Accepted Manuscript

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PII: S1042-9573(17)30055-4
DOI: 10.1016/j.jfi.2017.09.001
Reference: YJFIN 764

To appear in: *Journal of Financial Intermediation*

Received date: 29 December 2016
Revised date: 24 August 2017
Accepted date: 4 September 2017

Please cite this article as: Olga A. Rud, Jean Paul Rabanal, John Horowitz, Does Competition Aggravate Moral Hazard? A Multi-Principal-Agent Experiment, *Journal of Financial Intermediation* (2017), doi: 10.1016/j.jfi.2017.09.001

Does Competition Aggravate Moral Hazard? A Multi-Principal-Agent Experiment

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September 8, 2017

Abstract

We conduct an experiment to determine whether market structure affects financial intermediary behavior. The intermediaries (Agents) are perfectly informed regarding project types and can recommend that their clients (Principals) either proceed or discontinue a project. Intermediaries earn revenues only when they recommend proceeding with the transaction. Thus, our design captures some of the incentives faced by financial advisers in commercial banks, where compensation depends on sales performance, and also by money-managers, whose income depends on the size of their portfolios. We find that a monopolist intermediary protects the interest of clients better than when intermediaries compete. Our results are robust to a significant fee increase and provide additional evidence on the impact of market structure on individual incentives and equilibrium outcomes.

Keywords: Delegated portfolio management, conflict of interests, rating services, market design, deception, laboratory experiment
JEL codes: D03, D40, D82, G02, G23, G24, C90

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