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# Ownership, risk and performance of mutual fund management companies

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**Abstract**

This paper compares the performance of mutual funds managed by publicly-traded management companies with those managed by private management companies. We find that publicly-traded management companies invest in riskier assets and charge higher management fees relative to the funds managed by private management companies. At the same time, however, the risk-adjusted returns of the mutual funds managed by publicly-traded management companies do not appear to outperform those of the mutual funds managed by private management companies. This finding is consistent with both the risk reduction and agency cost arguments that have been made in the literature.


*Keywords:* Management companies; Performance; Ownership

## 1. Introduction

The mutual fund industry has been one of the fastest growing sectors within the Canadian capital market over the past 10 years. As shown in Table 1, the growth of the Canadian mutual fund industry has been remarkable. According to the Investment Funds Institute of Canada, as of June 2000, Canadians invested more than $400 billion in mutual funds—more than 10 times the total at the beginning of 1991. A survey in 1999 found that close to 40% of Canadians now own a mutual fund, an increase of 168% since 1991.[1] The mutual fund industry has benefitted from a combination of low interest rates, the increasing age of the population, a growing large

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Table 1
Canadian mutual funds industry—IFIC Members[a]

| Year | Net assets at market | Net new sales | Number of funds | Number of unitholders |
| --- | --- | --- | --- | --- |
| 1991 | 49,916 | 12,481 | 505 | 4,533,686 |
| 1993 | 114,598 | 34,863 | 663 | 8,928,661 |
| 1995 | 146,228 | 10,272 | 916 | 15,295,121 |
| 1997 | 283,159 | 64,387 | 1023 | 32,826,069 |
| 1999 | 389,696 | 29,340 | 1328 | 45,752,433 |

Source: The Investment Funds Institute of Canada.
[a] As of September 1991, IFIC Members represent 97% of assets under management in Canada.

deficit in the Canada Pension Plan, the moving of savings from defined-benefit pension plans to defined-contribution plans, and an increasing awareness of mutual fund products over the past decade.[2]

The purpose of these popular investment vehicles to provide professional management and the opportunity for investors to diversify. Each mutual fund within the larger fund complex is overseen by a board of directors which is responsible for carrying out the activities of the fund. The board of directors, in turn, appoints a management company that chooses a portfolio manager which in turn determines the composition of the investment portfolio within the bounds set by the fund's objective. Like other business organizations, there are two major forms of ownership structure of these management companies: partnership and corporation.

An interesting puzzle that exists in the industry is that some management companies choose to be publicly-traded on an exchange while others choose not to be. As of June 2000, there were approximately 200 companies managing mutual funds in the Canadian market and of those, seven were publicly-traded.[3] Although the number of publicly-traded management companies is relatively small compared to the number of private management companies, they have been playing an important role in the Canadian mutual fund industry. More than 400 mutual funds were under management of these seven publicly-traded management companies as of June 2000. At the same time, the aggregate net asset value managed by these publicly-traded management companies was approximately $155 billion which accounted for 40% of the total assets held by the Canadian mutual fund industry.[4]

Given the growing popularity of mutual funds and their sheer size within the Canadian capital market, it is important to try to get some insight into how the ownership structure of the management companies affects the performance of the mutual funds they manage.[5] Publicly-traded management companies are characterized by the separation of the ownership and management roles similar to other corporate entities. The question of how diffusion of ownership affects the performance of companies has attracted a great deal of attention in the financial economics literature. Jensen and Meckling (1976) suggested that the managers' incentive to maximize shareholder value increases with their level of ownership. The greater the concentration of ownership, the better is the performance of the firm. Demetz (1983), however, argued that the shareholder, who decides to dilute the ownership structure, must already be aware of the consequences of the moral hazard problem of the managers. The cost of loosening control over the managers should be offset by other advantages of diluted ownership, such as the lower