# The Research of China Capital Market Institutional Investors Function Absence Problem

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## Abstract

*This paper analyzes the transaction both functional absence of institutional investors from investment strategy issues distortions, institutional and insider collusion. With the Efficient Market Theory to explain the reasons for the absence of institutional investors functions. Finally, the relevant policy recommendations. I believe this research will help investors have a better understanding of the nature of institutional investors.*

**Keywords:** Capital market; Institutional investors; the absence of function

## *1. Introduction*

In the development process of China's securities market, retail investors have been the main force in this market, the number of institutional investors little. However, at present the development of capital markets in Europe and America and other developed countries, the institutional investors in the stock market plays an increasingly important role, and affect their investment behavior of the stock market is also growing, especially in the stock price and formation and volatility in bond prices had a significant impact.

However, with the continuous development and improvement of China's capital market, the situation has changed. Since the beginning of the 21st century, China Securities Regulatory Commission proposed the "extraordinary development of institutional investors," the strategic vision, after the formation of securities investment funds led to the annuity, the Qualified Foreign Institutional Investor (QFII) insurance funds , annuity, pension funds, securities company funds (including securities company's own funds as well as a collection of financial funds) and other investors to supplement the body pattern. As of the end of 2012, the fund investor accounts amounting to 227,174,200, an increase compared with the end of 2011 10,808,700, or 5%, of which institutional accounts 406 800, 226 767 400 individual accounts.

## *2. Literature Review*

Research to institutional investors since its emergence in the capital market has been no interruption, whether foreign or domestic scholars and scholars of institutional investors a lot of normative analysis and empirical research. The late 1980s, scholars look to the influence of institutional investors on financial market macro efficiency. Studies suggest that the development of institutional investors can improve the efficiency of financial markets and the economy (E.Philip Davis, 1999) through a variety of ways. Davis believes that trading behavior of institutional investors will help improve liquidity in financial markets, to promote the development of capital markets. They contribute to the demand for information to improve the level of information disclosure, and accelerate to the underlying value of the asset price adjustment. In addition, the development and growth of institutional investors as well as financial instruments conducive to innovation in the financial market, providing more risk management tools for financial markets. Nofsinger & Sias (1999), Jones, Lee & Weis (1999), Cai, Kaul & Zheng (2000) and other scholars to study the influence of institutional investors on the stock price behavior generated. In addition, Scharfstein & Stein (1990) studied the institutional investors in the mutual fund herding market. In China, many scholars have played the role of institutional investors in the capital market for in-depth study. For example, Qi Bin, Huang Ming, Chen Zhuosi (2006), they are both from the perspective of the inversion phenomenon and inertia Institutional Investors and market efficiency were studied. ChenLu, ZhouJian, XieLin (2011) herd behavior and positive feedback from two perspectives on the phenomenon of institutional investors and market stability were studied.

Xu Xuchu (2001) assume that institutional investors are a special person and a profit-driven economy is the fundamental nature of institutional investors, which studies the efficiency of the institutional investors and the capital markets. Liujing Jun, Xu Haoping (2013) based on turnover characteristic institutional investors Institutional investors will be divided into long-term investors and short-term opportunists, transaction characteristics systematic study of institutional investors and the effects of different types of institutional investors in the capital market impact. But these conclusions Institute scholars are not entirely consistent.

Although scholars of institutional investors in the capital markets function in-depth analysis and discussion of proposed institutional investors often affects the stable operation of the securities market, but did not go into its essence. Therefore, the function of the absence of institutional investors is particularly necessary to study the problem. This paper analyzes the institutional investors plan to start the function and development of capital markets in developed countries learn from the experience of institutional investors, China's capital market to function absence of institutional investors study the issue.

### *3. The Development of Institutional Investors in China's Original Intention*

The past 30 years, the global financial system has undergone a number of significant changes, including the rise of institutional investors is one of the most significant changes. Western countries to optimize its allocation of resources to improve the terms of the savings rate, prosperity and stability in the capital markets and corporate governance have had a profound and significant impact. From the development process of the Western developed countries, the development of institutional investors and promoting competition in the financial system and to improve the operating efficiency of the financial system and capital markets. At present, the development of China's capital market is still in the "emerging and transitional" stage, whether in institution building, market-based or in the investment philosophy, and the developed countries there is a big difference. Meanwhile, the development history of China's institutional investors are still very short, in terms of investment behavior or in the investment ideas are not yet fully mature. But since the beginning of the 21st century, China Securities Regulatory Commission, "the extraordinary development of institutional investors," the strategic concept, the increase in China's capital market, the number of investors soon, and society as a whole is becoming an important wealth management platform. To sum up, China's development of institutional investors in mind mainly in the following aspects:

(a) Improvement of the savings - investment mechanisms, development of direct financing market. Development of institutional investors, can guide the flow of funds from investors in the hands of the bank's capital markets, and expand the size of the stock market, thereby expanding the proportion of direct financing on the stock market.

(b) Improve the efficiency of China's securities market. In the capital market, compared with institutional investors, individual investors do not have the scale advantages and information superiority. Therefore, they usually prefer short-term speculation, which may lead to the market allocation of resources deviates from the normal price levels, to the detriment of the efficiency of the securities market. However, institutional investors are more long-term value of the enterprise value, seeking value investing, thus making the stock market run more efficient.

(c) Decentralized capital market risks. Because institutional investors have scale advantages and information superiority and there is a strong market information analysis and processing capabilities, the use of diversified investment strategy to invest in the funds collected from the various financial markets, so this decentralized market risk capital has played a positive role.

(d) Actively involved in corporate governance through institutional investors, changing the traditional business-oriented manager, governance structure, improve corporate governance environment to create business value. All along, due to the presence of asymmetric information, many small investors are unable to supervise the conduct of the company's management or supervision and restraint and constraint costly. However, due to the shares held by institutional investors is more, there is the daily management of the company greater say and easy to use of "voting with their feet" strategy, the company's management has a strong binding, and thus to a large extent alleviate information asymmetry caused by moral hazard problems and improve the corporate governance environment.

### *4. Institutional Investors and the Reasons for the Absence of Functional Analysis*

Since the "extraordinary development of institutional investors' strategic vision put forward, a sharp increase in China's capital market in the number of institutional investors, but the accompanying legal environment, institutional facilities has not kept pace with the development of institutional investors, resulting in our bodies many behavioral and institutional investors' lack of legal constraints. Therefore leads to severe functional institutional investors absence.

(a) The Absence of Function Analysis

An investment strategy twist. In the past, Europe and other countries of the shareholders, including institutional investors, primarily to monitor and control the activities of the company and the manager of the company through stock trading activities on the stock market. If you are not satisfied with the company's management shareholders operation, will select the "vote with their feet" policy, forcing management to shareholders' interests for the business objective. Otherwise, the company's stock will continue to decline, which may allow the company's competitors the opportunity to acquire a large number of the company's shares, which carry out acts of a hostile takeover. It will not help their reputation managers and future career.

With the status of institutional investors in the capital market is rapidly increasing, the investment behavior of institutional investors and the supervisory role of the target company's management and business activities become the focus of attention of some investors. At the same time the proportion of institutional investors, investment changes to China's capital market has formed an important role in guiding, some retail investors trading in securities of important reference. For retail investors, institutional investors are more likely to realize the value of the investment strategy, and they are hoping to institutional investors in a listed company's business activities and supervision. However, due to the presence of a variety of practical problems, such as the country's listed companies has immaturity and instability of the performance, the length of the fund manager's tenure uncertainty and imperfect financial market system, etc., has led to the pursuit of institutional investors long-term value is not a business, but the short-term income fund assets. Caused institutional investors in the capital markets frequent trading, such frequent trading not only increases transaction costs, affect the performance of investment funds, but also to the capital market to bring a series of problems. On the one hand, frequent trading for institutional investors are short-term trading purposes, obviously speculative, resulting in the role of institutional investors in the supervision and management of the target company cannot be fully exploited; on the other hand, frequent short-term trading is easy to destroy the market stable operation, causing the market ups and downs.

Thus, while institutional investors shoulder "stable market" and "price discovery" of the burden, but because of their short-term speculative trading practices not only led to corporate governance did not play an active role, and to bring the stable operation of the financial markets had a negative impact. So distorted investment strategy is a manifestation of institutional investors in the capital markets function Absence.

Conspiracy and insider trading institutions. From the above analysis, the development of institutional investors in our mind is good. But then the facts tell us that many acts of institutional investors have deviated from our original idea, they not only did not play due to a function, but increased the speculation, increased stock market volatility. Insider trading is a way in which its speculative trading.

Insider trading refers to insiders or people illegally obtaining insider information, insider information before the public sale of the relevant securities, or disclose the information or suggestions related to the behavior of others to trade securities. In our current environment, this information is opaque market, the company's internal management aspects of the company to have more information about the direction of investment funds, investment risk and return, etc., with a significant information advantage. Institutional investors in the capital, human resources account for a large advantage, but usually only to understand the listed company's financial condition and operating results through external sources published financial statements of listed companies, market research, industry research. Therefore, people within the company, institutional investors and external conspiracy is a rational choice, this is the so-called institutional investors, strategic alliances and corporate insiders between hypothesis (Pound, 1988). Company insiders through funding and personnel to have an external institutional investors insider information, in order to achieve "information superiority" and "financial advantage" complementary to circumvent the law and securities regulators constraints related self-dealing behavior, and ultimately through insider trading information to obtain high rent.

It is this "information superiority" and "financial advantage" separation, so that in our legal and regulatory constraints on the company's management is weak, the collusion between the company management and institutional investors has become an inevitable trend.

In recent years, China's stock market insider trading on the common. Especially after 2007, China's capital market into the circulation time, as companies large shareholders in the decision-making and access to information on a great advantage, so they have a financial advantage with institutional investors also the possibility of insider trading larger, so the circulation times worse than insider trading tradable. Exist makes insider trading price of the securities of a small number of people take advantage of insider trading trading results, losing the essence of securities prices reflect the value of securities. And finally to China's stock market is difficult to optimize the allocation of resources and the loss of function of a barometer of the national economy. Therefore, institutional conspiracy and insider trading is one of the manifestations of the absence of institutional investors functions.

(b)Analysis the causes of the absence of function

The absence of institutional investors function can be explained by the efficient market theory. According to Fama's Efficient Market Theory (EMH), the market consists of three forms: the weak form efficient market, semi-strong efficient market, strong form efficient market. Moreover, China's market has been a weak form efficient market. In this market, the information asymmetry problem is serious, this is a direct cause of the absence of institutional investors to function.

In China's securities market, the institutional investors have significant information advantage and scale advantages, and through diversified investment strategy can reduce investment risk. However, due to information asymmetry leads to the principal - agent problem occurs, institutional investors, fund managers are often not seek to maximize the interests of investors, but to consider their own management fee income and maximize their professional reputation. This leads to a conflict of interest proxy investment patterns. The principal - agent problem exists makes the investment behavior of fund managers and investors often target inconsistent, prone to "Rat", "shady fund" and other vicious incidents harm the interests of investors, investment, resulting in functional institutional investors the absence, but also reduces the efficiency of the market, undermining the stable operation of the financial markets. At the same time, there is also the problem of information asymmetry between institutional investors and companies. Under normal circumstances, participate in corporate governance, explore the value of social responsibility is an institutional investor. However, due to the existence of information asymmetry, corporate management is not to shareholders (including institutional investors) to maximize the benefits for their own business objectives, but to consider to maximize their own interests between corporate management and institutional investors. Thus, the management of behavior often harm the interests of institutional investors. Because of this, institutional investors know that as a result of information asymmetry in the case of damage to their own interests, the will not be actively involved in corporate governance, explore the value, but make short-term investments. Therefore, in this case, the company's development is very unstable, and not conducive to long-term development.

In addition, the stock market is information-intensive markets, securities price information sensitive to changes. According to the efficient market theory, China's securities market are weak-form efficient market, stock prices can fully reflect their history, investors are not possible through analysis of historical price information and to obtain extraordinary gains. Therefore, it is possible that some investors could take advantage of the presence of private information (especially the private information of major events) to obtain abnormal returns. Typically, insiders more information advantage over outsiders. Due to the internal people directly involved in the production, operation and management, internal cost people more clearly of the company's revenue, profitability, prospects and other directly related to the company's stock price of basic information. More importantly, for the event mergers and acquisitions, issuance of new shares, stock dividends, stock repurchases, which may have a significant impact on the stock price, company insiders, especially the high-level insider private information has obvious advantages. In this case, the internal person qualified in their possession will be a lot of information to share with institutional investors, and to share the resulting huge speculative profits and institutional investors. Thus, in the weak-form efficient market, insider trading is inevitable.

## *5. Conclusions and Policy Recommendations*

### (a) Conclusion

With the development of China's capital market, the growth of institutional investors, institutional investors, investment style will gradually differentiation, this article from distorting investment strategy, institutional conspiracy and insider trading point of view of both the absence of institutional investors functional problems. With the efficient market theory to explain the reasons for the absence of institutional investors functions. We conclude that distort investment strategies and insider trading caused by the weak-form efficient market, resulting in the instability of the capital market inefficiencies and development.

### (B) Policy Recommendations

Suitable for the development of institutional investors to create the institutional environment, the legal environment. In the early development of China's capital market, with supporting legal framework and institutional facilities, no follow-up, leading to the development of institutional investors in the beginning was not legally binding and standardized guidance. This was later standardized development of institutional investors caused some resistance, the formation of institutional investors soft constraints, heightened volatility of capital markets. Strengthen information disclosure, improve market information dissemination mechanism. The capital market is the market information, standardized information disclosure mechanism conducive to avoid insider trading issues, constraints, the investment behavior of institutional investors, the interests of individual investors are effectively protected.

Improve capital market innovation. Through financial product innovation, institutional innovation to guide institutional investors rational investment, the value of the investment. Rich diversified financial market investment tools. At the same time, actively promoting the development of institutional investors from negative shareholders to positive shareholders, institutional investors and try to promote the active participation of supervision and management of the target company.

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