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## The influence of academic interactions on stock selection and performance: Evidence from Japan

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### ABSTRACT

Using mutual fund holdings data and fund manager demographic data, this paper examines whether academic interactions between fund managers and board members affect fund manager investment decisions and fund performance. I show that mutual fund managers are more likely to hold academically related stocks. Performance tests provide empirical evidence that academic interactions are beneficial to earn more profits. In addition, I show that mutual fund managers seem to lose profitable opportunities due to academic interactions because of their investment styles. Overall, this paper shows that mutual fund managers seem to take advantage of academic interactions to earn greater profits.

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### 1. Introduction

This paper examines whether an academic link between mutual fund managers and board members affects managers' investment styles and performance. Based on an analysis of mutual funds' equity holdings data, the results show that mutual fund managers favor academically related stocks. This paper also shows that the academic link between mutual funds and board members is important with regard to yielding higher performance.

In the field of finance, how information has been incorporated into securities prices has been rarely discussed in the past few decades despite the common sense that information moves prices. To understand the mechanism through which information affects asset prices, academics have recently tried to relate the effect of information on prices to social interactions. In keeping with previous studies, this paper examines whether one type of social interaction, namely, the academic interactions of fund managers, impacts fund managers' preferences for stocks and the subsequent performance of stocks. The contribution of this paper is its implications for stock market efficiency. Under the traditional efficient market hypothesis (hereafter EMH), no investor can beat the mar-

ket if the stock market is efficient in terms of information. The finding of profitability due to academic interactions indicates a violation of the traditional EMH. Instead, as documented in Grossman and Stiglitz (1980), it implies that some investors can outperform the market because of an informational advantage.

This study considers one kind of social interaction, namely, academic interaction. I expect that fund managers who engage in academic interactions are more likely to hold academically related stocks that perform well due to informational advantages.<sup>1</sup> To test whether academic interactions have important effects on stock selection and performance, I use holdings data on 79 active mutual fund managers. As these data are produced semi-annually or annually, I can observe trading decisions by observing changes between the two reporting dates. Combining these data with demographic data regarding fund manager' academic backgrounds obtained from the Morningstar website, I examine whether academic backgrounds influence stock preferences and fund performance. I construct variables to measure the strength of the academic interactions of managers. If a fund manager graduated from the same university as one of the board members in a listed firm, the firm is regarded as "academically related" to the fund manager.

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<sup>1</sup> There is a possibility that such fund managers only hold these stocks because they are subject to some behavioral bias. In this case, we expect a performance lower than the market performance.

By measuring academic interactions between managers and board members, I examine whether academic interactions impact the stock preferences of fund managers. In the analyses of stock picking by mutual fund managers, I find that they tend to hold academically related stocks even after controlling for the effects of investment style, manager-specific characteristics, and time-series fixed effects. However, in the analysis of portfolio weight decisions, fund managers do not always tilt their investment toward academically related stocks, which implies that mutual fund managers cannot take advantage of the full information obtained from academic interactions. To test whether holding academically related stocks is beneficial, I compare the performance of academically related stocks to that of academically unrelated stocks. I create calendar-time portfolios that mimic the aggregate portfolio allocation of mutual funds in related and non-related stocks. The results show that academic interactions yield economically and statistically significant profits for the mutual funds. Academically related stocks outperform academically unrelated stocks by 0.018 percent per day, that is, 4.5 percent per annum. The results hold in some robustness checks. In addition, I examine whether mutual fund managers can take full advantage of information induced from academic interactions by comparing the performance of academically related stocks held by them to that of these stocks not held by them. The results show that academically related stocks held by mutual fund managers do not always outperform academically related stocks not held by them, which implies that mutual fund managers seem to be unable to take advantage of full information included in academic interactions. The comparison of academically related stocks held by mutual fund managers to stocks not held by them also shows that stocks in the latter group are more likely to be concentrated among smaller and value stocks, which are less likely to be held by mutual funds. Because of the investment styles that fund managers employ, these managers might be unable to take advantage of full information from academic interactions. Overall, the empirical evidence shown in this paper is consistent with the prediction that one type of social interaction, namely, academic interaction, drives informational advantages of mutual funds and yields higher performance.

The remainder of the paper is organized as follows. In Section 2, I describe the background and related literature based on theoretical and empirical evidence. In Section 3, I describe the data. Section 4 provides empirical results on holding decisions. The empirical results on performance tests are reported in Section 5. In the last section, concluding remarks are documented.

## 2. Background and related literature

Many researchers have devoted their work to addressing whether security prices are set in an informationally efficient way. If securities prices are informationally efficient, then investors cannot outperform the market. Using mutual funds holdings data, many studies have examined the informational efficiency of security prices. Most studies (Jensen, 1968; Carhart, 1997; Davis, 2001) find that mutual funds consistently underperform relative to the market. Though these studies examine the returns of a particular type of investors, mutual fund demographic data have only rarely been used to discriminate investments for which there is evidence of stock selectivity. Recent works by Coval and Moskowitz (2001) and Cohen, Frazzini, and Malloy (2008) succeed in finding evidence that an informational advantage can be used to help mutual funds outperform the market. Coval and Moskowitz (2001) report that mutual fund managers who live near firm headquarters of held stocks tend to earn abnormally high returns. They point out that their findings imply that fund managers have a substantially

enhanced ability to select local stocks due to a local informational advantage.<sup>2</sup> Cohen et al. (2008) find that academic ties between mutual fund managers and board members lead to higher performance than the market. They also suggest that academic ties may be a source of informational advantage.

In this study, I consider one type of social interactions, namely, academic interactions, as likely to yield informational advantages for mutual fund managers. An academic interaction is a form of social interaction that tends to persist after an individual graduates college. Most people select their schools according to their interests and educational levels. Students in the same university are therefore expected to have similar backgrounds and characteristics even before matriculation. Opportunities to continue college-based interactions after graduation include such events as alumni parties. As people from the same university tend to have similar cultures and backgrounds as well as stronger relationships with one another after graduation than with others from different universities, academic ties are expected to provide an informational advantage for fund managers. There is also empirical evidence to support this hypothesis. Flap and Kalmijn (2001) show that academic ties are more effective bases for building relationships than other ties.

## 3. Data

### 3.1. Mutual fund data

This study obtains data from several sources. Mutual fund holdings data are obtained from the Electronic Disclosure for Investors' Network managed by the Financial Service Agency of the Japanese government. The data contain the annual or semi-annual holdings of individual mutual funds from 2003 to the present. In the analysis presented here, I focus on actively managed Japanese equity funds; index funds, funds that invest mainly in foreign equities or bonds, real estate funds and closed-end funds are excluded. This restriction yields a sample of about 650 funds during the sample period.

The use of demographic data on mutual funds portfolio managers is also important in this study; these data are obtained from the Morningstar website. To enhance the sample used in this study, I use data from the websites of firms to which fund managers belong or from articles in *Nihon Keizai Shinbun*. The combined dataset provides the name of portfolio managers, brief cumulative vitae of some managers, the university from which they graduated, the degree earned, and the graduation year. After matching the data to the mutual fund holdings data, I obtain 79 actively managed funds. This sample is employed in my tests. Stock return and financial data on firms are obtained from Nikkei NEEDS. The analysis in this study is limited to common stocks. Table 1 shows summary statistics on fund holdings and demographics data in more detail.

### 3.2. Academic interaction

I assume that strong academic ties between fund managers and managing boards lead to informational advantages for fund managers. To construct the academic interaction variable, I rely on the cumulative vitae of management board members. I obtain these data from Nikkei Telecom, which is managed by Nikkei Media Marketing. The data provide detailed biographies on board members, their alma mater, degree, year of graduation, birth date, hobbies, and so on. I only use the biographies of chief executive officers, chief operating officers, and board directors. By matching the

<sup>2</sup> However, Grinblatt and Keloharju (2001) report that local bias of institutional investors may does harm their performance.

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