

Active vs. Passive Management in Emerging Markets – A Comparative Analysis

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SUMMARY

This article proposes a comparative analysis between active management and passive management models in context of emerging markets. The aim is to understand the main conceptual differences, operational and strategic between approaches, evaluating their performance, risks and viability in economies that are still developing. To this end, studies and data were used published until 2020, prioritizing accessible yet technical language, without losing the scientific rigor. The goal is to offer the reader an in-depth view of the opportunities and challenges that each model presents in this type of market.

Keywords: Active Management; Passive Management; Emerging Markets; Investments; Strategy Financial.

ABSTRACT

This article proposes a comparative analysis between active and passive management models in the context of emerging markets. The aim is to understand the main conceptual, operational and strategic differences between the approaches, assessing their performance, risks and viability in economies that are still developing. To this end, studies and data published up to 2020 were used, prioritizing accessible but technical language, without losing scientific rigor. The objective is to offer the reader an in-depth view of the opportunities and challenges that each model presents in this type of market.

Keywords: Active Management; Passive Management; Emerging Markets; Investments; Financial Strategy.

1. INTRODUCTION

The evolution of financial markets has brought with it different investment approaches, between

them, active management and passive management. Both strategies have particularities that become more or less suitable depending on the investor profile, the economic scenario and, mainly, the market environment. In emerging markets —characterized by greater volatility, potential growth and political and institutional risks — the debate between the two management becomes even more relevant.

As Bogle (2007), a precursor of index funds, points out, passive management aims to replicate the

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performance of a market index, reducing operating costs and seeking returns consistent in the long term. Active management aims to outperform the market through careful selection of assets, requiring greater analysis, time and, often, incurring greater rates. In developed economies, where predictability is greater, passive lending has proven to be efficient. However, in emerging economies, where distortions are more frequent, it will be what

Wouldn't active management have an advantage?

The choice between one management or another is not just a technical decision, but also a strategic one.

According to the study by Cremers, Ferreira, Matos and Starks (2016), published in the Journal of Financial Economics, active managers tend to perform better in less efficient — a common characteristic of emerging countries. This leads us to reflect on how these

strategies behave in these environments, especially in times of crisis or growth accelerated.

Thus, this article aims to explore the characteristics, benefits and limitations of both strategies. in emerging markets such as Brazil, India and South Africa, drawing on data, authors and research published up to 2020. Ultimately, the aim is to provide support for decision-making more aware on the part of investors and financial analysts.

2. ACTIVE MANAGEMENT IN EMERGING MARKETS

Active management involves a strategic approach in which managers seek to identify market opportunities to obtain returns above benchmark indices. This requires in-depth analysis of companies, sectors and macroeconomic trends. In emerging markets, This practice is even more complex, considering the constant regulatory, political and exchange rates that directly affect financial assets.

According to the study by Dyck, Lins and Pomorski (2013), published by Harvard Business School, active managers in emerging markets have managed, on average, to outperform the indices of reference between 2000 and 2010, especially in countries with low accounting transparency and protection to shareholders. This suggests that in environments where inefficiencies are more visible, work manager's asset can really add value. Another important point concerns the ability of active managers to adapt to unexpected events. During the 2008 financial crisis, for For example, active funds in emerging markets showed a smaller decline compared to passive funds, as shown in the research by Khan and Vaqar (2010), published in Emerging Markets Review. This advantage was attributed to managers' flexibility in reallocating

quickly resources. However, this approach also presents significant challenges. Higher operating costs, management and performance fees, and dependence on individual talent of managers makes the strategy less accessible to small investors. Furthermore, performance does not always outperform indexes in the long term, which raises questions about its real effectiveness when costs are considered.

3. PASSIVE MANAGEMENT IN EMERGING MARKETS

Passive management represents an investment approach based on the replication of stock indexes market, such as the MSCI Emerging Markets, rather than strategies that attempt to outperform them. This investment philosophy is anchored in the Efficient Markets Theory, proposed by Eugene

Fama in a seminal article published in *The Journal of Finance* (1970), in which the author argues

that asset prices quickly and accurately incorporate all available information.

Because of this, the attempt to obtain returns above the market average through active analysis tends to be ineffective in the long run.

In emerging markets, where structural risks are more pronounced and transparency of information may be limited, passive management offers a robust alternative, especially for investors with a more conservative profile or with a long-term vision. Burton

G. Malkiel, professor emeritus at Princeton University, argues in his work *A Random Walk Down Wall Street* (11th ed. New York: WW Norton & Company, 2012) which funds

passive funds outperform, on average, more than 70% of active funds in the United States over long horizons broad times. Although the focus of the analysis is the North American market, Malkiel highlights that indexing can also offer consistent returns in emerging markets, as long as

adopt a patient and well-diversified perspective. Another factor that contributed to the dissemination of passive management was the growth of ETFs (Exchange Traded Funds). According to

with the annual *ETFs and Index Investing Report*, published by BlackRock in 2019, the Emerging market-focused ETFs have moved over \$300 billion in assets

at the end of the decade. The report, which is circulated internationally, highlights the attractiveness of these funds due to its liquidity, transparency and diversification, elements considered crucial for mitigate the specific risks of these markets.

The publication is available through BlackRock's institutional platform and is one of the most comprehensive sources on the index fund sector in the world. Despite the advantages evident, passive management is not without its critics. One of the main concerns lies in the



the fact that by blindly following an index, the investor may end up exposed to companies with poor corporate governance or located in problematic sectors.

This criticism is discussed in detail by David Blitz and Laurens Swinkels in the article “Emerging Markets:

Good Diversifiers, Poor Performers?”, published in the Journal of Asset Management, volume

9, number 6, pages 389–400, by Palgrave Macmillan, in 2008. The authors warn what

Replication of indices in emerging markets may increase the systemic risk of portfolios, since that the criteria for composing indexes do not always reflect quality or stability financial.

Furthermore, it is worth noting that in many emerging countries, the benchmark indices themselves are highly concentrated in a few sectors – such as energy, commodities or banking – which can generate distortions in investors' exposure. This structural limitation reduces the effectiveness of diversification, one of the main attractions of passive management. Therefore, it is essential that the investor evaluates not only the replicated index, but also the weighting criteria and composition used.

Therefore, although passive management offers significant advantages such as reduced cost and greater predictability, its use in emerging markets should be carefully analyzed. The absence of qualitative criteria in asset selection can lead to exposure to unwanted risks. Therefore, This strategy, although efficient in certain contexts, needs to be complemented by a critical analysis of the assets and sectors that make up the replicated indices.

4. PERFORMANCE COMPARISON: WHAT DO THE STUDIES SAY?

The debate between active and passive management has motivated a vast academic production in recent decades. In emerging markets, this discussion is even more relevant, given the institutional heterogeneity and the greater volatility characteristic of these economies. Several empirical studies have attempted to directly compare the performance of both strategies, considering different criteria such as profitability, risk, liquidity and operating costs.

One of the most robust studies on the subject was conducted by Miguel A. Ferreira (Nova School of Business and Economics), Anil Keswani (Cass Business School), Antonio Miguel (University of Lisbon) and Sofia Ramos (ESSEC Business School). Entitled The Flow-Performance Relationship around the World, the article was published in the scientific journal Journal of Banking and Finance, volume 36, number 6, pages 1759–1780, published by Elsevier,



in 2012. The authors analyzed more than 4,000 equity funds in 27 countries, including several emerging economies of Latin America, Eastern Europe and Southeast Asia. The main conclusion is that active management tends to outperform in markets with lower liquidity, weak investor protection and lower financial development – all characteristics common to emerging markets.

However, the study also shows that this additional performance is often neutralized by the high fees charged by active funds, such as management and performance. This finding is consistent with the classic study by Eugene Fama and Kenneth French, Luck versus Skill in the Cross-Section of Mutual Fund Returns, published in the journal *The Journal of Finance*, volume 65, number 5, pages 1915–1947, by American Finance Association, in 2010. The authors, both professors at the University of Chicago, concluded that, after deducting fees, very few active funds manage to outperform their benchmarks in a statistically significant way, which reinforces the superiority of passive management in terms of liquids. Another factor that influences this comparison is volatility. According to the Global Fund Investor Experience Study, prepared by Morningstar in 2020, passive funds tend to exhibit lower volatility over time because they are anchored to indexes widely diversified. The report, published by Morningstar Research Center (Chicago, USA), is considered one of the most comprehensive analyses of the behavior of investment funds investment in different jurisdictions. Active funds, on the other hand, are based on discretionary actions of managers, can present excellent performances in certain periods, but are also more vulnerable to significant declines when strategies adopted do not materialize as expected.

In addition to volatility, the predictability of returns is also a differential of passive management. While active management relies heavily on the manager's competence and experience, passive offers greater transparency and ease of monitoring, which favors investors

who prefer automated solutions or those with less operational complexity. In this way, the choice between active or passive management should not be made in a generalist way. The investor you need to consider your risk profile, time horizon, cost tolerance and, above all, the market environment in which it is inserted. In emerging markets, where risks and the opportunities are equally amplified, both approaches can play complementary roles in an efficient allocation strategy.

Therefore, the literature points to a strategic duality. Passive management offers efficiency, predictability and low cost, while active management can capture market inefficiencies — provided it is conducted with technical rigor and under a reasonable cost structure. It is up to the

investor,

with qualified technical support, decide which approach best aligns with your goals and your investment context.

5. FINAL CONSIDERATIONS

The analysis between active and passive management in emerging markets demonstrates that both strategies have merits and limitations. Active management is attractive in high-risk environments. Inefficiency, such as emerging markets, offering the possibility of superior gains by through the analysis and expertise of managers. However, it requires higher costs and is not always can justify these costs with consistent returns.

Passive management, in turn, offers simplicity, low cost and broad exposure to the market, being ideal for investors with a long-term vision and lower tolerance for operational risks.

However, this approach may lead to unwanted exposure to assets of questionable quality, which which represents a point of attention in economies with institutional challenges. In short, the investor operating in emerging markets should consider an approach balanced. Hybrid strategies, such as multifactor funds or active ETFs, have gained space as an alternative to capture the best of both worlds. As demonstrated by studies until 2020, it is not about choosing between “right” or “wrong”, but about understanding deeply into the context and financial objectives involved.

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