Outsourcing Mutual Fund Management: Firm Boundaries, Incentives and Performance

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Abstract:
We investigate the effects of managerial outsourcing on the performance and incentives of mutual funds. Fund families outsource the management of a large fraction of their funds to advisory firms. These funds under-perform those ran internally by about 50 basis points per year. After instrumenting for a fund's outsourcing status, the estimate of under-performance is three times larger. We hypothesize that contractual externalities due to firm boundaries make it difficult to extract performance from an outsourced relationship. Consistent with this view, an outsourced fund faces higher-powered incentives; they are more likely to be closed after poor performance and excessive risk-taking.

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