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LAYERED AGENCY CONFLICTS IN MUTUAL FUNDS: AN INTEGRATED GOVERNANCE FRAMEWORK

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Abstract

Through this study, we present mutual fund governance challenges as a composite system of layered agency conflicts and suggest a framework to mitigate the combination of agency conflicts. Mutual funds are among the most important forms of delegated investment arrangements in modern capital markets Their institutional structures differ fundamentally from those pertaining to the conventional joint-stock corporations. Existing research has provided important insights into managerial incentives, board oversight, disclosure, and regulation. However, these aspects have typically been examined in isolation, or limited combinations. We develop an integrated governance perspective that could enhance the effectiveness of the broader governance architecture of mutual funds.

An integrative review of the mutual fund governance literature has been conducted using a PRISMA-informed review process. From the extracted studies, we categorise the potential agency conflicts, examined the governance mechanisms employed, and provided the theoretical underpinnings for the same. Various perspectives - from agency theory, managerial power perspectives, and behavioural governance research - are documented and used to develop a composite and layered agency conflict schematic, and to suggest an integrated governance framework.

The study identifies four major conflict domains: investor–board, AMC–investor, investor–manager, and manager–AMC conflicts. These conflicts coexist within a layered governance architecture, where

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accountability is distributed across multiple organisational actors and systems. Our analysis suggests effectiveness of governance depends on the combination of complementary structural (board monitoring, inventive policy, internal monitoring processes), institutional (regulation, disclosure norms, investors' fund flow sensitivity), and behavioural (organisational culture, investment processes and policy) controls rather than on any single governance mechanism. The study suggests sponsor neutrality to be a critical enabling requirement for effective governance and emphasizes the ex-ante control mechanisms for mitigating agency costs, since these are difficult to reverse ex post.

Keywords: mutual fund governance; agency conflicts; corporate governance; delegated investment systems; sponsor neutrality; board effectiveness; investor protection; fiduciary governance.

JEL Classification: G180, G230, G320, G380

1. Introduction

Mutual funds have become a dominant vehicle for households and institutions' participation in capital markets. These funds manage vast pools of savings and have increasingly significant influence over corporate stewardship. This systemic significance makes questions of governance, fiduciary accountability, as well as investor protection very important. These developments have led to an evolution of extensive regulatory oversight, norms on the structure and staffing of boards, disclosure requirements, and market discipline. Simultaneously, this has given rise to concerns regarding managerial incentives, board effectiveness, conflicts of interest, and investor welfare within the sector. These concerns, despite the regulatory mechanisms, are revealed by the repeated breach of trust episodes (Davis et al, 2007).

Traditional corporate governance frameworks only partially explain these challenges. Most governance models assume a relatively direct relationship between shareholders, boards, and managers. They employ the classical principal-agent relationship conflict to explain the problem and suggest various forms of an optimal contracting approach to mitigate these. One needs to note though, that there are two dimensions that make for the distinctiveness of the governance challenges in the mutual fund context.

The first is the structure of the mutual fund complex. Mutual funds (MFs) operate through a complex institutional architecture in which multiple entities combine to form the fund complex. Consequently, authority, oversight responsibilities, and fiduciary obligations are distributed across various agencies. Mutual fund as a legal entity is like a shell company without any employees. Sponsors are at the core of the fund complex. They appoint the board of trustees, often promote the advisory firms or asset management companies (AMCs) that operate the investment funds, as well as a number of other agencies for specialised, ancillary investment services. Fund investors entrust the board to oversee advisory arrangements that include selecting AMCs, contracting their fees and monitoring the performance. The AMCs in turn appoint fund managers, who are domain experts, to take charge of the fund management process. This arrangement is holistically termed the mutual fund complex (Jensen & Meckling, 1976). Sponsors influence the structure and operation of fund complexes, while fund managers exercise substantial discretion over investment decisions. Since sponsors have such a central role in the fund complex, their involvement or neutrality can have a significant impact on the way agency conflicts emerge, or are mitigated. This is crucial in shaping institutional outcomes.

The second dimension is that mutual fund investors are both shareholders in the fund as well as customers of the fiduciary services they provide. This dual role of owner and consumer further complicates the agency relationship. As a result of these facets, governance outcomes are no longer the result of a singular principal–agent connection and resulting conflict. Instead, they are a product of multiple and overlapping agency relationships (Birdthistle, 2006).

The agency conflicts resulting from this unique corporate arrangement in a mutual fund complex gives rise to agency costs, consisting of three elements: monitoring cost, bonding cost, and residual cost (Jensen & Meckling, 1976). These costs are primarily internal, attached with agents and occur due to the misalignment of the interest between the agent and principal (Eisenhardt, 1989). In mutual funds, the bonding and monitoring costs are captured in the fees paid by mutual fund shareholders. Inefficient, self-serving or unethical managerial actions cause suboptimal performances of the fund. These are the residual costs . Hence, this becomes the measure of value in assessing the impact of agency conflicts in the mutual fund complex (Panda & Leepsa, 2017). A major contributor to the residual cost is the combination of risk asymmetry between fund shareholders and fund managers, with the high transmission of investment authority to these managers (Kong and Tang, 2008).

Existing research has generated important insights into specific, individual dimensions of mutual fund governance. These include managerial incentives, board independence, fee structures, investor fund flows, disclosure practices, stewardship responsibilities, and regulatory oversight. However, the literature is largely fragmented, often examining specific conflicts or control mechanisms in isolation or limited combinations. There is no doubt that such studies have enhanced understanding of particular institutional arrangements. Yet, these do not offer sufficient guidance on how multiple agency relationships interact within the broader governance architecture of mutual funds. Or, how these mechanisms collectively shape institutional outcomes.

This limitation is critical. In a mutual fund complex, governance effectiveness is less likely to depend on any single control mechanism. Instead, it is more likely to be impacted by the interaction of structural controls, institutional checks, market discipline, and behavioural influences impacting multiple layers of delegated authority. Therefore, we need to have a holistic perspective on how accountability is administered when responsibilities are distributed across multiple organizational actors with divergent interests.

This study addresses this gap by examining mutual funds as layered governance systems in which multiple agency relationships between organizational actors coexist and interact. It builds on insights from agency theory, managerial power perspectives, and behavioural governance research. It also reviews the role of the sponsor as a critical enabling factor in the mutual fund complex. The study further examines the importance of the temporal dimension of control mechanisms in sustaining accountability within delegated investment structures.

The rest of the paper is organized as follows. Section 2 describes the review design and analytical approach for the paper. Section 3 synthesises the literature to present a composite schematic for layered agency conflicts in mutual funds. Section 4 develops an integrated governance framework and forwards a set of theoretical propositions. Section 5 provides the conclusion, discussing implications for governance scholarship and regulators.

2. Review Design and Analytical Approach

2.1. Review Design

This study uses an integrative literature review to first understand and then extend existing findings on mutual fund governance. The current research focusses on discrete theoretical perspectives and empirical findings. We find the integrative review quite appropriate here, since we seek to assimilate individual studies to synthesise broader conceptual insights (Toracco, 2016).

The review process was anchored in the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) framework. This was done to reduce bias and help ensure systematic identification, screening, and selection of relevant literature (Page et al, 2021).

We used the review to identify common threads among mutual fund governance mechanisms and bring together alternate theoretical explanations. This helped develop a more comprehensive understanding of how institutional arrangements operate within delegated investment structures. We further adopted a theory-building approach, and combined insights from agency theory, managerial power perspectives, and behavioural governance research to construct an integrated governance framework.

2.2. Search and Selection

To gather literature, we searched major academic databases including Scopus, Web of Science, and Google Scholar. The search keywords included mutual fund agency conflict, mutual fund agency problem, corporate governance in mutual funds, agency costs in mutual fund, stewardship in mutual fund, Morningstar stewardship grading, ownership structure in mutual fund and board structure in mutual fund. We restricted the search to peer-reviewed journal articles and other select scholarly work of high quality. A few additional studies were identified through citation cross-searches to include other influential contributions. Given the large literature on fund performance and investment strategies, we screened the papers to ensure they were focussed on agency conflicts and institutional monitoring arrangements

The final selection of literature, comprised 52 peer reviewed journal articles as well as a few from the SSRN and a book chapter. These represented work on multiple governance dimensions, including managerial incentives, board oversight, sponsor influence, disclosure mechanisms, stewardship practices, and regulatory controls.

Figure 1 presents a summary of the review process.

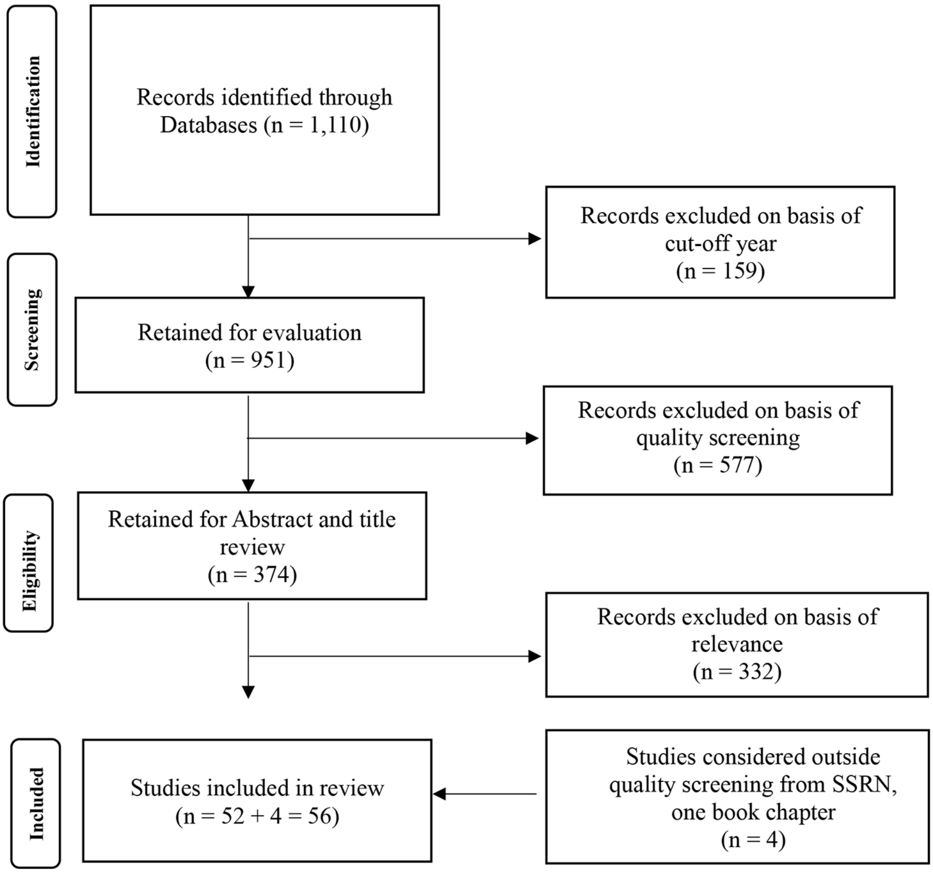

Figure 1. PRISMA 2020 flow diagram for Agency Conflicts and Governance in Mutual Funds.

2.3. Analytical Approach

In order to extract relevant thematic content, we focussed on three analytical dimensions: (1) the agency conflicts examined, (2) the oversight mechanisms proposed or evaluated, and (3) the theoretical explanations used to account for governance outcomes. This helped synthesise the output into a better understanding of the governance challenges and their potential mitigants in the mutual fund complex.

Our analysis identified a number of recurring agency relationships or conflicts. These included conflicts between investor and board, investor and AMC, investor and fund manager as well as between fund manager and AMC. These observations helped us conceptualize mutual fund complexes as structures consisting of layered agency conflicts.

We examined the various governance mechanisms employed to mitigate these conflicts, and were able to group these into three broad categories. The first group, structural controls, include board monitoring, incentive policy, and internal monitoring processes among others. The second, institutional and market controls, illustratively consist of regulation, disclosure requirements, competition, and investors' fund flow sensitivity. The third, behavioural controls comprise organisational culture, stewardship policy and investment processes. This classification helped draw comparative inputs from across studies that otherwise examined these measures in isolation.

We further focused on the theoretical explanations of governance outcomes. Agency theory was the predominant lens within this body of literature. A number of studies looked at optimal contracting as the mitigating means to this classical explanation. These studies also identified pertinent explanations stemming from managerial power perspectives and behavioural control dimensions. Analysing these threads together helped us identify complementary dimensions of governance and also some less obvious limitations of current theories about them.

These three dimensions were synthesised to develop the integrated governance framework presented in this paper. By linking multiple and layered agency conflicts, interdependent governance mechanisms, as well as theoretical explanations in a unified conceptual presentation, we posited a broader and composite schema of governance effectiveness in delegated investment systems.

3. Layered Agency Conflicts in Mutual Funds

We trace the recognition of the agency conflict back to Adam Smith (1776), who opined that directors of joint-stock companies act as managers rather than owners. Hence, it would be unrealistic to expect them to watch over the company with the same anxious vigilance with which partners in a private partnership frequently monitor their own. The agency conflict basically occurs when the goals and risk preferences of principal and agent differ, and it is difficult and expensive to verify if the agent is behaving properly (Eisenhardt, 1989).

The agency problem in a mutual fund complex is more intriguing than a regular corporate entity due to its layered nature that involves multiple agencies. In Table 1 below, we tabulate how the definition of the agency conflict in mutual funds has become more nuanced and multi-dimensional.

Table 1. Definition of Mutual Fund Agency Conflict

Author	Definition of Mutual Fund Agency Conflict
Mehran et al. (2006)	A conflict of interest exists when a party to a mutual fund transaction can gain by taking actions that are detrimental to its counterparty (the principal). Conflicts are present when contracting is costly and the principal is imperfectly informed.
Tkac (2004)	The conflict in a mutual fund occurs because the two parties—investors and advisors—will in general have differing objectives. The investors would like the agent to invest their money to maximize their investment objective. The investment advisor, as the agent, desires to maximize his own profit and would prefer not to exert much effort (i.e., cost) in fulfilling his role.
Kong and Tang (2008)	The agency conflicts between mutual fund managers and fund shareholders are created by fund managers' incentives to maximize total compensation, the product of proportional management fee and total assets under management, while fund shareholders care about risk-adjusted net-of-fee returns.
Bogle (2005)	Nowhere in mutual fund America is the conflict between the owners' capitalism and managers' capitalism more severe than in the costs assessed against fund shareholders.

(*Contd.*)

Author	Definition of Mutual Fund Agency Conflict
Ferris & Yan (2009)	Agency conflict is more acute for fund management companies with a short-term focus and fund management companies with short-term focus are not going to create long-term value for its shareholders but focus on maximizing their own.
Bebchuk et al. (2017)	Source of agency conflict in a mutual fund occurs as the cost of stewardship activity to protect shareholders' interests is borne by the investment manager. But the cost–benefit analysis does not favour active stewardship for the investment advisors which result in agency conflict.

In this context, we examine the issues of governance and the implications on mitigation of these agency conflicts and associated costs.

3.1. Mutual Funds as Governance Outliers

As an organisation structure, the mutual fund is like a shell company without employees. The typical, multifaceted structure of the mutual fund complex gives rise to a rather distinct oversight framework. The sponsor is at the core of the complex. They appoint the initial board and their independent directors as well as float an AMC. The sponsor also contracts with other outsourced entities such as custodians, transfer agents, fund administration and accounting firms. The mutual fund board technically selects the AMC (albeit tends to go with the sponsor promoted entity), sets the fees and monitors the performance of the fund, on behalf of the fund investors. The AMC recruits qualified, highly specialised fund managers to administer the investment process and fulfil the investors' investment objectives.

In typical joint-stock corporations, agency conflicts and mitigation efforts are usually focused on interactions among shareholders, boards, and managers. However, the mutual fund complex creates a structure in which governance responsibilities are distributed across multiple organizational actors: board, AMC and the fund manager, all held together by the sponsor. This results in a delegated and multi-actor accountability structure.

Two major elements differentiate mutual fund governance systems from corporate mechanisms. First, mutual fund investors are also consumers of the products of the entity they own, and so have the right to 'vote with their feet' by redeeming their capital at the intrinsic value at any time. This right of redemption, apart from being a financial claim, imposes discipline on the AMC, and is essential to the governance mechanism of mutual funds. This is so, as the AMC's fees charged are proportionate to the amount of assets under management (AUM) of the fund, and redemption of each share reduces the AUM (Roiter, 2016).

Second, the mutual fund board has no executive power over the core investment management activities of the fund. This is unlike a corporate board, which gets involved in all aspects of strategy and business of the firm. Notably, the investment decision-making prerogative rests with the AMC, which technically, is just an outsourced entity. Therefore, an AMC acts as agent to two principals: the fund sponsor as its promoter and fund investors as suppliers of its capital. While the former is interested in increasing the aggregate fee income by maximizing AUM across all funds managed, the latter is interested in optimization of their mean-variance outcome at the fund level, where their capital is deployed (Davis et al, 2007).

This institutional structure is the basis for governance challenges unique to mutual funds. Investors have to depend on multiple intermediary agents to achieve their objectives. Decision-making responsibilities lie with extremely powerful fund managers, and the monitoring of these managers is entrusted to multiple organisational actors with varying incentives, levels of information, and degrees of power. Consequently, governance outcomes cannot be understood solely through the conventional lens of a specific principal–agent relationship.

The distinct positions and incentives of the directors, the AMC, the fund managers and the overarching presence and interest of the sponsor creates divergent interests and multifaceted conflicts. Hence, we need to understand the mutual fund complex as a whole, as well as the structure of multiple principal-agent dyads. This is vital to appreciate how this complex is characterized by a system of layered agency conflicts where multiple governance relationships coexist and interact.

Figure 2 depicts our interpretation of the layered governance architecture and conflicts of the mutual fund complex.

The literature brings forward four recurring conflict domains shaping governance outcomes within mutual funds: investor–manager conflicts, AMC-manager conflicts, investor–board conflicts, and AMC–investor conflicts. Although these are analytically distinct, the conflicts overlap in the organisational framework and create a collective influence on the institutional effectiveness.

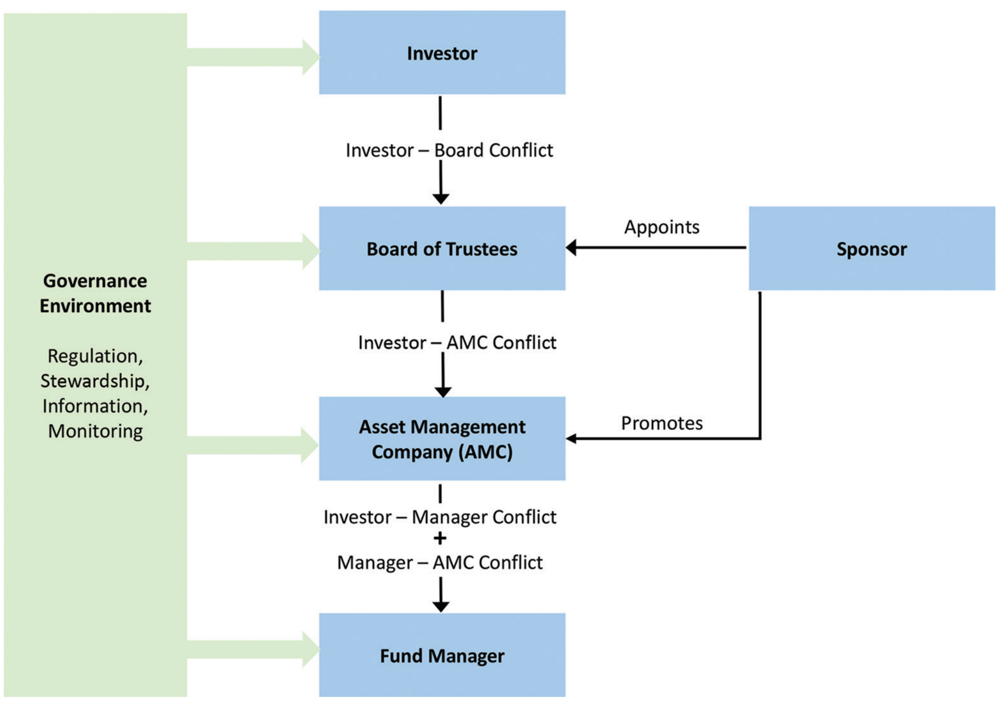

Figure 2. Layered Agency Conflicts in the Mutual Fund Complex.

3.2. Investor–Board Conflict

Tufano and Sevick (1997) argue that the institutional framework of utilizing a mutual fund board to safeguard investor interests is inherently defective. First, the responsibility of a mutual fund board is framed by law. Notably, it does not involve itself in business execution or strategies. Rather, it focuses on setting up the fee structure, monitoring and renewal of contracts with service providers, including the AMC. Hence, while corporate board of directors mediate between investors and the management, mutual fund investors on the other hand, have an unmediated relationship with the AMC which ultimately manages their money (Houge & Wellman, 2005; Roiter, 2016). Second, corporate boards are involved in all aspects of management, but the primary responsibilities of a mutual fund board are focussed on ensuring regulatory compliance. Given that independent directors are appointed by the sponsor, it is difficult to imagine these directors negotiating lower fees with the sponsor-promoted AMC or removing them for suboptimal performance. Thus, the very process of the directors' appointment and compensation can undermine their independence and heighten the conflict of interest (Ferris & Yan, 2009; Fama & Jensen, 2019). Studies also show connectedness of independent directors with AMCs dilutes benefits of directors' stewardship, and results in increased agency costs. Further dilution has been documented when same directors serve with multiple funds of the same sponsor (Kong & Tang, 2008; Kuhnen, 2009; Meschke, 2019).

Policymakers have emphasised independence of the board from the sponsor as a major attribute for investor protection. However, board independence is a behavioural trait rather than a mere legal status. Within the complex structural framework of mutual funds, a board can operate with true independence only when the sponsor maintains a neutral stance.

3.3. Investor-AMC Conflict

A relatively less examined but important governance challenge arises from the relationship between AMCs and fund investors. While the AMC aims to increase aggregate fee income by maximizing Assets Under Management (AUM) across all managed funds, the individual investor seeks to optimize their mean-variance outcome at the specific fund level where their capital is allocated (Davis et al, 2007).

Sponsors are at the centre of the mutual fund complex, and are responsible for establishing mutual funds and appointing AMCs. These AMCS in turn design product offerings, employ fund managers and provide the disclosures to investors, the board and regulators. Thus, they exert significant influence over governance activities within fund complexes. AMCs benefit from the growth and profitability of fund operations, which could be contradictory to the motivation of investors who seek risk-adjusted returns and effective stewardship of their capital.

This divergence of interests carries potential for AMC–investor conflicts. Research has brought forward concerns that include fee structures, product proliferation, and distribution incentives. Add to these monitoring arrangements that tend to favour organizational objectives over investor benefits, and we have a veritable bevy of agency conflicts. AMCs are prone to launch more products to gather fresh funds. This diverts attention from the existing funds, and creates additional pressure for fund managers to perform on higher volumes or larger breadth of portfolios. This is counter-productive to investor benefits. The AMC is also caught in a duality bind – simultaneously being agent to two principals: the sponsor as its promoter and the fund investors as suppliers of its capital (Chen et al, 2021).

Sponsors significantly influence the institutional environment within which coordination takes place. Their actions, if self-motivated rather than neutral, can impact the effectiveness of boards, and in turn incentive systems for AMCs and fund managers, playing a pivotal part in this context. The institutional characteristics of the sponsor thus dictate the governance culture embedded within the AMC. Hao and Yan (2012) find that investment bank-affiliated mutual funds exhibit a higher propensity to hold shares in recent initial public offerings managed by their underwriting sponsors, thereby inflating agency costs. On the other hand, a commercial bank as a sponsor may prioritize its AMC's governance standards being higher, recognizing that reputational damage or poor client experiences within the fund business could adversely impact its core operations.

3.4. Investor–Manager and Manager-AMC Conflict

Optimal diversification of portfolio risks for investors, particularly individuals, is a core tenet of the mutual fund industry's raison d'etre. Mutual funds take advantage of pooled investments and provide shareholders with diversified portfolios at a lower cost than they could achieve independently. By purchasing mutual fund shares and agreeing to pay associated administrative fees, investors essentially hire professional money managers to handle their investments. Investors usually lack the time, expertise, or desire to manage their own funds, and so this instrument offers significant appeal (Tkac, 2004; Birdthistle, 2006).

Therefore, fund managers are central to the operations of an AMC. They bear responsibility for the optimal diversification of investors' capital, which are substantial sums of money. The ultimate responsibility for each fund may be held individually by a single fund manager, or by a team of managers jointly taking investment decisions. In either case, fund managers are star investment advisors, and are compensated accordingly.

Research suggests that well-crafted compensation agreements combined with 'mandatory skin in the game' for these managers would lead to agency alignment. However, it has fallen short in explaining the illicit behaviour of mutual fund managers over the years (Cremers et al, 2009). These episodes have resulted in substantial losses for mutual fund investors. The incidents have ranged from late trading scandals, overpaying commissions, to manipulating the fair value of underlying securities. However, irrespective of the nature of such agency costs one thing has been common: an active involvement of mutual fund managers in such agency misalignment. These fund managers often use their powers to alter the course of arm's length bargaining by directors on behalf of shareholders in their favour through rent-seeking behaviour. Importantly, the optimal contracting approach suggested by positivist agency theorists fails to explain this tendency of self-serving unethical behaviour among mutual fund managers (Bebchuk et al, 2002; Mahoney, 2004; Huang et al, 2011).

One plausible explanation for such illicit behaviour could be the inherent structural weakness of the legal framework of mutual funds as shell companies, as compared to mainstream joint-stock corporations. The source of any agency problem is the imbalance in powers between the principal and agent. In a mutual fund contract the balance of power is tilted towards the fund managers. More often than not, MF board members serve on a part-time basis. This reduces their effectiveness in monitoring highly skilled professionals operating in the esoteric field of fund management. Given that a board of trustees presides without any executive power, mutual fund contracts are highly susceptible to abuse by these powerful managers. Instances of this abuse include style drift, risk shifting, and tournament behaviour, particularly when their performance is benchmarked to peers or an external standard (Patel & Sarkissian, 2021; Agarwal et al, 2022). The fund has no assets or resources of its own (offices, equipment or employees). All functions necessary to perform its primary mission, i.e. increasing the shareholders' value of investment are outsourced to third parties. Notably, the most esoteric of these service providers is the entity that manages the fund's investment portfolio, the AMC.

Agency conflicts may arise even in the absence of explicit self-interest, driven by behavioural dimensions. Cognitive biases, overconfidence, herding behaviour, and short-term performance pressures can influence managerial decision-making and contribute to governance failures. These behavioural influences are especially relevant in investment management contexts characterized by uncertainty, complex information environments, and continuous performance evaluation (Wiseman & Gomez-Mejia, 1998; Westphal & Zajac, 2013; Pepper & Gore, 2015; Cuthbertson et al, 2016).

The illicit and self-serving behaviour of fund managers can be structurally and behaviourally controlled by the sponsor. The mutual fund industry is essentially built on trust. A sponsor who establishes an environment of accountability and transparency can effectively align managerial behaviour with investor interests. Structural control over these managers can be affected by implementing a rigorous investment process designed to mitigate cognitive biases and self-serving behaviours. Further, if a sponsor's board comprises both independent and competent directors given due executive power, they will be in a much stronger position to effectively monitor, guide, and direct these powerful managers to act in the best interests of investors.

3.5. Synthesis: Mutual Funds as Layered Governance Systems

Research on mutual fund governance has largely followed the path of positivist agency theory, focusing on designing an optimal contract to align stakeholder interests. The success of optimal contracting in meaningfully reducing agency costs depends on three critical factors. First, the fund's board must be independent and capable of negotiating with service providers at arm's length. Second, market forces must be sufficiently robust to induce actors toward optimal bargaining outcomes. Third, mutual fund shareholders or investors must be legally empowered to reject managerial compensation packages that are detrimental to their interests. Researchers have largely utilized the combination of these three pillars as the underlying construct of the optimal contracting approach. Consequently, much of the literature on mutual fund agency problems centres on effective board monitoring, investors' fund flow sensitivity, and excessive fees as proxies for these three essential preconditions (Birdthistle, 2006; Bebchuk et al, 2017). These prerequisites rarely coexist in practice, highlighting the limitations of the optimal contracting approach in effectively mitigating agency costs.

This situation also gets confounded by the free rider problem in the context of mutual funds. Individual, smaller-ticket investors do not invest time and effort in examining the governance of mutual funds. They rely on the diligence of larger institutional investors to avert any major governance concerns (Chen et al, 2011; Evans & Fahlenbrach, 2012; Qian, 2011).

Taken together, these conflicts reveal a cascading system in which accountability is distributed across multiple layers of delegated authority. Investors depend on boards to monitor advisory arrangements. Boards rely on information and cooperation from sponsors. And fund managers operate within organizational environments shaped by both institutional frameworks and behavioural influences. Governance outcomes therefore emerge from interactions among multiple actors rather than from any single or particular monitoring arrangement or agency relationship.

This combined, holistic perspective, provides a foundation for moving beyond disjointed analyses of individual oversight arrangements between various principal-agent dyads. It supports a more integrated understanding of governance effectiveness. In the next section, we build on this insight by developing an integrated governance framework. It presents an explanation on how different policy instruments interact to mitigate layered agency conflicts and sustain accountability within the delegated investment systems that mutual funds represent.

4. Toward an Integrated Governance Theory

The preceding discussion has shown that mutual fund governance is characterized by multiple overlapping agency conflicts between investors, boards, AMCs, and fund managers. Existing studies have generated valuable insights into specific governance mechanisms and their failures, but are largely focussed on individual conflicts or specific mitigation arrangements embodied by the optimal contracting approach. This fragmentation pre-empts a broader question: what determines institutional effectiveness in a system characterized by multiple layers of delegated authority, especially in the context of fiduciary relationships?

In this section, we build on the analysis presented so far to present an integrated governance framework to address this question. We argue that governance effectiveness does not depend on the presence of any single oversight mechanism. Instead, it is the outcome of the interaction among complementary institutional controls operating across the mutual fund complex. This framework also highlights the importance of sponsor neutrality and ex ante governance in ensuring accountability within delegated investment systems such as those of mutual funds.

4.1. Governance Complementarity

Mutual fund governance studies usually evaluate governance mechanisms independently, or in limited combinations of board independence, managerial incentives, disclosure requirements, market discipline, regulatory oversight, or stewardship practices as discrete governance solutions. These approaches have yielded important insights, but largely fail to consider the interdependence of governance mechanisms. Even if explored, these have not been taken as a composite framework.

To better explain these interdependent relationships, we group governance mechanisms into three broad categories: structural controls, institutional and market controls, and behavioural controls. Structural controls include board oversight and monitoring, incentive policy and systems, ownership arrangements, compliance structures, and internal monitoring processes. Institutional and market controls comprise regulation, disclosure requirements, competition, institutional investor presence, investor fund flow sensitivity, and reputational considerations. Market research information and investor education also form part of this group. Behavioural controls include organizational culture, stewardship policy, and investment processes and policy. The latter largely comprises behavioural constraints to mitigate cognitive biases and short-term decision-making.

To Illustrate some structural controls that interact with the other dimensions, board oversight is influenced by the nature and extent of regulation imposed by the competent authority – it is practically framed by law. Further, a higher degree of competition among mutual funds also spurs a more meticulous board involvement. Internal monitoring processes of a more conservative institution are likely to create more behavioural controls or stricter adherence to well documented investment processes.

Furthermore, institutional and market controls also interact with other mechanisms. Examples include higher reputational consideration leading to better internal monitoring. Also, a more vibrant market research information availability will induce better defined investment processes and policy as well as increase the onus on the board to monitor the fund’s governance. Similarly, an institution having an organisation culture with a higher degree of investor-orientation would be more diligent in the appointment of the board members, as well as would influence the type of investment policy pursued by the fund. Increased information flows in certain markets promote a culture of stronger research and dissemination by specialised entities on performance as well as stewardship, thus reinforcing structural controls.

These institutional mechanisms operate as complementary controls rather than substitutes. Weaknesses in one governance domain may reduce the effectiveness of others, while sound regulatory outcomes are more likely to emerge when multiple methods act simultaneously to reinforce one another.

Governance effectiveness therefore reflects the quality of interaction among governance controls rather than the strength of any individual mechanism. Figure 3 depicts this integrated governance framework.

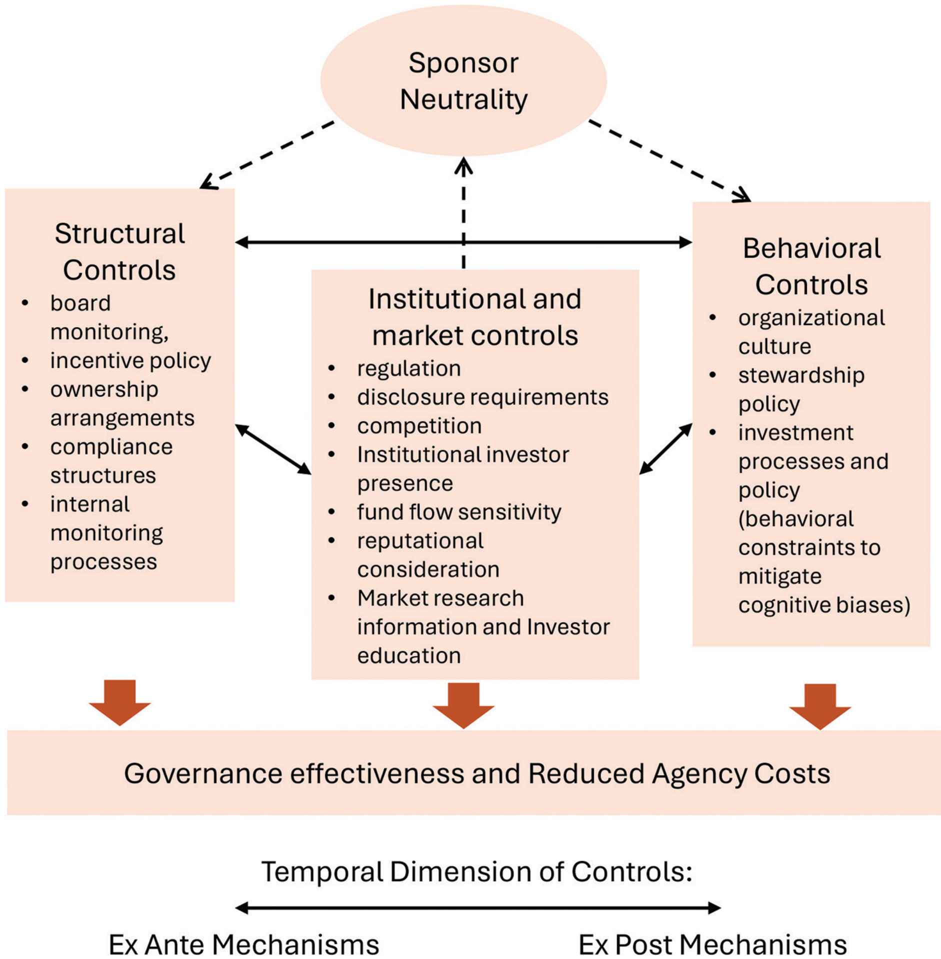

Figure 3. Integrated Governance Framework for Layered Agency Conflicts.

This integrated framework seeks to explain why governance outcomes often vary across fund complexes despite having similar formal organisational structures. The presence of independent boards, disclosure requirements, or meticulously crafted optimal contracts that detail performance-based compensation do not necessarily result in effective governance when used by themselves or when complementary controls are absent or weakened.

4.2. Sponsor Neutrality

Sponsors are the critical and gravitational centre of the mutual fund complex. After all, they are the entities that establish fund complexes and appoint service providers. They influence control structures as well as shape the organizational culture and environment. In effect, they impact the whole mutual fund ecosystem within which monitoring arrangements operate. Sponsors, hence, are not actually subjects of oversight. Instead, they frequently influence the design and operation of institutional frameworks themselves.

Governance outcomes are hence, driven not just by monitoring mechanisms but also by the extent to which organisational actors can operate with minimal sponsor influence. In other words, sponsor neutrality is critical for effective mitigation of the multiple and layered agency conflicts in the mutual fund complex.

Independent boards, disclosure arrangements, and compliance structures may not be as effective when institutional actors depend upon sponsors. Such dependence may be for appointment, information, resources, or organizational support. Sponsors also have a significant role to play in establishing organisational control, shaping stewardship and investment policies and procedures. Simultaneously, sponsor neutrality depends in part on the type and extent of regulation, the presence of institutional investors, reputational considerations as well as market research vibrancy. Together, these factors influence the degree to which sponsors are able, or permitted, to impact the monitoring arrangements in the mutual fund complex.

In effect, this study posits sponsor neutrality as the extent to which sponsors refrain from influencing institutions intended to monitor and constrain them. Sponsor neutrality does not imply the absence of sponsor involvement in governance. Instead, it reflects the degree to which institutional monitors get autonomy to exercise independent judgement on behalf of investors. We contend, sponsor neutrality functions as an enabling factor for monitoring effectiveness. Conversely, even well-designed oversight mechanisms may be weakened when sponsors retain substantial influence over governance processes.

The concept of sponsor neutrality has the potential to reconcile findings within the existing literature. It could be the unexplained factor that might help explain the current mixed evidence regarding board effectiveness, disclosure quality, and governance outcomes. Sponsor neutrality therefore provides a useful lens through which to evaluate governance effectiveness beyond formal institutional structures.

4.3. Ex Ante and Ex Post Governance

A further implication of the studies in this domain involves the temporal dimension of governance. Control mechanisms can be broadly distinguished according to whether they operate before or after agency costs are realized.

Ex ante governance encompasses mechanisms designed to prevent dysfunctional agency behaviour before they occur. These include board composition, manager selection, incentive policy and design, organizational culture, stewardship policy, investment processes, and risk management systems. These mechanisms are intended to shape behaviour and decision-making to pre-empt governance failures.

Ex post governance operates after accountability failures have occurred or become observable. Prominent examples include investor fund flows (mainly redemptions), reputational penalties, regulatory enforcement, litigation, market research downgrades and disciplinary interventions. These induce accountability by imposing consequences for undesirable outcomes.

Although both forms of governance are important, mutual funds exhibit characteristics that increase the importance of ex ante interventions. Investors delegate absolute authority to the mutual fund and fund manager to decide on their investment portfolio. These investment decisions can have irreversible consequences, and agency costs may not be fully observable until after investor wealth has been affected. Poor investment decisions, excessive risk-taking, or oversight failures can generate losses that are irreparable, and hence cannot be recovered through subsequent corrective or disciplinary measures. Therefore, ex post governance comes across as less effective and desirable. Ex post measures are more definitive, but relying on them alone may provide insufficient protection for investors due to the irreversible losses imposed on them.

We suggest that governance effectiveness in mutual funds depends disproportionately on the quality of preventive monitoring and institutional arrangements. Effective accountability requires not just mechanisms that detect and punish undesirable behaviour. It also requires institutional structures that reduce the likelihood of governance failures in the first place.

4.4. Research Propositions

On the basis of the integrated governance framework developed above we offer three propositions for further investigation.

Proposition 1. The effectiveness of governance depends on the interaction among structural, institutional, and behavioural governance mechanisms. Governance outcomes show a significant increase when these mechanisms are simultaneously and strongly enacted.

This proposition reflects the argument that control mechanisms operate as mutually reinforcing components of a broader oversight architecture. Effective governance is therefore expected to emerge when these controls are structured as complementary measures across multiple institutional dimensions. In other words, the interaction terms of these controls will positively and significantly reduce residual costs for mutual fund investors.

Proposition 2. Significant sponsor neutrality moderates the impact of structural controls such as board monitoring on governance effectiveness in layered institutional arrangements.

This proposition extends existing research in this area by emphasizing that formal governance structures alone may be insufficient. The effectiveness of monitoring mechanisms is expected to vary inversely with the degree of sponsor influence over the mutual fund complex and in effect, the governance structure.

Proposition 3. Ex ante governance mechanisms, positively moderated by irreversible agency costs, exert greater influence on governance effectiveness than ex post governance.

This proposition reflects the distinctive characteristics of delegated investment management, where governance failures may generate losses that are not or only partially recoverable through ex post corrective mechanisms. Therefore, it is better to build a set of strong ex-ante controls for better institutional performance.

Collectively, these propositions suggest that mutual fund governance is best understood as a layered system in which accountability depends on interactions among control mechanisms, institutional conditions, and temporal oversight arrangements. Governance effectiveness emerges not from any singular control device but from the broader institutional and governance architecture through which agency conflicts are managed and mitigated.

5. Conclusion and Future Directions

5.1. Reframing Mutual Funds as Layered Governance Systems

The paper makes three contributions. First, it presents mutual fund governance challenges as a system characterized by interconnected and layered agency conflicts rather than as a singular principal–agent relationship. We identify four conflict domains as particularly significant: investor–board conflicts, AMC–investor conflicts, investor–manager conflicts, and manager–AMC conflicts. Collectively, these relationships in the mutual fund complex construct an integrated structure where accountability is distributed across multiple layers of delegated authority. These jointly impact governance effectiveness.

Second, existing studies have produced important insights into individual governance mechanisms and agency relationships. Their cumulative implication is that organisation outcomes are shaped by a broader monitoring framework comprising structural, market and institutional as well as behavioural controls. Building on this synthesis, we develop an integrated governance framework for mutual funds. This highlights that governance effectiveness emerges from the interactions among institutional actors, overlapping agency conflicts, and complementary mechanisms operating throughout the mutual fund complex.

Third, it identifies sponsor neutrality and ex ante governance as important, yet less investigated dimensions of effective governance in mutual funds. Together, these provide a broader understanding of institutional controls in delegated investment systems. They also offer a foundation for extending governance scholarship beyond the mutual fund context into similar delegated investment institutions.

We forward three propositions for further investigation. These hypothesise that governance effectiveness depends on the complementarity of various mechanisms, are influenced by the neutrality of sponsors and are better served by ex ante governance mechanisms.

5.2. Implications for Regulators

Regulators can draw on the integrated governance framework developed in this paper to review the regulatory framework governing mutual funds. Current regulatory requirements have painstakingly evolved numerous measures for investor protection and market balance, but may not take into account the interplay between different forms of control. Hence, this presents an opportunity to integrate multidimensional controls to enhance effectiveness of governance and strengthen institutional architecture.

The implications of this study extend beyond the mutual fund industry. For both scholars and regulators, there is an opportunity to reframe governance architecture in other institutional contexts that involve delegation, intermediation, and distributed accountability. Pension funds, sovereign wealth funds, private equity corporations, and other investment institutions all involve multiple actors with independent authority over different aspects of governance. These actors exercise that authority on behalf of beneficiaries who are not directly represented in governance processes.

The setting of the mutual fund complex therefore establishes a powerful context for examining this broader governance challenge. It provides the opportunity to test how accountability can be maintained when oversight responsibilities are shared across multiple organizational layers. The integrated governance framework developed in this paper provides a foundation for future research on governance in increasingly complex organizational environments, where distributed controls significantly shape governance outcomes.

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