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Foreign ownership in Australian firms

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ABSTRACT

This paper constructs free float adjusted foreign ownership measure for Australian firms over the period 2001–2009 and explores the determinants of foreign ownership. Foreigners prefer investing in large Australian firms, value firms with high book to market ratios, firms which are listed abroad and firms with domestic cross holdings. Foreign institutions are found to have significant holdings in Australian firms. Results are robust to various econometric estimation techniques.

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1. Introduction

The Australian economy is highly integrated into the world financial system, with Australians holding large amounts of foreign assets and foreigners holding a large amount of Australian assets. Australia's strong and stable economy together with deregulation of industries such as finance, telecommunications and utilities, recent liberalisation of air transport ownership rules and mining boom have attracted foreign investment in Australia. The total stock of foreign investment in Australia was \$2 trillion as at December 2010. Portfolio investment comprised of about 58% and direct investment remaining 42% of total Australia's inward foreign investment.¹ Foreign investors make up around half of the investor base for the combined value of Australian equities and bonds.

The study of foreign ownership in Australia is important because foreign portfolio equity investment in Australia increased from US \$58,449 million in 1997 to US \$330,950 million in 2009. Of the total foreign portfolio equity investment in Australia in 2009; United States invests about 40%, followed by United Kingdom (38%), New Zealand (3.6%) and other countries.² While there are papers

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¹ ABS Catalogue No. 5352.0, 2010.

² Coordinated Portfolio Investment Survey (2010).

investigating Australia's investment abroad and home bias,³ there is no paper that specifically focuses on foreign ownership bias in Australian firms. This paper fills in the gap in the existing literature on foreign ownership bias and investigates the determinants of foreign ownership in Australian firms.

There are several papers which focus on home bias for individual countries i.e. Japan (Kang and Stulz, 1997), Sweden (Dahlquist and Robertsson, 2001), Korea (Kim and Shang-Jin, 2002), United States (Ahearne et al., 2004), China (Mishra and Ratti, 2011), Chile (Holland and Warnock, 2003), Finland (Liljeblom and Loflund, 2005), Taiwan (Lin and Shiu, 2003). For Finland, Grinblatt and Keloharju (2000) state that less sophisticated domestic investors take the opposite position to that of more sophisticated foreign investors. For Korea, Choe et al. (2001) find that foreign investors buy at higher prices than resident investors and sell at lower prices. For Japan, Hiraki et al. (2003) state that investment behaviour of money managers is more consistent with the agency-familiarity explanation than the information based explanation regardless of their nationalities. Gompers and Metrick (2001) state that US institutions invest in firms that are large, more liquid and have had relatively low returns during the previous year. Chan et al. (2005) state that stock market development and familiarity variables have significant, but asymmetric effects on the domestic bias and foreign bias and that economic development, capital controls and withholding tax variables have significant effects only on the foreign bias. Mishra (2007) examines the bilateral, source and host factors driving portfolio equity investment across a set of 41 countries and finds that information asymmetries and cultural-institutional proximity are important for bilateral equity investment.

Ferreira and Matos (2008) state that institutional investors have a strong preference for the stock of large firms and firms with good governance, while foreign institutions tend to overweight firms that are cross listed in the US. Chan et al. (2009) state that at firm level, firm value increases as the compositions of local equities held by domestic and foreign investors tend toward the firm's global market capitalization weights, but decreases as their weights deviate from global weights. Forbes (2010) states that foreigners hold greater shares of their investment portfolios in United States if they have less developed financial markets and countries that trade more with United States also have greater portfolio shares in US equity and bond markets. Berrill and Kearney (2010) state that by investing in home-based internationalised firms, investors can free ride the costs and risks associated with internationalisation at the level of firm and exhibit home bias while availing of international diversification benefits. Berrill and Mannella (2012) state that firms from more advanced economies tend to be older, larger and more multinational than firms from emerging markets.

There is literature that focuses on corporate governance and foreign ownership. Bailey et al. (1999) state that foreign investors are attracted to and pay a premium for large company, liquid stocks offered in countries with a good credit rating and general reputation. Dahlquist and Robertsson (2001) state that foreign portfolio investors underweight Swedish firms as the fraction of those firms held by controlling shareholders rises. Gillian and Starks (2003) state that foreign institutional investors play a more important role in prompting changes in corporate governance practices than domestic money managers. Claessens and Schmukler (2007) state that firms are more likely to internationalize if they are from larger, more open, higher income economies with better macroeconomic structures. Leuz et al. (2008) state that after accounting for freefloat, foreigners reduce investment when insiders' control exceeds a threshold. Foreigners invest less in firms that reside in countries with poor outsider protection and disclosure and have ownership structures that are conducive to governance problems. Kho et al. (2009) state that the home bias of US investors decreases the most towards countries in which ownership by corporate insiders is low. Bekaert and Wang (2009) and Knill (2010) examines the impact of foreign portfolio investment on the capital issuance behaviour of small listed firms. He finds that foreign portfolio investment (scaled by gross domestic product) is associated with an increased probability of small firm security issuance in all nations, regardless of property rights development. Bekaert et al. (2011) state that regulation of foreign capital flows and stock market openness and development are important segmentation factors in explaining home bias and foreign investment bias. Aggarwal

³ Mishra (2008, 2011).

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