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Role of Managerial Incentives and Discretion in Hedge Fund Performance

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ABSTRACT

Using a comprehensive hedge fund database, we examine the role of managerial incentives and discretion in hedge fund performance. Hedge funds with greater managerial incentives, proxied by the delta of the option-like incentive fee contracts, higher levels of managerial ownership, and the inclusion of high-water mark provisions in the incentive contracts, are associated with superior performance. The incentive fee percentage rate by itself does not explain performance. We also find that funds with a higher degree of managerial discretion, proxied by longer lockup, notice, and redemption periods, deliver superior performance. These results are robust to using alternative performance measures and controlling for different data-related biases.

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