

A THEORETICAL STUDY OF THE IMPLICIT INCENTIVE ABOUT OPEN-ENDED FUNDS⁴

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Abstract. This paper discusses the issue of implicit incentives under discrete case and continuous case. Our results show that the greater the fund clients motivate the manager in the daily management or in seeking investment opportunities, the more efforts the manager will make. If the activities of the daily management (or seeking investment opportunities) are alternative, then the increasing incentive strength will lead to a decline of the effort level in those circumstances. Further, we find that when the risk of seeking investment opportunities is huge, all the incentive of clients is reflected in the motivation for the efforts of the daily management.

key words:Open-ended funds; Investment opportunity; Implicit incentives; Agency by agreement

1 Introduction

The mutual fund industry has a saying, "real currency management is not managing money, but to make more money to be managed"[1]. This sentence implies the implicit incentive effect that the current performance of the open-ended fund will affect future capital inflow; thereby affect its future reward. Specifically, if the performance of the manager is better than the benchmark, new capital will flow in, and thus obtain a higher management fee income, which is the award of the manager; When the fund performance is poor, future capital will flow out, and the management fee will decline, thus making the punishment for managers. The realization of significant positive correlation between income and the inflow of expected fund becomes the form of implicit incentive mechanism in fund market. Implicit incentive mechanism has three elements: (1) Open structure: the open structure of open-end funds provides a convenient for the fund holders and a natural channel for the implicit incentive; (2) Reward structure: the reward structure which is proportional to

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