Family Descent as a Signal of Managerial Quality: Evidence from Mutual Funds

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Executive Summary

Many investors delegate decision-making about their portfolios to professional managers. Choosing these managers is consequently a central task for those with investable assets. Oleg Chuprinin and Denis Sosyura provide evidence that a manager's family wealth and access to abundant resources during formative years, which can be gleaned from public records, are negatively correlated with the manager's performance.

Individuals are endowed with different opportunities at birth and, as a result, face dramatically different entry barriers into managerial roles. Some can ascend to leadership roles with the help of their inherited status, wealth, or access to professional networks, as in the extreme case of the heirs to family-owned firms. Others lack family wealth and status, and face limited access to education and professional advancement during the formative years, a crucial period for subsequent career outcomes. Because individuals from less-privileged backgrounds have much higher barriers to entry into prestigious positions, on average those who exceed these thresholds and build a career in a management profession have greater skill.

The authors of this paper study the relation between mutual fund managers' family background and their investment performance. To identify managers' family characteristics, they collect data on the households in which managers grew up by examining individual census records at the National Archives. These records provide detailed information on the income, home value, education, and occupation of a manager's parents during his childhood, as well as other demographic characteristics. Most fund managers come from families wealthier and more-educated than those in the general population. For example, the median value of father's income for fund managers in the sample was at the 89th percentile of the income distribution for U.S. men. Managers' fathers were also more educated, and owned homes valued at nearly twice the median of their census tract. Consistent with the notion that family economic status is an important factor for an individual's subsequent career progression, the researchers observe that managers from wealthier backgrounds are more likely to attend comparatively selective, more expensive private colleges. The median undergraduate tuition was five times higher at colleges attended by managers from the top quintile of family wealth than at those attended by managers from the bottom quintile, and the admission rate was 38 percentage points lower.

The study's main finding is that mutual fund managers from wealthier backgrounds deliver significantly weaker performance than managers descending from less wealthy families. The risk-adjusted return earned by managers from families in the top quintile of wealth is about 0.93 percent per year lower than that of managers who grew up in the bottom wealth quintile. Similar results hold for a variety of measures of performance, such as benchmark-adjusted fund returns and dollar value extracted from capital markets. The researchers' analysis accounts for a comprehensive set of controls that proxy for

the quality and type of the manager's own education and demographics, and for fund and management firm characteristics. While it is not feasible to control for all potentially relevant effects, it should be noted that plausible omitted variables, such as professional connections or privileged access to information, would favor a positive relationship between family wealth and performance and thus are unlikely to explain the findings.

To further explore their central hypothesis that candidates endowed with fewer opportunities face higher selection thresholds, the researchers investigate fund managers' career progressions and study how a manager's likelihood of promotion varies with his family background and past performance. They define a promotion as an event when a manager obtains an additional fund or is reassigned to a fund with significantly greater portfolio size. For managers with negative to neutral past performance, as measured by their past five-year risk-adjusted return, promotion chances increase with family wealth. Managers from poorer families can close this gap by delivering better performance, which suggests a mechanism that leads to selection of the more-talented managers among the less-privileged candidates.