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Multitasking By Mutual Fund Managers Benefits Companies, Not Investors

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Say the word "multitasking" in most offices, and you'll be met with a shrug. Most workers nowadays are expected to be able to keep their eyes on multiple customers and deliver multiple projects without a problem. But say the same word at a major investment house, and you could be met with a look of terror, followed by the inevitable question, "Which fund comes first?"

Of course, in the investment world multitasking doesn't mean filling out a spreadsheet while also checking the performances of new companies to add to a fund. Rather, the term describes a relatively new phenomenon of managers taking on multiple funds, either through acquiring poorly performing investment funds within their firms or by launching new ones.

I recently examined this phenomenon in a study titled "Managerial Multitasking in the Mutual Fund Industry," coauthored with Linlin Ma, a doctoral student at Georgia State University. As of 2010 multitasking managers identified in the study's sample constituted about 44 percent of all managers and together oversaw about half of the total assets in the equity mutual fund industry. But although managerial multitasking is a prevalent practice, there is limited understanding of its effects. Hence the purpose of our study was to fill this gap by examining the determinants and consequences of managerial multitasking in light of the principal-agent relationship between mutual fund investors and companies.

We found that when managers multitasked, the funds that used to be their sole focus (that is, incumbent funds) suffered a significant deterioration in performance from the two years before the switch to multitasking to two years after the move. In contrast, the performance of acquired or new funds improved over the same period, indicating a transfer of wealth from the investors in incumbent funds to the investors in acquired funds.

So in an industry that depends highly on reputation and performance, why would investment companies continue to put well-performing funds in a position that almost guarantees losses? The findings of our study offer three possible explanations. First, investors' capital chases superior past performance. Managers with a strong performance record can generate a positive spillover effect on the inflows into acquired and new funds, similar to new funds launched by companies that already have "star funds" in their portfolios.

Second, multitasking is used to turn around poorly performing funds, essentially stopping the bleeding while also helping mutual fund families retain their best managers and replace their bad ones.

Last, because the fund companies usually receive a fixed percentage of assets under management as compensation, they have incentives to take actions that increase the net flows into their funds.

The effects of managerial multitasking on net dollar flows put that last point into sharp relief. In our study there is a significant increase in the inflows into the newly acquired funds in the first two years after the switch (about $41 million); however, the reaction of investors in the incumbent funds is somewhat muted — on average, there are no significant net cash outflows after the switch. This type of asymmetry does not occur with single-managed funds.

Though multitasking helps mutual fund companies achieve their objective of maximizing aggregate net capital flows, this benefit comes at a cost to incumbent funds' investors. The fact that some investors (the principals) are adversely affected by the distorted incentives of their portfolio managers (the agents) should have policy implications for the regulatory bodies governing the mutual fund industry. In fact, there have been similar regulatory concerns about having mutual fund managers simultaneously running hedge funds (known as "side-by-side management"). Given the structural difference in fees between mutual funds and hedge funds, side-by-side managers may favor the latter.

In the case of side-by-side management, there is mixed evidence of managerial conflicts of interest. One recent study shows that there is a strategic transfer of performance from mutual funds to hedge funds by allocating more underpriced initial public offerings to hedge funds. In contrast, another study asserts that allowing managers to run hedge funds and mutual funds simultaneously leads to higher financial rewards, thus helping managerial recruiting and retention. The jury still seems to be out on that subject. Interestingly, multitasking across several mutual funds is much more prevalent than side-by-side management, despite evidence that it leads to uneven investment results. • •

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