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THE COLOR OF GOVERNMENT MONEY. DO INVESTORS DIFFERENTLY VALUE THE INVESTMENT OF SOVEREIGN WEALTH FUNDS?

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Abstract

The article aims at pointing out the differences in market reactions regarding the announcement of an investment of selected Sovereign Wealth Funds in companies listed on the London Stock Exchange. The research sample consists of 796 market transactions made by four selected Sovereign Wealth Funds. The author employed event study methodology to calculate the average abnormal returns and cumulative abnormal returns for each fund in subsamples. The empirical findings suggest that investors react differently to the information about a fund's investment. To the best of the author's knowledge, the literature does not provide any answer as to how the market reacts to information disclosure of individual funds. Therefore, this paper bridges the gap in the literature within this field.

JEL classification: F21, G14, G23
Keywords: sovereign wealth funds, event study, London Stock Exchange, investment

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Introduction

Sovereign Wealth Funds (SWFs) are investment vehicles established in order to manage in a rational and profit oriented way pools of national wealth for future generations. Nowadays over 70 of them with over 7,000 billion USD of assets under management exist and operate on global financial markets. Several of them were created decades ago, however, the number of those whose history starts at the beginning of the 21st century represents the majority of the total existing. SWFs are among the most important institutional investors all around the world and constitute a solid element in the architecture of the international financial safety net. What distinguishes them the most from other financial institutions is the fact that they are 100% owned, managed and controlled by sovereign states. These state-run funds have limited liquidity needs, a lower than market average level of redemption risk, focus on the long term (measured in decades) investment horizon and have a relatively high risk tolerance. SWFs are simultaneously innovative investment tools of the managing country's foreign exchange reserves as well as hybrid in nature investment vehicles combining the private sector's methods of investment with public-sector goals, determined by governments.

Given the increasing capital involvement of SWFs within a wide range of asset classes globally, a further understanding of the broader aspects of their investment activity seems to be needed, including the consequences of asset allocation in capital markets as well as in individual listed companies. In recent years several articles have been dedicated to analysis of the impact of SWF investments on the financial performance of the entities they invest in and market reactions to these events. The empirical findings of this research do not provide a clear picture of the issue. One of the questions that has not been raised yet is the reaction of investors to the announcement regarding information about the acquisition of shares of listed companies by an individual state-run fund. This question is justified by the fact that a group of SWFs consists of relatively different entities, different in terms of the political system in country of origin, transparency and size of funds, their main goals of creation and investment strategies. Thus, it is reasonable to assume that investors and markets might be reacting differently to the information. The main goal of this paper is to analyze whether short-term market reactions to the disclosure of information about the investments differs or is similar within a selected sample of SWFs.

This article builds on the previous papers of Fotak, Bortolotti and Megginson (2008), Kotter and Lel (2008), Dewenter, Han and Malatesta (2010) and Dinh (2011), Bortolotti et al. (2015) who are also interested in analyzing whether or not SWF investments have an impact on stock return in the short run. However, this article's approach differs in that it focuses on examining market reaction to the investment of each individual fund on just one market – the London Stock Exchange - rather than the group of funds and their investment activities on different markets all around the world. This paper contributes threefold to ongoing research in the field of studies related to financial aspects of SWF behavior. First, it uses a large sample of total transaction events as well as a number of deals for each selected fund. Second, this research is based on a relatively short time-span to avoid the changes in investor preferences, which can lead to potential biases. Third, this is to the author's knowledge the first study providing empirical evidence on differences in market reaction to the investments of an individual SWF.

The remainder of the paper is organized as follows. Section 2 discusses the literature and formulates the hypothesis. Section 3 describes the data and methodology. Section 4 reports and discusses the empirical findings of the research. Conclusions provide a brief summary of the research.

Background and hypothesis

Since the similarity or diversity of market reaction to the announcement of investments made by individual SWFs have yet to be addressed, we look to the related literature that provides analog predictions, from which we can draw conclusions. Specifically, we look to the literature on government ownership in companies and on institutional investments for insight as to how features of selected funds might affect the short-term financial performance of target companies.

As SWFs are under the full control of governments, their target firms are at least partially government-owned as well (Knill, Lee & Mauck 2012). This strand of literature suggests that governments usually have a negative impact on firm financial performance, which improves with privatization (Estrin, Hanousek, Kočenda &

Svejnar, 2009; Sun & Tong 2003). Because of their political connections, SWFs are likely to have objectives other than obtaining the highest possible financial return. Hence, target firms might be relatively inefficient and experience reductions in their market value (Fernandes, 2014). In the case of public-private ownership, some authors suggest that such mixed ownership also has a negative impact on the value of the company (Borisova, Brockam, Sales, Zagorchev, 2012). In consequence, investors can react negatively to the information that the fund acquired stocks of a company, thereby discounting potential future disadvantages of such a shareholder structure. However, on the other hand, it is likely that SWFs, due to their ability to open doors to new markets and by helping companies market their products in their home markets, will increase the financial performance and value of the firm. As long-term investors, SWFs can significantly relax financing constraints of companies, thereby allowing them to undertake promising investments with more distant payoffs (Fernandes, 2014). Thus, in this case the possible outcome of the information about SWF investment might be a positive market reaction. Some funds are manifesting their politically-biased behavior (Kamiński, Obroniecki & Wiśniewski, 2015), which may put the target companies at a disadvantage to other companies with purely market-driven owners. On the other hand, most acquisitions of SWFs have been made on foreign markets, where a state purchaser has a limited ability to exercise any sovereign regulatory or supervisory power and to monitor target firm managers as private investors do, especially if they are politically constrained (Bortolotti, Fotak & Megginson, 2014).

Different political systems in the origin country of a SWF can also have an influence on the extent to which using its ownership rights in target companies, governments will try to achieve economic, financial as well as social and political goals of the state. Another factor possibly determining the investment activity of the fund is the economic and political relationship between countries and also standards of corporate governance within listed companies, in particular the capital market. In light of that, it seems to be reasonable to assume that investors will differently value the investment of SWFs coming from different countries and additionally it is likely that the investment of a single fund in different markets can have a different influence on the stock performance of the company.

As regards to the second factor mentioned above, it is worth noting that SWF investment activities reflect a broader phenomenon of equity ownership concentrated within a group of institutional investors rather than in the hands of an individual. Nowadays, institutional investors hold around 60% of all publicly listed stock in the United States, around 72% in Japan and around 89% in the United Kingdom (UK) (Çelik & Isaksson, 2014). The prediction that investors positively react to the investment of SWFs arises from the assumption that large institutional owners have an incentive to and can efficiently monitor insiders, reducing the likelihood that will make suboptimal decisions (Navissi & Naiker 2006). A number of research studies provides empirical evidence that institutional investors have a positive effect on firm performance (Hsu & Wang, 2014; Elyasiani & Jia, 2010, Yuan, Ziao & Zou, 2008). However, on the other hand, the literature provides evidence on the negative relationship between institutional ownership and company performance (Liang, Lin & Huang, 2011; Charfeddine & Elmarzougui, 2010; Ruiz-Mallorquí & Santana-Martín, 2011). Thus, it seems likely that investor reaction to the disclosure of information that an SWF invested in a company will be in the opposite direction.

Another factor possibly affecting market reaction to the announcement might be the level of a fund's engagement in monitoring the management of a target firm using its ownership rights. In this context SWFs differ as a group – some of the funds are passive investors while others behave like active owners, monitoring the managers and participating in the decision-making process. Although the current literature on SWFs does not provide evidence on the relationship between the financial performance of a target company and the capital involvement of a passive or active investor, it is reasonable to presume that investors might be valuing differently the investment from each group.

Since 1970 and the work of Akerloff, who brought the information issue to the forefront of economic theory (Salehi, Rostami & Sehali, 2012), information and the access to it has widely been considered an important element in a large number of studies in the field of finance and economics. Access to different information is a common explanation of why investors trade assets on stock markets (Barlevy & Velonesi, 2000). Given the fact that it is typically assumed that the information is costly to acquire, transparency of the investor might be

affecting the market reaction to the investment. SWFs vary considerably in terms of transparency, measured by the Linaburg-Maduell Transparency Index (SWFI, 2016). Lack of information about investment strategies, asset allocation, financial performance of the fund or the difference in information disclosures between SWFs might be the factor determining diverse market reactions to the information about an investment.

And last but not least, it is likely to assume that the size of the fund can determine short-term market reaction to the disclosure of information about an investment in the target company. Large firms can exploit economies of scale, employ more skilled managers and formalize the procedures (Kumar, 2004), thus a large SWF seems to have better potential to monitor the companies in their portfolio. Moreover, with relatively lower liquidity needs coming from the domestic economy, large SWFs can provide relatively more stable long-term capital to the target firms. As a consequence of the abovementioned factors, it provides sound grounds to believe that investors might be differently reacting to the investment of large and small SWFs.

Based on the arguments presented above the conclusion can be drawn that several factors determining the potential reaction of investors to the announcement of information about the investment are country-specific, market-specific and fund-specific. Meanwhile, previous studies on this issue assumed at least to some extent a homogeneous reaction within the group of SWFs and on different capital markets. Moreover, the empirical results found in the literature are controversial with reference to the short versus long term, as well as to investment and divestment issues which are relatively sparse, mainly due to difficulties in obtaining comprehensive and systematic data (Heaney, Li & Valencia, 2011) as well as information gaps (Ciarlone & Micelli, 2014). In the case of short-term market reaction to the SWF investments, a great number of studies are relatively consistent.

Dinh (2011), using the sample of 60 SWF investments in companies listed on six capital markets and with a research time span of 2003-2009, presented results that indicate that SWF investments generate substantial and positive cumulative average abnormal returns during the two trading days before and after the announcement of the investment. The average five-day cumulative abnormal returns were 1.69% for a (-2,+2) window and 1.23% for a (-1,+1) window. The empirical findings of Dewenter, Han and Malatesta (2010), based on the research sample consisting of 227 SWF transactions between 1987-2008, suggest that SWF investments are associated with positive abnormal stock returns for the target firms. The average three-day cumulative abnormal returns were 1.5% with a statistical significance at the 1% level. Kotter and Lel, analyzing the stock price impact of 163 announcements of SWF transactions between 1982-2008 in 28 countries, show that the market reacts positively to an event involving SWFs. The average cumulative abnormal returns were 1.9%, 2.15% and 2.43% for the time windows of (0,+1), (-1,+1) and (-2,+2), respectively. Similarly, Fotak, Bortolotti and Megginson (2008) using a sample of 212 SWF acquisitions have documented a significantly positive 0.8% mean abnormal return around the announcement date. In line with the previous evidence, the empirical results of Mietzner, Schiereck and Schweizer (2015) suggest substantial positive stock returns in response to the announcement of SWF investments. For the sample of 147 transactions the cumulative average abnormal returns for targeted companies were 2.71% and 3.4% in (-1,+1) and (-5, +5) event windows, respectively.

Summing up, previous studies addressing the issue of short-term performance of companies in which SWFs had invested have mainly focused on the overall impact of SWF investments on the financial performance of listed companies, analyzing the overall portfolio of different funds, consisting of different markets. However, the potential reaction of investors to the announcement of information about an investment and therefore the impact of the investment on a stock's rate of return might be different for each fund. Such reasoning is justified by the fact that SWFs differ in term of transparency, size, goals of investments and strategies employed to achieve these goals as well as political systems in the origin country of the fund (Shunmugam, 2012; Urban, 2009). Each of these factors alone, and all of them together, can determine the investment behavior of the fund. Moreover, the investors from different markets might be diversely valuing the investment behavior of individual funds in political, culture and historical contexts. In consequence, the market reaction to the investment might be different in response to a combination of factors underlying the investment decisions. Thus, the aggregation of data for the group of funds from different capital markets can affect the research results and lead to misleading conclusions. There is a lack of empirical evidence as to whether investors react similarly or differently to the investment of each

SWF, and the impact of investments for the short term financial performance of listed companies in this context remain unknown.

We summarize the above reasoning in the following hypothesis:

Investors differently value the investments of selected SWFs.

Methodology

Information on SWF transactions in the UK was obtained from the Sovereign Wealth Fund Institute database. We restricted the initial sample to transactions made in companies listed on the London Stock Exchange in 2013. This particular stock exchange was chosen primarily because of its size, liquidity and maturity and secondly because it offered a large number of transactions made by various funds to compare. Such a relatively short time-span of the research, compared to previous studies, helped to avoid possible biases coming from changes in investor preferences, which can have an influence on the findings. We cleaned the database of errors coming mainly from including transactions from other markets. Then, in order to balance the number of events in the subsamples of the compared funds, we restricted the database to funds with 50 or more transactions. Given the fact that SWFs have preferences over the liquid stock of companies listed on the London Stock Exchange (Urban 2016), there was no need to exclude companies from the sample to avoid potential biases from illiquid stocks.

In the next step, we obtained daily stock prices of shares as well as values of the index (FTSE-All Share) from Thomson Reuters Eikon. Matching both databases, we excluded transactions of delisted and acquired or renamed companies. The final sample used in this study consists of 796 transactions made by four SWFs in companies listed on the London Stock Exchange, which is over 80% of the total number of SWF investments on this market in 2013. Table 1 presents the key characteristics of SWFs analyzed in our study.

To analyze the market reaction to the announcement of investments we used event study methodology. Since the work of Fama, Fisher, Jensen and Roll (1969), this methodology is commonly used in the field of finance (see e.g. Bank & Baumann, 2015 for a literature review). Event study methodology derives from the efficient market hypothesis (Fama, 1970), which holds that stock prices reflect all available information about listed companies and also that information arrival through market surprises are instantly incorporated in the prices of shares. Thus, if the market is efficient, stock prices will respond to the information that investors believe is important to the company. Assuming that changes in shareholder structure is such information, with other things being equal, there are grounds to expect that price changes occur immediately around the announcement, or on the first day of trading. However, a large number of event studies challenge this assumption by showing that the stock market over- and under reacts to new information (Bond & Thaler, 1985; Baytas & Cakici, 1999; Nam, Pyun & Avard, 2001). To deal with potential delays in market reaction the authors also calculated relative price changes within a longer event window. Price reactions – average abnormal

Table 1: Characteristics of funds

Name of the fund	Country of origin	Transparency*	Size**	Number of transactions
Abu Dhabi Investment Authority (ADIA)	United Arab Emirates	6	773	242
Government of Singapore Investment Corporation (GIC)	Singapore	6	344	227
Kuwait Investment Authority (KIA)	Kuwait	6	592	122
Government Pension Fund Global (GPFG)	Norway	10	824,9	205

SNote:- in the Linaburg-Maduell Transparency Index, scores from 1 to 10, where 10 is the highest transparency; **- in billions of USD of assets under management, at the end of 2015*
Source: Own elaboration based on Sovereign Wealth Fund Institute

returns (AARs) or cumulative abnormal returns (CAARs) are measured relatively to the reaction of the market in that particular time. Positive AARs or CAARs suggest that investors value the investment of SWFs as bringing potential value added to the company in the future, while negative AARs and CAARs might be suggesting that in the opinion of investors SWF ownership will be harmful to the company. Differences between market reactions in response within the group of funds might be the evidence that investors differ in valuing the impact of particular funds on the future of a company's perspectives.

In this study, we calculate abnormal returns as the difference between a company's returns that are observable at the stock market and return from the index covering all shares of companies that are listed at that particular time on the stock exchange (Fiszeder & Mstowska, 2011):

$$AR_{it} = R_{it} - K_{indt} \quad (1)$$

where:

AR_{it} - Abnormal return of i-company in time t,

R_{it} - Observed return of i-company in time t,

K_{indt} - Observed return of index (ind) in time t.

The author used stock returns in logarithms and calculated abnormal returns for the time window covering the period from 10 days before the announcement to 10 days after the announcement of information about an investment. In the next step, the author calculated the AARs for companies in the portfolio of each fund. Then the daily AARs were aggregated across the different event periods to obtain CAARs for each fund. Unlike previous studies, AARs and CAARs between funds were tested using the Kruskal-Wallis test to capture the significance of potential differences in market reactions to the disclosure of information about investments of each individual fund. The difference in subsamples were also analyzed based on the transparency level of the fund (fully transparent versus transparent) and the origin of the fund's money (commodity versus non-commodity) using the Mann-Whitney-Wilcoxon test. Statistical calculations were done using SPSS.

Empirical results

Results presented in Table 2 support the view that investors differently value the investment of selected SWFs. In t+1 to the event day with p value equals 1% there is statistical difference in the distributions of stock abnormal returns of target companies between the four analyzed funds. Moreover, this difference remains for the next three days (t+2, t+3, t+4), although less statistically significant (p value equals 5% and p value equals 10%). However, looking at the sign of calculated measures in each case we cannot draw a coherent conclusion about the directions of the market reaction to the information in the following days. Only on the event day is there a positive sign of AARs within the whole sample, with no statistically significant difference between the funds.

Given the calculated CAARs, the empirical results provide a rather clear picture on the issue of market reaction to the disclosure of information about the fund's investments (Table 3). In three out of the four funds the CAARs around the investment event were positive for three estimation windows, with statistically significant differences between funds in two of them (-1,+1) and (0,+1). These findings suggest that the market reacts positively to information that an investment in a listed company on the London Stock Exchange was made by ADIA, KIA and GPFG. The strength of the reaction in (-1,+1) and (0,+1) estimation windows, measured by CAARs, suggest that investors value the capital allocation of ADIA the most. In the case of GIC, CAARs within three estimation windows were negative, suggesting that investors find the investment of this fund to be harmful to the company, *ceteris paribus*.

The empirical findings presented in Table 4 suggest that the origin of the money used to create SWFs seems to be the factor determining different reactions to the investment. In three days following the event, there are statistically significant differences between two groups, those consisting of commodity funds (ADIA, KIA, GPFG) and those of non-commodity funds – GIC. However, these results do not allow us to draw a clear conclusion about the direction of the potential relationship between commodity versus non-commodity funds and the investor reaction to the investment and further study is needed in order to answer this question. As regards transparency, similar conclusions can be drawn. Although there are statistically significant differences between two groups, one with GPFG and the second with ADIA, GIC and KIA, the obtained results do not allow us to conclude that a higher transparency of the fund fosters a positive market reaction to the investment or that a lower transparency correlates with a weaker investor reaction to information

Table 2: Average abnormal returns (%)

Day	ADIA	GIC	KIA	GPFG	Kruskal--Wallis	No. of obs.
-10	-0,0367	0,0267	-0,0366	-0,1316	2,231	796
-9	-0,0493	0,0481	0,1148	-0,1959	6.560*	796
-8	-0,0023	0,4074	-0,0661	0,0728	8.862**	796
-7	-0,0246	-0,1023	-0,1474	-0,3756	7.230*	796
-6	-0,1345	-0,5305	0,0161	-0,0321	9.844**	796
-5	-0,0373	0,0665	0,0289	-0,2678	9.340**	796
-4	0,0532	0,1352	-0,2379	-0,0287	4,514	796
-3	-0,2657	-0,2466	-0,0094	-0,1637	3,751	796
-2	-0,0053	0,0684	0,1169	0,0555	2,32	796
	-0,0077	-0,0505	0,0182	-0,0236	3,022	796
0	0,0468	0,2432	0,1234	0,0723	3,521	796
1	0,1552	-0,5499	-0,1122	0,044	28.703***	796
2	-0,1126	0,0411	0,0049	-0,0036	6.427*	796
3	-0,0057	0,3617	-0,1441	-0,0611	9.490**	796
4	0,0552	0,177	0,0537	-0,328	7.484*	796
5	0,0719	0,1699	0,1065	0,0236	2,457	796
6	0,0357	-0,1065	0,077	-0,0863	2,203	796
7	-0,0463	0,5446	0,0713	0,0132	14.961***	796
8	0,0106	0,2788	-0,1163	0,1422	7.169*	796
9	-0,1149	0,1633	-0,1728	0,1139	7.331*	796
10	-0,1176	0,5222	0,0258	-0,0795	30.091***	796

*Note: ***, ** and * indicate a statistical significance at the 1%, 5% and 10% levels, respectively.*
Source: Own elaboration

Table 3: Cumulative average abnormal returns (%)

Estimation window	ADIA	GIC	KIA	GPFG	Kruskal--Wallis	No. of obs.
(-1,+1)	0,1942	-0,357	0,0294	0,0927	6.747*	796
(0,+1)	0,202	-0,307	0,0112	0,1163	7.244*	796
(0,+2)	0,0893	-0,266	0,0161	0,1127	0,708	796
(0,+3)	0,0836	0,0961	-0,128	0,0516	1,506	796
(0,+4)	0,1388	0,2731	-0,074	-0,276	1,092	796
(0,+5)	0,2107	0,443	0,0323	-0,253	0,329	796

*Note: *, indicate a statistical significance at the 10%, levels.*
Source: Own elaboration

Table 4: Average abnormal returns in subsamples (%)

Day	Commodity (ADIA, KIA, GPFG)	Non-commodity (GIC)	Mann-Whitney-Wilcoxon test	Full transparent (GPFG)	Transparent (ADIA, GIC, KIA)	Mann-Whitney-Wilcoxon test
0	0,0724	0,2432	-1,477	0,0723	0,138	-1,574
1	0,0578	-0,55	-5.053***	0,044	-0,0171	-1.917*
2	-0,048	0,0411	-2.000**	-0,0036	-0,029	-0,77
3	-0,055	0,3617	-2.947***	-0,0611	0,1068	-1,148
4	-0,083	0,177	-1,118	-0,328	0,1017	-2.701***

*Note: ***, ** and * indicate a statistical significance at the 1%, 5% and 10% levels, respectively.*
Source: Own elaboration

announcing that an investment was made in companies listed on the London Stock Exchange. Summing up, empirical findings of this research support the hypothesis that assumes investors differently value the investments of selected SWFs However, the question about the factors determining the reaction are yet to be answered. Further studies in this field might be aided by using regression to analyze whether a fund's characteristics such as transparency or size have influence on abnormal returns following an investment in listed companies. Comparing reactions between markets seems to be another promising avenue for further research. And finally, the ambiguous findings of this research might have been obtained due to the fact that short-term stock performance correlates with the size of the investment, thus future studies should control for this variable.

Conclusions

With over 7,000 billion USD assets under management and global investment activity, SWFs prove to be important institutional investors with possible implications for stock markets and target companies. The question that arises is whether or not such a status of global investors will be undermined by falling prices of oil and gas, which fueled the expansion of a large numbers of SWFs. Nowadays, over 50 countries have been using these investment vehicles to achieve economic, financial as well as social and political goals. This article addresses the issue of market reaction in response to the information about SWF investment in companies listed on the stock exchange. The empirical findings obtained with the usage of event study methodology point to the differences in investors' reactions to information about the investment made on the London Stock Exchange within the group of four selected SWFs. Although to the best of the author's knowledge this study attempts to fill the gap in the literature on SWFs, further studies are needed to provide comprehensive and coherent evidence in this field.

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