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Sovereign wealth funds targets selection: A comparison with pension funds☆

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ABSTRACT

This paper investigates the determinants of sovereign wealth funds' (SWFs) decisions to invest in publicly traded firms in comparison to pension funds. Using a sample of 344 firms targeted by SWFs over the 1991–2011 period and a control sample of 663 firms targeted by pension funds, we find that SWFs, in comparison to pension funds, are more likely to invest in firms operating in strategic industries as defined by Fama and French (1997) (financial sector, natural resources, mining, transportation, telecommunication and utilities) and in countries with sustainable economic growth and weak legal and institutional environment. Our findings are robust to disproportional size of some SWFs, their financing sources, their transparency level and acquisition activities during the recent financial crisis.

"*China Investment Corp (CIC), the government's 747 $billion sovereign wealth fund, is shifting its focus to US investments and broader global ambitions as it prepares to move its North American headquarters to New York from Toronto early next year (...). CIC's new appetite for US investments would likely attract political scrutiny in Washington, where concern is growing that China is seeking to boost its influence in key sectors of the American economy.*

CIC declined to comment."

The Telegraph. December 14th, 2015

1. Introduction

Sovereign wealth funds (SWFs hereafter) are investment funds owned by sovereign entities or governments (Knill et al., 2012b). They are mainly funded by foreign exchange reserves stemming, for the commodity financed SWFs, from the sale of natural resources[1] (Kotter and Lel, 2011). In December 2015, the SWFs' Institute identifies the Norwegian SWF as the largest in the world with 825 $billion assets under management,[2] followed by the Emirati SWF, Abu Dhabi

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[1] Commodities mainly include oil, gas, diamonds, and copper.
[2] Interestingly, the Norwegian SWF was the smallest SWF in the world in 1996 (Chambers et al., 2012).

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Investment Authority (ADIA), and the Chinese SWF, China Investment Corporation (CIC), with 773 $billion and 747 $billion assets under management, respectively. Other important SWFs actively involved in international M&A activities, are SAMA Foreign Holdings (Saudi-Arabian SWF, 669 $billion), Kuwait Investment Authority (KIA, 592 $billion), SAFE Investments Company (Chinese SWF, 547 $billion), Hong Kong Monetary Authority Investment Portfolio (418 $billion), Government of Singapore Investment Corporation (GIC, 344 $billion), and Qatar Investment Authority (256 $billion). In December 2015, SWFs' portfolios amounted to 7193.2 $billion.

The recent literature documents mixed results regarding SWFs objectives and activism. While Dewenter et al. (2010) and Fernandes (2014) find that SWFs behave, on average, as active investors, Bortolotti et al. (2015) show that SWFs act as passive investors. Several studies identify the Norwegian SWF as an exception in this regard since it conducts an effective monitoring effort over its targets, and maintains a continuous presence in their corporate governance activities. Moreover, because SWFs' objectives are generally not disclosed or clearly stated (e.g., CIC and SAMA), and given their links to foreign governments, SWFs are described as being opaque (Kotter and Lel, 2011), hence shedding doubt on the objectives they pursue by making their investments. While Balding (2008) provides evidence that SWFs tend to behave as rational investors that diversify their portfolios by asset class and geographic region, Dewenter et al. (2010) argue that SWFs investment decisions may reflect nonfinancial objectives in comparison to private investors. In the same vein, Kotter and Lel (2011) and Chhaochharia and Laeven (2009) provide evidence that SWFs pursue other objectives besides return maximization, and suggest that SWFs' investments do not exclusively obey to the principals of portfolio theory. More recently, Knill et al. (2012a) document that bilateral political relations play a role in SWF decision-making, confirming Bernstein et al.'s (2013) results that are suggestive of political considerations. Nevertheless, Bortolotti et al. (2015) show that, in general, SWFs' motives to invest abroad are free of any political agenda, and that the number of cases where SWFs act as sovereign political agents, are limited. This is consistent with findings in Dinç and Erel (2013) who argue that instantaneous and intense political reactions as well as an increased regulatory scrutiny from the governments of the host countries are triggered when cross-border SWFs' acquisitions are perceived as politically driven.

This intensive debate surrounding SWFs objectives is one of the motivations of our study, that focuses on the determinants of SWFs' acquisitions of publicly traded firms in comparison with pension funds (PFs hereafter). A second motivation of our work is the growing size of SWFs relatively to other major funds. According to the SWF Institute, the aggregate size of SWFs went from 830 $billion in December 1999 to 7193.2 $billion in December 2015. SWFs' phenomenal growth over the last decade as well as the recent financial crisis, during which they became major players, have brought to the forefront a heated debate on SWFs and their strategic agendas, particularly after few publicized acquisitions involving major US banks (Citigroup, Blackstone, Merrill Lynch and Morgan Stanley). In addition, the opacity of most SWFs has increased the suspicion of hidden political objectives, raising calls for enhanced regulation and protectionist measures in countries targeted by SWFs investments.[3]

To the best of our knowledge, little is yet known on the determinants of SWFs investments, especially when compared to other funds (including PFs), except for few descriptive studies and some anecdotal evidence. The objective of this paper is to address this specific question. Although their respective sources of funding are different, both SWFs and PFs are considered long-term oriented investors. Our choice of PFs as a control sample for SWFs is justified by the fact that PFs around the world are characterized by a size magnitude comparable to SWFs. In addition, both types of funds are seen as long-term oriented investors. Finally, SWFs just like PFs are described as non-activists.

We contribute to the literature on several grounds. *First*, to the best of our knowledge, our study is the first to conduct a quantitative multivariate comparative analysis between SWFs' investment strategies and those of PFs. Our results identify firm-, country- and industry-level factors that differentiate SWFs from PFs investment strategies. In particular, the likelihood of being targeted by a SWF rather than by PFs is negatively related to liquidity, size, and the quality of legal and institutional environment, and positively related to strategic industries and economic growth. These results are neither driven by investment activities during the financial crisis nor by those made by the biggest SWFs. *Second*, we contribute to the debate on SWF motivations' in corporate investments. In fact, we show that SWFs have higher preferences for firms operating in poor legal and institutional quality environment, are more likely to invest in strategic industries in comparison to other funds in order to diversify the sources of revenues for their owning nations. We also show that SWFs are less attracted by liquidity and dividends, hence confirming the long term perspective of SWFs as state-owned financial vehicles. *Finally*, we add to the literature by focusing on SWFs investment decisions rather than the outcome of such decisions as is done in concurrent studies: for instance, Bortolotti et al. (2015), Dewenter et al. (2010), Kotter and Lel (2011), Knill et al. (2012b), Chhaochharia and Laeven (2009) and Fernandes (2014) all focus on the impact on firm value and performance. These studies generally show that SWFs targets experience short-term positive and significant valuation effects, but no such impact (negative impact) in the three years following the investment (Kotter and Lel (2011) and Dewenter et al. (2010), respectively). By focusing on how SWFs select their targets, we provide a perspective on the determinants of SWFs decision making, rather than how the firm is affected ex-post.

[3] An agreement on general principles and practices that should guide SWF investments was reached between western nations and the most important SWFs in September 2008, and officially signed one month later. These principals are presented and described in (http://www.iwg-swf.org/pubs/gapplist.htm).