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Empirical Study on the Preference of Shareholding of Institutional Investors after Split Share Structure Reform

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Abstract: Since the 1960s, rapid development of institutional investors is a prominent feature of global financial market. In china, full circulation of stock will realize after the completion of Split Share Structure Reform. Under the circumstance of institutional investors holding a large scale of stock, will they change their invest style? Whether they place more emphasis on value investment and concerning about long-term development of their enterprises or utilize their advantage of controlling large scale of capital, continue to use "dominate" and "speculation" methods to seek short-term interests? In this paper, we focus on institutional investor's preference for stocks, trying to find certain evidence from their stock preference to judge whether the institutional investors were intended to make long-term investment or short-term investment when they invested in stocks. Here we used the stocks holding by institutional investors at the end of the fourth quarter from 2003 to 2007 to perform empirical analysis. The regression results of non-equilibrium panel data model indicate that there is a definite positive correlation between market value of negotiable shares and the rate of shareholdings by institutional investors. Our conclusion support the statement that institutional investors were preferred to holding large capitalization stocks. The volatility of large capitalization stocks are less than small capitalization stocks, and the information disclosure degree of large capitalization stocks is higher than small capitalization stocks. Therefore, the actions of institutional investors prefer large capitalization stocks indicates that when they were selecting the stock, they didn't intended to perform short-term "speculation", but to long-term investment.

Keywords: Institutional investors, Active-monitoring, Corporate Governance

1. INTRODUCTION

Since the 1960s, rapid development of institutional investors is a prominent feature of global financial market. Whether in developed country or in developing country, the ratio of institutional investors continuously increases, and the institutional tendency of financial market is becoming more and more obvious.[错误!未找到引用源。]

In particular, the concept of institutional investors in this paper, are including eight main categories of institutional investors, they are: stock investment fund, insurance company, finance company, supplementary pension, securities trader, social security fund, trust company and qualified foreign institutional investors (QFII). In countries whose capital market is developed, such as England and America, institutional investors are becoming the backbone of supervising listed companies, they perform long-term investment and actively involved in corporate governance.

There are two opposite opinions in existing research on what role is Chinese institutional investors play in the market. One assumes that institutional investors are capable and should be the effective subject of monitoring listed companies.[2] They can "actively" participate in governance of listed companies and prepare long-term investment. The other one consider that the existing institutional investors are attempting to adopt passive monitoring form by "voting by foot" under the circumstance of themselves were lack of strong and effective supervision mechanism, "their rational choice is to pursue maximal rewards in the short-term",[3] they are essentially "speculators". Moreover, an article named "inside story of funds" published on "Business News" in 2000 is a powerful support to "speculation" theory.[4] In this article, Ping Hu and Li Jing disclose many violation operations in securities investment fund industry. As an important representative of institutional investors, the securities investment fund industry is figuring for short-term private profit through “false transactions” and “turnover volume” actions. The publishing of this report has evoked great sensations in Chinese financial markets. In a market which is lack of supervision, funds are not able to play its role to stabilize the market as people were expected, on the contrary, they manipulate stock prize. Their domination and speculate actions greatly disturbed the market and invaded the profit of small investors. This is the phenomenon we have seen in the early stages of development of the fund industry China has gone though more than 30 years of planned economy before the Split Share Structure Reform in 2005, which responsible for Chinese characterized capital structure: state-owned shares occupies the extreme higher position, small and medium shareholders are dispersed, institutional investors are underdeveloped,. Because the enterprises are lack of appropriate supervision mechanism, most of the companies were controlled by "inside people". In order to resolve the extreme higher shareholdings by state-owned enterprises and owner of state enterprises falls vacant, china began to discuss reduce state-owned shares in listed companies since 1999. Form reducing state-owned shareholdings in the initial stage to Split Share Structure Reform started in 2005, Chinese stock market has undergone earth-shaking changes.

As the completion of Split Share Structure Reform, institutional investors have been playing a more and more important part in Chinese capital market. Until October in 2007, 46% of circulation stocks in Chinese stock market has been holding by various kinds of institutional investors.

After the Split Share Structure Reform, under new market environment, will the institutional investors change their investment style? Under the circumstance of institutional investors holding a large scale of stock, whether they place more emphasis on value investment and concerning about long-term development of their enterprises or just utilize their capital advantage, continue to use "dominate" and "speculation" methods to seek short-term interests?

In this paper, we focus on institutional investor’s holding preferences, trying to find certain evidence from their holding preferences to judge whether the institutional investors were intended to make long-term investment or short-term investment when they invested in stock markets. If the institutional investors are figuring for short-term profit through “dominate” and “speculation”, just as Ping Hu and Li Jing disclosed in “inside story of funds”, they should prefer small capitalization stocks, which is, to prefer the stocks has relatively lower circulating market value and easy to manipulate. On the contrary, these large capitalization stocks which are higher in circulating market value should be their evading object. For the reason that the capital amount needed when manipulate the stock price is too large, and speculation costs are too high. Therefore, we can judge whether the institutional investors are intended to “investment” or “speculation” according to their special preference of large capitalization stocks or small capitalization stocks.

2. SAMPLE AND VARIABLE SELECTION

We use the measurement of market value of listed company’s circulating shares as the independent variable to investigate the impact of this variable to the rate of institutional investors’ shareholding We select the shares holding by institutional investors at the end of the fourth quarter between 2003 and 2007 as the samples, including eight categories of institutional investors altogether. Through combination and calculation, listed companies holding by the above mentioned eight categories of institutional investors in Shenzhen and Shanghai stock market are 711, 1201, 1206, 1231 and 911 respectively between 2003 and 2007.

And then, excluding the incomplete data companies, valid sample number of the year 2003 is 708, year 2004 is 1185, year 2005 is 1196, year 2006 is 1215 and year 2007 is 909, altogether 5213 samples, which constitute the unbalanced panel data.

The data about the rate of institutional investors’ shareholding is gained in terms of Wind Data System. The other data is obtained from CCER.

In this regression model, dependent variable is the rate of institutional investors' shareholding (INSTRATIO), independent variable is the market value of circulating shares of listed companies. In general, we named the company who boasts a relatively higher market value of circulating shares as large capitalization stock company, and the company who has a lower market value of circulating shares as small capitalization stock company.

Dependent variable (variable being explained)

The variable being explained is the proportion of certain listed company's shareholding by institutional investors, it stands for the proportion of the sum of shares holding by the eight categories of investors divided by the this company's tradable shares of the same period at the end of each year.

Independent variable (explaining variable)

The explain variable in this paper is market value of circulating shares (LIQAVALUE), it indicates the market value of circulating A-share of listed company at the last effective trading day at the end of a particular year.

Table 1 shows the definition of each variable:

Table 1. Definition of each variable

Dependent variable	Variable definition
The rate of institutional investors' shareholding (INSTRATIO)	proportion of the sum of shareholding by the eight categories of institutional investors divided by the this company's tradable shares of the same period at the end of each year from 2003 to 2007
Independent variable	
Market value of circulating shares (LIQAVALUE)	market value of circulating A-share at the last effective trading day at the end of a particular year

3. MODEL DESIGN AND EMPIRICAL RESULT

We established the following regression model based on the above analysis as shown in equation (1).

$$INSTRATIO_{i,t} = \alpha + \beta_1 LIQAVALUE_{i,t} + \varepsilon_{i,t} \tag{1}$$

Table 2 shows the descriptive statistics result of correlated variables.

Table 2. Descriptive statistics for correlated variables

Variable name	Numbers of sample	Mean	Standard deviations	Minimum value	Maximum value
the rate of institutional investors' shareholding %(INSTRATIO)	5213	10.2153	15.4619	0.0001	87.112
Market value of circulating shares(LIQAVALUE)	5213	2.64e+09	1.40e+10	0	7.77e+11

Then we use Stata10 to perform unbalanced panel data estimation and inspection.

F-test and Hausman-test indicates that we should select random effect model. Table 3 shows the regression result of random effect model.

Table 3. Regression result

Independent variable	Independent variable: the rate of institutional investors' shareholding%(INSTRATIO)		
	coefficient	T-value	P-value
Intercept(CONS)	9.148***	28.98	0.000
Market value of circulating shares (LIQAVALUE)	9.50e-11***	6.81	0.000

Note: *, **, *** respectively stands for 10%, 5% and 1% statistically significant

The regression result indicates: there is a definite positive correlation between the market value of circulating shares and the rate of institutional investors' shareholding, and 1% statistically significant. In another word, the greater the market value of circulating shares, the more the shares holding by the institutional investors, that is, institutional investors are not preferring to small capitalization stocks, on the contrary, they prefer to invest large capitalization stocks.

4. CONCLUSIONS

This paper demonstrated that institutional investors prefer large capitalization stocks to small capitalization stocks, which was in accordance with Wu Fulong's research result in 2004[5]. He utilized the data of listed companies between 2000 and 2001 to proving herd behavior in Chinese fund investment. He found that in this period, the fund investment focus has a tendency to shifting from small capitalization stocks to large capitalization stocks. Our conclusion support the statement that institutional investors were preferred to holding large capitalization stocks. The volatility of large capitalization stocks are less than small capitalization stocks, and the information disclosure degree of large capitalization stocks is higher than small capitalization stocks. Therefore, the actions of institutional investors prefer large capitalization stocks indicates that when they were selecting the stock, they didn't planned to perform short-term speculation, but to prepare long-term investment. Because compared with small capitalization stocks, large capitalization stocks price are harder to manipulate and its costs are much higher. If the institutional investor is interested in short-term speculation, he is sure to choose small capitalization stocks, for which is easy to manipulate the stock price. As to whether they were carrying out effective "active" supervision to improve the quality of listed companies are left for further research.

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