Essays on Institutional Investors' Trading Behaviours

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Abstract

This research is the first comprehensive academic endeavour to explore the trading behaviours for both domestic and foreign institutional investors in China, the world largest emerging market, using a unique data set. In 2003, Chinese regulatory authorities established a scheme named Qualified Foreign Institutional Investors (QFIIs), which allows foreign institutional investors to directly trade in "A" shares. Before then, no foreign investors were allowed to do so. According to numerous media reports and anecdotes, QFIIs in China have been much more successful than their Chinese counterparts. These have aroused a great deal of curiosity among academics and practitioners. Thus, it is of great interest to examine the trading activities engaged by both domestic and foreign institutional investors in China.

This research embraces three subprojects for three essays respectively. The first essay investigates the preferences and stock characteristics of domestic and foreign institutional holdings in China. The results indicate that they have similar preferences regarding certain stock characteristics, but different preferences when it comes to industry allocations. The results also highlight the differences regarding corporate governance and stock picking patterns. The panel regression suggests that firms with institutional holdings in the previous period perform better in the following period. This phenomenon is stronger for domestic holdings, indicating that domestic institutional investors have an edge in stock picking over foreign institutional investors. This study also finds that ownership concentration plays a positive role in firm performance. The second essay conducts a comprehensive performance evaluation of Chinese mutual funds and style investment. Using a characteristic-based benchmark, results indicate that mutual fund managers have stock picking talents over time, with relative weak ability to time the market. Style investments contribute the most to funds' gross returns. Active funds exhibit lower style consistency but still realise better net returns compared to their passive counterparts. This essay further suggests that mutual fund managers who concentrate their holdings in certain industries perform better after controlling for common risk factors. The second essay also concludes that Chinese mutual fund managers have the ability to select superior industries. The third essay examines the fund performance by sorting the equity holdings into deciles based on the style consistency and industry concentration. Results suggest that fund managers with consistent investment styles and concentrated industry holdings outperform the others. This positive style-performance relation remains statistically significant after controlling for various fund characteristics. Small funds and growth funds exhibit stronger style effects. Funds investing more in state-owned stocks have inferior returns. The stocks purchased by fund managers perform better than the stocks sold. Similar results are observed for stocks held by the foreign institutional investors (QFIIs).

This thesis contributes to the existing literature by examining the trading behaviour of both the domestic institutional and the foreign institutional investors in China. It sheds extra light on issues related to the Qualified Foreign Institutional Investors scheme, which has contributed largely to the reform of the Chinese financial market since 2003. The analysis of the investment styles of institutional investors has important implications for academics, practitioners and, in particular, policy makers, and enables China to further enhance its financial market liberalisation with the rest of the world.

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