Scaling Challenges on Portfolio Management: Does Psychological Dynamics Affect Managerial Decisions ?

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Abstract

This paper pioneers an exploration into the scale economies of mutual funds, addressing the intricate dynamics of portfolio adjustments amid substantial capital flows. Unlike previous studies that predominantly focused on external market constraints—such as price pressures and portfolio size, as highlighted in the seminal work of Berk and Green (2004)—our research delves into the less explored terrain of internal managerial psychology. We examine the critical roles of behavioral biases and threat perception in shaping mutual fund strategies and vulnerabilities. By introducing a novel analytical framework, we shift the lens towards the internal decision-making process, unveiling how managers' perceptions of threats and opportunities crucially influence their investment behaviors. Our empirical findings reveal a nuanced decision-making landscape where managers engage in strategic trades based on information richness that transitions to speculative behaviors during heavy inflows. The previous exists through a non-linear relationship between fund flows and managerial competitiveness that varies across skill levels. Our work offers significant implications for stakeholders, opening a new path to understanding scale economies' multifaceted challenges and opportunities.

Keywords: Mutual Funds, Active Equity Management, Economies of Scale, Fund Flows, Managerial Decision-Making, Behavioral Biases.

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[2] Please ensure that you are referring to the most recent version of this paper before proceeding. I regularly update the content to refine the analysis and incorporate new data. The latest version and R statistical code for replicating the study's analyses are available on my GitHub repository. Access it directly by clicking HERE.