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A strategic fund family business decision: The pension fund liquidation

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ABSTRACT

We study the pension fund liquidation decision from a fund-family perspective. We examine whether fund families liquidate funds based on fund outcomes or as a family strategy. Analysing Spanish equity pension funds, we find that liquidations are not only motivated by fund return, but the fund size and the number of family funds are also significant. Consequently, liquidations are strategic decisions to form families with fewer and larger individual funds, to adapt to market conditions. Furthermore, participants prefer to invest in one family and re-allocate resources to other funds in the same family. Additionally, the managers of liquidated funds who do not manage other family funds are not re-employed within that family. These dismissals are a result of the family restructuring process, rather than being a response to the manager's performance. Finally, we find that, despite the industry concentration, competition is substantial because the Spanish pension fund market is fragmented.

1. Introduction

With a total of €24.5 trillion of assets under management worldwide (INVERCO, 2017), pension funds have become the main investment vehicle for retirement and one of the major players in financial markets (Vo, 2016). Pension fund development has been particularly remarkable over the last two decades because of increased population aging and the onset of doubts about the viability of the public pension system in many western countries, especially in Europe. Additionally, several governments point out that public pension system reforms may not be enough, and emphasise the need to save for retirement, encouraging investment in pension funds (primarily through tax exemptions or deferments). As a result, pension fund management is crucial for the future retirement savings of their beneficiaries, primarily non-professional investors.

The importance of pension funds in financial markets is also due to the industry concentration in a few important pension fund families (Hacohen & Tene, 2008; IMF, 2007; OECD, 2004; OECD, 2007; Queisser, 1998; Vittas, 1997; Voronkova & Bohl, 2005). One feature of the pension fund industry is the prevalence of fund-family organization; in this setting, pension funds are not independent and are controlled by one investment company, forming a fund family, often referred to as a family of funds (Kolokolova, 2011). This implies that managers do not work directly for the funds' participants, and may induce the sacrifice of the participants' best interests for the benefit of the overall family (Gaspar, Massa, & Matos, 2006).

In this context, the fund family is the decision-making unit responsible for fund-liquidation and promotion (Jain & Wu, 2000; Khorana & Servaes, 1999), for cross-fund subsidizations, for fund tournaments (Chan, Lai, & Lee, 2017; Kempf & Ruenzi, 2008; Zhang, Ding, & Zhou, 2014; Zhang, Zhou, & Fu, 2014), and for manager promotion or demotion, among other decisions. Such actions may not necessarily arise out of shareholder interests (Bhattacharya, Lee, & Pool, 2013; Gaspar et al., 2006). The fund family as an organizational structure is extended because it may provide economies of scale to the distribution, servicing, and promotion of funds (Nanda, Wang, & Zheng, 2004), as well as economies of scope, and reduction of operating costs. Nanda et al. (2004) also argue that families are more flexible in answering market conditions in reallocating their resources, compared to stand-alone funds. On the other hand, funds comprising a family may obtain branding and marketing advantages (Gaspar et al., 2006), and recognition compensations (customer loyalty). Some authors find positive associations between fund performance, family size, and market concentration in pension funds (Petraki & Zalewska, 2013). Nanda et al. (2004) find that good performance in one family fund attracts higher inflows to other funds in the same family. Guedj and Papastaikoudi (2004) obtain higher performance persistence among the larger fund families. Sialm and Tham (2015) determine that prior family performance predicts flows into affiliated funds However, Chen, Harrison, Huang, and Kubik (2004) find that family size does not affect fund returns, and fund size erodes performance due to potential organization diseconomies.

The financial literature on family decisions focuses on particular decisions, such as fund creation (Khorana & Servaes, 1999), promotion of certain funds (Gaspar et al., 2006), boosting spillover effects (Nanda et al., 2004), or family tournaments (Zhang, Zhou, & Fu, 2014).

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Nevertheless, one family decision rarely analysed, and commonly undertaken since the latest financial crisis, is the fund liquidation. Fund-liquidation decisions have been analysed in mutual funds (Zhao, 2004) and hedge funds (Kolokolova, 2011), but most of these studies ignore the family role in this decision. Prior studies find that fund liquidations are based on fund return, risk, assets under management, and/or managerial incentives (Ackermann, McEnally, & Ravenscraft, 1999; Brown, Goetzmann, & Park, 2001; Getmansky, 2005; Liang, 2000).

This paper examines pension fund liquidations, considering the influence of both family variables and fund variables. In a fund family context, not only fund results are important, and the family fund number and the fund position in the family may be triggers for fund-liquidation. Nanda et al. (2004) find that increasing the family fund number does not support subsequent returns. Kolokolova (2011) finds that multi-hedge fund families provide significantly lower returns, and families tend to liquidate under-size and under-performing hedge funds with respect to the family average. Consequently, while independent funds may liquidate funds based on fund results, liquidations at the family level may be based on strategic behaviours to attract resources, eliminate funds with lower management fees, or promote certain funds to increase family profits (Gaspar et al., 2006; Kolokolova, 2011; Nanda et al., 2004), among others.

Empirical work on pension fund liquidations, as far as we are aware, is non-existent, which provides us an opportunity to study an industry with specific characteristics. Thus, we expect to find new evidence with regard to mutual fund liquidations. The pension and mutual fund industries are similar in certain basic aspects: portfolio management services, investments from the same asset universe, and the use of passive and active managerial strategies (Del Guercio & Tkac, 2002). Nonetheless, their dissimilar purposes (Petraki & Zalewska, 2013) and clientele (Del Guercio & Tkac, 2002) may differentially motivate fund-family decisions. Pension funds are long-term investment vehicles and their investors usually reallocate their savings less frequently (Sialm, Starks, & Zhang, 2015); consequently, pension fund results may not be the main liquidation factor.

The consequences of fund liquidation have not been previously analysed from a family perspective. Fund-termination decisions may be intended to enhance family performance, but may also favour specific funds, resulting in the appearance of fund “favouritism”. Cross-fund subsidization, or fund “favouritism”, emerges from the interest divergence between fund families and investors (Gaspar et al., 2006). Families transfer performance and resources across their funds to improve the performance of the most valuable funds at the expense of other funds (Lai, 2016). Families enhance high-performing funds because these funds generate inflows for, and by, themselves (Chevalier & Ellison, 1997; Sirri & Tufano, 1998), and for other funds in the same family (Khorana & Servaes, 2012; Nanda et al., 2004). Nonetheless, Filip (2014) finds limited influence of the dissolved funds on the surviving fund return, in Hungarian mutual funds.

In this work, we first study the determinants of pension fund liquidation in a sample of Spanish equity pension funds, from both fund and family perspectives. Second, we examine the liquidation consequences for the family results. We then investigate whether fund-termination decisions are intended to favour specific funds, and whether other family funds receive resources from liquidated funds. Massa (2003) observes that investors first choose the fund family and then the specific investment fund. As a result, the pension fund participants of liquidated funds may be willing to transfer the investment to another fund in the same family, rather than to another family. We also execute a manager-level analysis. Finally, we analyse the relationship between pension fund market concentration and fund liquidations.

Our results show that pension fund liquidations arise from strategic decisions to build larger families with larger funds and lower fund numbers, and to improve fee revenues. Thus, the fund return is not the only liquidation factor, and a small fund size, lower fund flows, and a larger number of funds in the family are also significant liquidation determinants, especially when the savings level in the economy is lower. These findings reveal that families perform strategic liquidations to adapt to market conditions. Liquidations are especially commom in families owned by financial institutions, due to sector restructuring since the financial crisis. Additionally, our evidence does not show that liquidations generate agency conflicts between families and pension fund participants. Specifically, we find no favouritism or cross-fund performance subsidization from liquidated funds to other family funds. In fact, family funds receive flows from the liquidated family funds, even prior to liquidation, showing that families disclose the liquidation news in advance, avoiding asymmetric information problems between families and participants. As a consequence, participants feel informed and prefer to maintain their savings in families that they already know and trust. On the other hand, the managers of liquidated funds continue working within the family if they were previously handling other family funds; otherwise, they are dismissed. Finally, we find that the fragmentation of the market guarantees market competition, but small families are the most affected by market concentration, negatively affecting their returns and management fee revenues.

The rest of the paper proceeds as follows. In Section 2, we describe the Spanish pension fund market and our data. Our method and empirical results are shown in Section 3, and we present our main conclusions in Section 4.

2. The Spanish pension fund market and data

2.1. The Spanish pension fund market

The limited evidence on this topic for pension funds lends support to our analysis. Moreover, we provide the first evidence outside the US market examining the Spanish pension fund industry, characterised by distinctive features that make it relevant to our study. First, despite the late appearance of pension funds in Spain (in 1988), the Spanish market has experienced remarkable growth, exceeding €111.08 billion of assets under management in 2017.[1] Nevertheless, this evolution has produced certain inequalities, such as market concentration in a few families. Moreover, all pension funds belong to a family and are internally-managed, unlike in other countries. As a result, the Spanish market is formed by 49 fund families and, among these, three families control more than half of the market assets. Additionally, a small number of large families coexist with many small families, originating funds with dissimilar characteristics. While large families are made up of a large number of funds of various sizes, small families own few large funds or many small funds. As a result, the Spanish pension fund market in 2016 comprised 1626 funds (DGSFP, 2017), despite a 3.7% decrease from 2015 (DGSFP, 2016). These figures show an excessive number of pension funds and justify the fund liquidations performed in recent years.

Pension fund families in Spain are owned by financial institutions, insurance companies, or specialised companies in management and financial advice. Among these, 47% are owned by financial institutions,[2] and the recent financial sector transformation has especially affected these families. Our sample consists of fund families with diverse characteristics (size, number of funds, performance, return, and fees), allowing us to discern the significant family characteristics in the liquidation decision. Additionally, the fact that the Spanish pension fund market is dominated by financial institutions, unlike other markets, lets us examine how banking crises affect an investment vehicle with social importance.

[1] According to INVERCO (Asociación de Instituciones de Inversión Colectiva y Fondos de Pensiones): www.inverco.es

[2] In 2017, according to INVERCO (www.inverco.es).