(8 minute) Discussion of

"Competition and Cooperation in Mutual Fund Families"

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Background

- Beginning with Jensen (1968), **typical study assumes every mutual fund manager competes with every other manager on risk-adjusted basis**
  - Refinements with respect to expected outcomes (e.g., positive after-fee alpha vs. positive before-fee alpha vs. value-added relative to tradeable indices vs. reduced underperformance in down markets)
  - ... and market segmentation (e.g., Bergstresser, Chalmers, Tufano (2009))
  - ... and manager incentives (e.g., Khorana, Servaes, Wedge (2006); Ma, Tang, Gomez (2016))
- All-against-all assumption often carries over to tournament literature (e.g., Brown, Harlow, Starks (1996); Chevalier & Ellison (1997))
- However, **more recent literature focuses on family-level incentives**
  - Gaspar, Massa, Matos (2006): convex flow-performance relation gives families incentive to engage in cross-subsidization
  - Bhattacharya, Lee, Pool (2013): families can minimize impact of fire sales through cross-holdings
- **How do we reconcile manager tournaments with cross-subsidization?**

This Paper (which I like)

- Considers the role of heterogeneity in family-level incentives
- Constructs family-by-year level measures of competition and cooperation
- Finds (net) competitive incentives are associated with:
  - Less cross-subsidization (T3) and cross-holdings (T4)
  - More star funds (T5), more disperse returns (T6), higher gross returns (T7)
  - Fewer recaptured flows (T8)
  - *Publicly traded asset managers:* More volatile cash flows and returns (T9)
  - *Regarding family-level choice of incentives*: Competitive families are more likely to engage in side-by-side management (proxy for institutional clients; T10) and less likely to sell through brokers (T11)
- Include IV specifications based on changes in competition following mergers (T12) and placebo tests based on pseudo families (T13)
- **Concludes families face tension between attracting and motivating skilled managers and coordinating actions that increase family value**
  - Claims broader contribution to literature on internal capital markets

Comment #1 – Measures

- Each measure is constructed from seven underlying measures...
  - ... many of which have been studied in isolation in earlier papers
    - Ma, Tang, Gomez (2016) on form of compensation
    - Massa & Patgiri (2009) on flat versus declining advisor fees
  - Minor: Overlapping teams more relevant for cooperation than existence of teams, which may reflect fund size (e.g., Massa, Reuter, Zitzewitz (2010))
- There should be more discussion of which components are driving time-series and cross-sectional variation in competition and cooperation indices
  - Plot how average values of 14 components vary year-by-year so that readers can see whether there are any interesting time trends
- Rather than dividing sample into competitive and cooperative families based on median of each index, how about four categories, based on quartiles?
  - If quartiles are defined using cutoffs in early time period, do we see shifts towards or away from competitive incentives?
  - How have the market shares of top-quartile competitive and cooperate families evolved over the sample period (with rise of passive investing)?

Comment #2 – Extensions

- Existing literature has convinced me that different mutual fund families compete on different bundles of services
  - Some compete on alphas while others compete on advice plus returns
    - Del Guercio & Reuter (2014); Gârleanu & Pedersen (2017)
  - To the extent that broker clients are more sensitive to downside risk, we should expect more cooperation inside broker-sold families

- Institutional investors should be most likely to value competitive incentives because they are best able to infer managerial skill from realized returns
  - Is side-by-side management the best proxy for institutional demand?
  - Implicit assumption that both vehicles face same set of incentives?

- Parallels to market for subadvisers?
  - Broker-sold families that hire subadvisers face tradeoff between higher expected returns (relative to counterfactual in-house portfolios) and lack of ability to coordinate fund actions?
  - Minor: Do subadvised fund incentives contaminate family-level indices?

Comment #3 – Econometrics

- The authors tend to estimate Fama-MacBeth regressions where the unit of observation is family *j* in month or quarter *t*
  - However, the independent variables of interest (competition and cooperation indices and dummies) appear to be highly persistent...
  - ... and several of the dependent variables also appear to be persistent
  - If only for robustness, I would like to see panel regressions with standard errors that are two-way clustered on family and time period

- In the fund-level Fama-MacBeth regressions (T7), I would like style fixed effects *(which are equivalent to style-by-time fixed effects in panels)*

- There is an apparent inconsistency in specifications in Tables 10 and 11
  - In Table 10, authors use level of side-by-side management to predict levels of competitive and cooperative indices
  - In Table 11, authors use levels of the competitive and cooperative indices to predict direct-sold distribution

Summary

- This is an interesting paper... on which I was almost a co-author
- Authors quantify heterogeneous incentives that fund managers face to compete vs. cooperate and relate incentives to reasonable measures of fund and family behavior
- Main comment: Before jumping into the analysis (or standardizing their indices), authors should help readers understand how market shares of competitive vs. cooperative vs. mixed families have evolved over time
- Audience: I welcome more such research on the heterogeneous incentives of mutual fund families