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Foreign ownership and stock return volatility – Evidence from Vietnam

Xuan Vinh Vo [a,b,*]

[a] School of Banking, University of Economics, Ho Chi Minh City, Viet Nam
[b] CFVG, Ho Chi Minh City, Viet Nam

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ABSTRACT

This paper examines the effects of foreign ownership on the firm-level volatility of stock returns in Vietnam. We use a detailed panel data set of firms listed on the Ho Chi Minh City stock exchange for the period from 2006 to 2012. Employing different econometric estimation techniques for panel data analysis, our empirical results show that firm ownership by foreign investors decreases firm stock price volatility in Vietnam stock market. The result implies the stabilizing role of foreign investors in emerging stock markets and this can be considered as one of the potential benefits of increasing the exposure of domestic stock markets to foreign investors.

1. Introduction

Stock market volatility is an important issue in equity markets worldwide which attracts huge interest from both researchers and investors. Most of the emerging equity markets are normally characterized by high price volatility since there exist various uncertainties with an unexpected market crash resulting from a crisis, either political or financial. Higher stock price volatility and its effects on investors in emerging markets are evidenced in times of crisis such as the Asian financial crisis in 1997 and the recent global financial crisis in 2008. Therefore, examining the stock price volatility in emerging stock markets is an interesting topic on its own merit.

* Correspondence to: School of Banking, University of Economics, Ho Chi Minh City, Viet Nam. Tel.: +84 913976688.
E-mail addresses: vxvinh@yahoo.com, vinhvx@ueh.edu.vn

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This study investigates the impacts of foreign investor ownership on the firm level stock return volatility in Vietnam, an emerging market. Similar to many emerging markets, Vietnam equity market is small and fragile to even small shocks. Stock price volatility is a serious matter of concern for all market participants and policy makers as volatility can exert huge pressure on the economy. Since the Asian Financial Crisis in 1997, there is a lingering concern that foreign capital may cause extreme volatility in emerging markets resulting in significant losses for these fragile economies (Bekaert and Harvey, 2000). This volatile issue can be more severe for Vietnam as the financial market is still in the infant stage of development.

The current paper has strong policy implications. Firstly, this paper sheds light on the volatility effects of foreign portfolio investment in Vietnam. A thorough understanding of this relationship is important for policy setting. The understanding of stock market volatility is more important in the context of a small open economy like Vietnam as the stock market is much more vulnerable to a small shock in the global market. Secondly, this paper equip many stakeholders with the information to deal with the current discussion on whether to increase the ownership room for foreign investors in a company from the current legal maximum level of 49% ownership in any listed non-financial firms. Thirdly, the paper provides an analysis for the policy makers in the setting of recent trend of removing legal restrictions on cross border capital flows and foreign direct investments among emerging markets.

Since early 2000s, there has been an increase in the presence of foreign investors in most of emerging markets as a result of financial liberalization and globalization. The removal of cross border restrictions and domestic capital market liberalization makes international investment easier. In many emerging countries, foreign direct investments and foreign portfolio investments are considered to be the sources of economic growth. Benefits attained from opening domestic financial markets to foreign investors are well documented in the literature theoretically and empirically (Boyd and Smith, 1996; Dachs and Peters, 2014; Gallizo et al., 2015; Levine and Zervos, 1996; Rajan and Zingales, 1998). In addition, foreign investors gradually become important players in emerging stock markets (Elliott and Zhou, 2015). The increase in the numbers of foreign investors and traded volume in the stock market worldwide has sparked strong interest amongst financial economists and policy makers in investigating the impacts on stock price volatility.

Even though the reform process is far from over, the economic reform and the financial system reform has yield significant results. Recent developments in Vietnam financial market and the continuous restructure of regulatory bodies and financial institutions have been seen recently by international financial investors. Important features of the reform in financial sectors include a better and stronger supervisory body with effective monitoring tools to achieve the stability and sustainability of financial system; a prudent financial liberalization with effective capacity to identify and mitigate risks; and a development of financial standard. As a result of globalization and liberalization trend in financial system, there is an increased presence of foreign investors in the local financial market. This increased presence of foreign investors is further supported by more open policies. For example, foreign banks are now allowed to set up branches and wholly owned subsidiaries in Vietnam and foreign portfolio investors can invest in Vietnamese firms with lower transaction costs.

Stock market is established in Vietnam in early 2000s and has gradually become an important channel for firms to raise fund to finance their investments. Even though banks are still the main sources of finance for Vietnamese firms, the Vietnam stock market has grown rapidly during the last two decades in terms of the number of listed firms and market capitalization. From a limited number of four listed firms at the establishment, there are currently more than 700 listed companies in the two official stock exchanges and many more in the over the counter market. The presence of foreign investors is expected to bring many benefits including providing liquidity and stock price stabilization for the stock market. Foreign investment in Vietnamese firms is also considered an alternative source of finance for firms. Moreover, large foreign ownership is expected to provide better corporate governance and transparency improvement in Vietnamese firms.

The remainder of the paper is organized as follows. Section 2 provides a review of literature investigating the impact of foreign ownership on stock return volatility. Section 3 introduces data and research methodology. Section 4 presents empirical results. Section 5 concludes the paper.