations of the order- $m$  and conditional order- $m$  measures.

Unit	$\hat{\beta}(x, y)$	$\hat{\beta}(x, y z)$	$\hat{\beta}_\alpha(x, y)$	$\hat{\beta}_\alpha(x, y z)$	$\hat{\beta}_m(x, y)$	$\hat{\beta}_{m,MC}(x, y)$	$\hat{\beta}_m(x, y z)$	$\hat{\beta}_{m,MC}(x, y z)$
1	0.0130	0.0130	-0.0410	0.0000	-0.0382	-0.0377	-0.0038	-0.0049
2	0.0000	0.0000	-0.1481	-0.0685	-0.1069	-0.1142	-0.0384	-0.0387
3	0.0045	0.0000	-0.1481	-0.2005	-0.1334	-0.1284	-0.1192	-0.1171
4	0.1434	0.0589	-0.0008	0.0589	0.0336	0.0327	0.0377	0.0340
5	0.0616	0.0491	-0.0024	0.0000	0.0182	0.0149	0.0161	0.0166
6	0.4852	0.3932	0.3359	0.3360	0.3565	0.3491	0.3569	0.3582
7	0.0000	0.0000	-0.0577	-0.0329	-0.0461	-0.0464	-0.0171	-0.0213
8	0.1836	0.0000	0.0329	0.0000	0.0647	0.0697	-0.0002	0.0000
9	0.7942	0.7207	0.6985	0.7048	0.7192	0.7202	0.6973	0.6977
10	0.3689	0.2917	0.2822	0.2583	0.3060	0.3057	0.2679	0.2668

We repeated the same exercise using  $MC=1000$  trials for the Monte-Carlo approximations in both cases, requiring 2071.64 seconds of CPU time (a factor around 1000 compared to the CPU time required by our new method). The results are reported in Table 2. The Monte Carlo approximations are improved over those in Table 1, but some error remains.

Table 2: The first 10 units from the sample  $n = 1000$ , in the simulated example. We fixed  $\alpha = 0.99$  and  $m = 100$ . Here  $MC = 1000$  have been used for the Monte-Carlo approximations of the order- $m$  and conditional order- $m$  measures.

Unit	$\hat{\beta}(x, y)$	$\hat{\beta}(x, y z)$	$\hat{\beta}_\alpha(x, y)$	$\hat{\beta}_\alpha(x, y z)$	$\hat{\beta}_m(x, y)$	$\hat{\beta}_{m,MC}(x, y)$	$\hat{\beta}_m(x, y z)$	$\hat{\beta}_{m,MC}(x, y z)$
1	0.0130	0.0130	-0.0410	0.0000	-0.0382	-0.0387	-0.0038	-0.0059
2	0.0000	0.0000	-0.1481	-0.0685	-0.1069	-0.1092	-0.0384	-0.0404
3	0.0045	0.0000	-0.1481	-0.2005	-0.1334	-0.1342	-0.1192	-0.1220
4	0.1434	0.0589	-0.0008	0.0589	0.0336	0.0336	0.0377	0.0379
5	0.0616	0.0491	-0.0024	0.0000	0.0182	0.0169	0.0161	0.0147
6	0.4852	0.3932	0.3359	0.3360	0.3565	0.3552	0.3569	0.3593
7	0.0000	0.0000	-0.0577	-0.0329	-0.0461	-0.0441	-0.0171	-0.0163
8	0.1836	0.0000	0.0329	0.0000	0.0647	0.0649	-0.0002	-0.0001
9	0.7942	0.7207	0.6985	0.7048	0.7192	0.7192	0.6973	0.6976
10	0.3689	0.2917	0.2822	0.2583	0.3060	0.3067	0.2679	0.2665

## 6.2 Real Data on Banks

In this section we illustrate our new methods using real data on US commercial banks observed in 2002. These data are also used by Simar and Wilson (2007), Bădin et al.

(2012) and Florens et al. (2014) for analyzing the of environmental factors on the production process, while Daraio et al. (2018) use the same data to illustrate their test of the separability condition described by Simar and Wilson (2007).

As explained by Florens et al. (2014) and Daraio et al. (2018), the three inputs (purchased funds, core deposits and labor) can be aggregated into one input factor and the four outputs (consumer loans, business loans, real estate loans, and securities held) can be aggregated into a single output factor with minimal loss of information.<sup>9</sup> After the dimension-reduction, we have a sample of  $n = 303$  banks with one input and one output factor and with two environmental factors  $Z_1, Z_2$  which include a measure of the size of the banks (log of total assets) and a measure of diversity of the services offered by the banks (see Simar and Wilson (2007) for a detailed discussion of the variables). Here we again focus on the gain in computing time afforded by our new methods.

Since we want to use robust measures of efficiencies, we have to select values of the order  $m$  and the order  $\alpha$ . As recommended in the literature (e.g., see Daraio and Simar (2007), Daouia and Gijbels (2011a) and Simar (2003)), the efficiency measures have to be computed for a number of values of  $m$  and  $\alpha$  to determine sensible values. Simar (2003) proposes computing the order- $m$  efficiency estimates for a grid of values of  $m$ , and reporting in a graph the corresponding percentage of points lying outside the corresponding frontiers in order to detect outliers.<sup>10</sup> This may involve substantial computational burden when Monte Carlo approximations are used to compute the order- $m$  estimates. burden when using Monte-Carlo approximations for the order- $m$  measures.

Figure 1 shows the percentage of observations lying above the order- $m$  frontier for  $m = 10, 30, 50, \dots, 390$ . Producing the estimates needed for this graph required only 0.91 seconds using the new computational methods and the MacBook Pro described above. Using the older Monte Carlo approximations, and only  $MC = 100$  Monte Carlo trials, consumed 444.0 seconds, an increase by a factor of about 488.

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<sup>9</sup> See also Wilson (2018) for detailed discussion of dimension reduction techniques for efficiency analysis.

<sup>10</sup> The idea is that in the absence of any outliers, this graph should show a steadily decreasing number of points outside the order- $m$  partial frontier with increasing  $m$  (recall that as  $m \rightarrow \infty$  the order- $m$  estimates converge to the corresponding FDH estimates). But if the graph exhibits a kink or “elbow” effect, then this is evidence that the remaining points outside the order- $m$  frontier for the corresponding value of  $m$  are potential outliers.

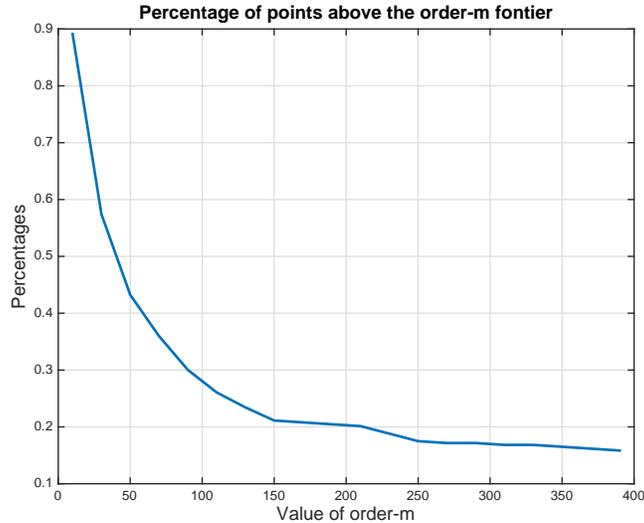


Figure 1:

Figure 1 indicates that  $m = 150$  may be reasonable value for the order  $m$  since the graph becomes nearly horizontal for larger values of  $m$ . To select  $\alpha$  one could use the same approach, but for purposes of comparison, we select  $\alpha = 0.995$  which results in the same proportion of observations lying outside the order- $\alpha$  quantile frontier as does  $m = 150$  in the case of the order- $m$  frontier. Note that this is close to the same value obtained by setting  $\alpha = 0.5^{1/m} = 0.9954$  as discussed by Daouia and Gijbels (2011a), where the two partial frontiers coincide if the expectation operator  $\mathbb{E}$  is replaced by the median operator in the definition of the order- $m$  frontier.

Table 3 shows the various directional distance estimates for the first 20 units in the sample of  $n = 303$  banks. The last four columns on the right allow comparison of the exact results for order- $m$  and their counterparts obtained by Monte-Carlo approximation with  $MC = 200$ . Producing the full table for all observations required 0.44 seconds with the new method and 104 seconds with the Monte-Carlo approximations (again, a difference involving a factor of about 200, with roughly only 2 decimal digits of precision).<sup>11</sup>

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<sup>11</sup> For the conditional-on- $Z$  estimates with bivariate  $Z$ , the optimal vector of bandwidths was obtained by least-squares cross validation yielding  $h_z = (0.0240, 0.2134)$ .

Table 3: Directional Distances for the Bank Dataset. Here  $n = 303$  and the Monte-Carlo approximations have been computed with  $MC = 200$ .

Unit	$\widehat{\beta}(x, y)$	$\widehat{\beta}(x, y z)$	$\widehat{\beta}_\alpha(x, y)$	$\widehat{\beta}_\alpha(x, y z)$	$\widehat{\beta}_m(x, y)$	$\widehat{\beta}_{m,MC}(x, y)$	$\widehat{\beta}_m(x, y z)$	$\widehat{\beta}_{m,MC}(x, y z)$
1	0.2612	0.2371	0.2371	0.2371	0.1705	0.1665	0.2206	0.2155
2	0.0326	0.0326	0.0102	0.0326	0.0120	0.0136	0.0325	0.0324
3	0.0975	0.0867	0.0867	0.0867	0.0703	0.0668	0.0867	0.0867
4	0.4638	0.4638	0.3885	0.4638	0.4081	0.4080	0.4629	0.4638
5	0.0000	0.0000	-0.1749	0.0000	-0.1608	-0.1516	-0.0000	0.0000
6	0.0379	0.0379	0.0373	0.0379	0.0318	0.0307	0.0379	0.0379
7	0.0254	0.0254	0.0197	0.0254	0.0154	0.0148	0.0254	0.0254
8	0.0012	0.0012	0.0000	0.0012	-0.0060	-0.0067	0.0007	0.0007
9	0.0000	0.0000	-0.0028	0.0000	-0.0037	-0.0039	-0.0000	0.0000
10	0.0579	0.0579	0.0547	0.0579	0.0477	0.0464	0.0579	0.0579
11	0.0871	0.0176	0.0384	0.0176	0.0461	0.0432	0.0168	0.0165
12	0.0174	0.0174	0.0000	0.0174	0.0005	-0.0003	0.0168	0.0168
13	1.4536	1.4536	1.2835	1.4536	1.1000	1.1346	1.4536	1.4536
14	0.0650	0.0509	0.0509	0.0509	0.0420	0.0471	0.0509	0.0509
15	0.0000	0.0000	-0.0074	0.0000	-0.0174	-0.0156	-0.0000	0.0000
16	0.1250	0.1250	0.1008	0.1250	0.0789	0.0760	0.1245	0.1250
17	0.0000	0.0000	-0.0695	0.0000	-0.0497	-0.0522	0.0000	0.0000
18	0.0000	0.0000	-0.0013	0.0000	-0.0442	-0.0386	-0.0000	0.0000
19	0.0151	0.0151	0.0000	0.0151	0.0006	-0.0005	0.0151	0.0151
20	0.2475	0.2078	0.2078	0.2078	0.1954	0.2030	0.2078	0.2078

## 7 Conclusions

This paper provides a new method for computing directional distance functions. The paper develops simple and easy-to-program expressions for computing full frontier, partial frontier (order- $\alpha$  and order- $m$  cases) with their corresponding conditional-on- $Z$  versions. The inputs, the outputs and the environmental factor can in principle be of any dimension, but we know that the curse of the dimensionality may in some cases jeopardize the quality of the estimators. In such cases, it is often possible to exploit multicollinearity in economic data using the dimension-reduction techniques analyzed by Wilson (2018). The direction vector  $d \geq 0$  can have an arbitrary number of zero elements in either  $d_x$  or  $d_y$  (provided at least one element remains positive to preserve meaningfulness of the directional distance).

The new method for computing directional distances is much faster than the older Monte Carlo approximations that have been used to date as illustrated the examples in the preceding section. For the order- $m$  cases (conditional and unconditional) to the best of our knowledge

this is the first time an exact expression is provided. We have shown in the numerical illustrations, that even if low precision of the estimates is acceptable, the computing time is increased by a factor of 200–400 when the older Monte Carlo approximations are used in place of our new methods. As illustrated in the example using bank data, the new method is particularly useful when several order- $m$  measures have to be evaluated, e.g., as in the outlier detection exercise discussed by Simar (2003) or when an appropriate value of  $m$  is chosen as discussed by Daraio and Simar (2007).

## **A Matlab Codes**

The Matlab codes will be made available once the paper will be published.

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