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Article

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Journal of Accounting and Management Information Systems (JAMIS)

Provided in Cooperation with:

The Bucharest University of Economic Studies

Suggested Citation: Martínek, Stanislav (2017) : The Investment Strategies of Sovereign Wealth Funds: A Reverse Engineered Pitch, Journal of Accounting and Management Information Systems (JAMIS), ISSN 2559-6004, Bucharest University of Economic Studies, Bucharest, Vol. 16, Iss. 4, pp. 648-656,
<https://doi.org/10.24818/jamis.2017.040012>

This Version is available at:

<https://hdl.handle.net/10419/310694>

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The investment strategies of sovereign wealth funds: A reverse engineered pitch

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Abstract: This letter describes personal reflection based on the utilization of the Faff's (2017, Pitching Research) pitch template for a reverse engineering technique in order to summarize, evaluate and properly interpret information from articles in respected scientific journals which represents key or seminal scientific research work upon which a researcher built his/her scientific work.

Keywords: pitching research, reverse engineered pitch, Sovereign Wealth Funds

JEL codes: G15, F00, F30

1. Introduction

One of the crucial preconditions for the final quality of a scientific study is performing effective search for relevant work in the field of the researched area. Literature review is inevitable part of "process of research" and interpretation of the researched findings predestines the final result and quality of every research work. Incorrect or incoherent interpretation of seminal article results can lead to confusion, significant delay and in extreme circumstances to the complete irrelevancy of the findings and complete waste of the researcher effort time and resources. Therefore, the consistent research and excellent understanding of the key articles relevant to the researcher work is required.

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Faff's (2017) pitch template is originally designed as a tool for providing a methodical approach to pitching a new research proposal to the expert audience however, this pitching tool can be utilized in many others ways and across various scientific sectors. For instance, research planning tool (e.g. Chang & Wee, 2016; Menzies *et al.*, 2016); a research skills development tool (Faff, 2016); a research learning tool (Faff *et al.*, 2016; Ratiu, 2016); for details see Faff (2017).

One of the possible applications of this pitching tool is using the template for transparent summary of seminal and key scientific works through the process generally known as a "reverse engineering" pitch in order to ensure the correct understanding of the findings, conclusions and methodology utilized in the research process.

This letter describes personal reflection on the utilizing the Faff's (2017) pitch template for the development of reverse engineering pitch for the Bernstein *et al.* (2013) "The Investment Strategies of Sovereign Wealth Funds", *Journal of Economic Perspectives*, 27(2): 219-38 which represents one of the key scientific article for my research work focusing on the Foreign Direct Investment generated by the Sovereign Wealth Funds and its impact on the market value of the acquired companies.

2. Sovereign Wealth Funds - topic overview

State owned investment funds also known as Sovereign Wealth Funds has undergone dynamic progression during the last decade. The global asset under management (AUM) of SWF soared from \$2 billion in 2005 to \$6.6 billion or even 7.1 billion in 2015 (according to UNCTAD). The total amount of AUM has doubled since 2008 and more than 30 new SWFs have been established since that.

The expression "Sovereign Wealth Funds" has been used for the first time in Rozanov (2005). The interest of financial regulatory authorities and academic sphere has been attracted during the financial crises 2007-2009 following the key role the SWFs played as almost only financial subject with available capital.

Entrance of SWFs upon the global financial podium has been spotted by academic sphere as well and after 2008 abundance of studies, conferences and research projects has been devoted to this topic. SWFs has been

thoroughly scrutinized in the Bolton's (2012) book *Sovereign Wealth Funds – Long term Investing* summing up the results of conference named “*SWFs and other long-term investors: A new form of capitalism*”. Investment strategy utilized by SWFs is described in Chhaochharia *et al.* (2009). One of the key and very often cited studies covering foreign investment strategies of SWFs is Kotter and Lela (2011 which on the large sample of investment (279 various companies in between 1980-2009], observes that SWFs investment strategy strongly resembling strategies utilized by large passive investment funds as pension funds for instance aiming at poorly managed companies in developed countries.

Another complex study has been delivered by a team led by Shai Bernstein (2013) where the authors look at different investment strategies utilized by SWFs and based on the direct equity investments carried out by the sovereign funds investigate whether there are any significant differences in the investment behavior compare to the large pension funds. They also scrutinize the relation between the governance structure of SWFs and its propensity to invest into the domestic companies or prefer cross boarder investment.

Since 2008 dozens of studies and scientific papers has been issued covering various aspects of the SWFs phenomena. The quality and relevance of work has varied substantially and getting properly organized in this pell-mell of articles with contradictory results is rather difficult therefore, pinpointing the key studies and articles and correct interpretation of their results becomes challenging.

3. Personal reflection from using reverse engineered pitch technique

This section describes my personal experience with the utilization of the Faff's pitch template for one of the seminal economic studies devoted to the Sovereign Wealth Funds and its investment strategies developed by Kotter and Lela (2011).

Similar to Wallin and Spry (2016) I encountered the Faff's pitching template in an advanced phase of the Ph.D. program at the department of the International Business during the Training and Career Development Course for Early Career Researchers at the University of Economics, Prague. The structural approach initially used for facilitation of pitching research ideas

helped me to realize certain inconsistencies within my own PhD work and showed me how to better (with higher consistency) explain what subject this thesis covers and what is its main contribution to the scientific research and who can possibly benefit from the work results and findings.

We also had an opportunity to apply the reverse engineering pitch approach with utilization of the Faff's pitching template to one of the research papers (process of research relevant article) for which we could subsequently compare our findings with the original pitch template created by the author. As we worked in group of only two people with an article we have been familiarized with it was rather straightforward process which led us to consensus on the completion of the reverse engineered template quickly and effectively. However, once we have received an original pitching template, we realized that there was for certain parts (especially So What and What's new sections) which we had approached in a different direction.

Later, I have chosen two papers which I consider the most relevant to my research work and developed the reverse engineered pitch for both of them. The results from the reverse engineered pitch of Kotter and Lela (2011) are shown in Table 1.

As a direct result from the applied structured approach guided by the Faff's pitch template I was able to quickly and effectively analyse this complex paper and identify main ideas, methodology and key findings of the study. Thanks to visualization of the research ideas incorporated in the article (and narrowing them down to the three most important) as pictured in the Figure 1. I have gained a better understanding of the study in significantly shorter period of time.

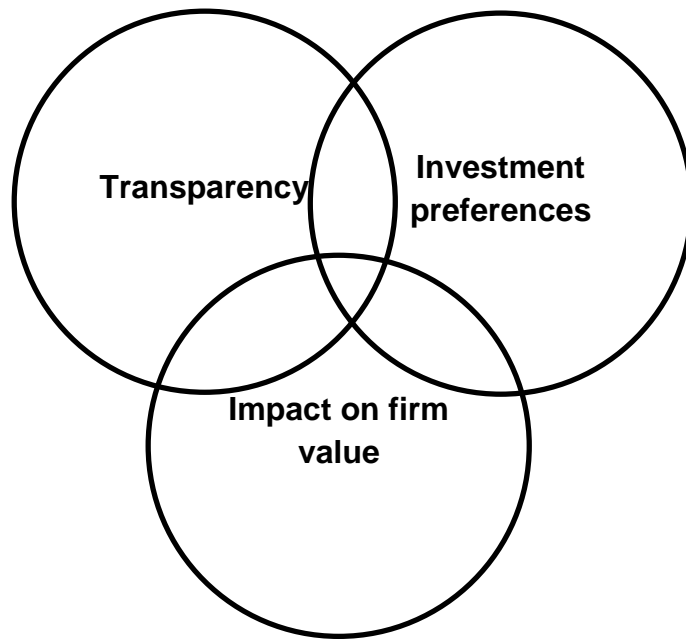


Figure 1. Mickey Mouse diagram characterizing novelty of research idea

Table 1. Completed reverse engineered pitch template on Kotter and Lela (2011)ⁱ

Pitcher's Name	Standard Martinek	Purpose	Reverse engineered "Seminar Paper" pitch	Date Completed	19-June-2017
(A) Full Reference	Kotter, J. & Lela, U. (2011) "Friends or foes? Target selection decisions of sovereign wealth funds and their consequences", <i>Journal of Financial Economics</i> vol. 101: 360-381				
(B) Basic Research Question	This paper examines investment strategies of sovereign wealth funds (SWFs), their effect on target firm valuation, and how both of these are related to SWF transparency.				
(C) Key paper(s)	Johnson, S. & Mitton, T. (2003). "Cronyism and capital controls: evidence from Malaysia", <i>Journal of Financial Economics</i> , vol. 67: 351-382 Leuz, C. & Nanda, D. & Wysocki, P. (2003) "Levered protection and earnings management: an international comparison", <i>Journal of Financial Economics</i> vol. 69: 503-527 Lins, K. (2003). "Equity ownership and firm value in emerging markets", <i>Journal of Financial and Quantitative Analysis</i> , vol. 38: 159-184				
(D) Motivation / Puzzle	In contrast to hedge funds and private equity funds, the objectives and behavior of Sovereign Wealth Funds as investors are not well understood. In particular, the foreign government ownership of these investment funds coupled with the opaqueness surrounding their structure and activities are among the major concerns in host countries. Addressing this knowledge gap is important because it can have significant implications for the performance and efficiency of target firms.				
THREE	These core aspects of any successful research project i.e. the "IDoTs" guide SWFs that intend to expropriate minority shareholders or use their investments for political or social ends are more likely to be opaque, as it is easier to conceal information about their investment activities under a weaker informative environment				
E) Idea	Further, managers at more transparent and better governed SWFs are more likely to be held accountable for their investment performance, which suggests that they are more incentivized to make better investment decisions and to put greater effort into maximizing the target firm value. Authors start the target selection analysis by conducting a multivariate logit analysis of the probability of being targeted by an SWF. Explanatory variables include firm and country characteristics and also target country, industry, and year fixed effects. Additionally, they compare robust standard errors that are clustered at the firm level. They also include three time-varying country-specific variables to evaluate the impact of capital market conditions and the legal environment on the probability of being targeted by SWFs to proxy for the degree of financial market development of the target country				
F) Data	Sample consists of SWF investment announcements that are hand-collected by searching Factiva from 1980 through February 2009 using key words such as "invest," "stake," and "acquire" combined with the SWF name and its well-known, wholly owned subsidiaries, and it is supplemented with data gathered on mergers and acquisitions from the Securities Data Corporation. They obtain the list of SWFs from Trueman (2008) and the Sovereign Wealth Fund Institute. Their search results in a total of 827 events, of which 324 are investments in firms without publicly traded equity. The final sample consists of 417 investment events in 326 unique firms, with some firms receiving multiple SWF investments				

Pitcher's Name	Stanslav Marinick	Purpose	Reverse engineered "Seminal Paper" pitch	Date Completed	19-June-2017
	<p>between 1988 and February 2009. Returns data for each stock and the market index (MSCI All Country World Index (ACWI)) are collected from DataStream and Bloomberg.</p> <p>The major data-relevant concern is the robustness of the data set as many (especially less transparent SWFs) utilize SPVs for the investment execution therefore, some of the transactions could be easily masked.</p> <p>For market reaction to the investment announcement: event study analysis. To measure abnormal returns, authors estimate a market model for each firm using local currency daily returns. As a proxy for the market return, they use the US dollar denominated MSCI ACWI from DataStream.</p> <p>With the announcement day defined as day 0, ordinary least squares (OLS) market model coefficients are estimated over a 160-day pre-event period, from day 180 to day 21 relative to the announcement date.</p> <p>Coefficients from the pre-announcement model are used to calculate abnormal returns from day 10 to day 20.</p> <p>Statistical validity is tested individually for every statistic results in this study utilizing various robustness checks appropriate to the applied methodology.</p>				
G) Tools	<p>TWO</p> <p>Two key questions</p> <p>The driving idea of the whole research paper is to develop and apply statistically robust model to evaluate the effect of the SWFs investment on the target company in the investment announcement period. The study represents the first of its kind bringing complex analysis of the SWF investment and for the first time applies the methodology utilized usually for pension funds to the Sovereign Wealth Funds.</p> <p>SWFs represents investors with approximately USD 6 + trillion AUM and in 2011 it was probably the first complex analysis looking closely at the SWF investment portfolio which serves as one of the seminal works in the SWF-related financial academic environment.</p>				
(I) So What?	<p>ONE</p> <p>One bottom line</p> <p>This paper contributes to the strands of literature on institutional ownership, state ownership, and financial disclosure, and it provides evidence in support of policies recently initiated by SWFs aimed at improved transparency.</p>				
(J) Contribution?	<p>1. Transparency matters – based on the study results transparent and opaque SWFs differ in their investment strategies, as investment choices of transparent SWFs are associated with a certification effect i.e. transparent SWFs are more likely to prefer firms facing financial difficulties than opaque SWFs.</p> <p>2. SWF investment preferences – results from the target selection analysis show that SWFs target financially distressed, cash-constrained, and large multinational firms with poor performance and located in financially developed countries, suggesting that SWFs are similar to institutional investors in their preference for asset characteristics.</p> <p>3. Impact on target firm value – The authors' findings suggest that SWFs are similar to institutional investors in their impact on target firm performance, where SWFs higher level of SWF transparency has positive significant impact on target firm value.</p>				
(K) Three Key Findings					

4. Conclusion

Working with the Faff's pitch template is intuitive and significantly contributes to keep the logical line in summarizing any research work. After performing the reverse engineered pitch analyses for Kotter and Lela (2011) I realized, that in spite of the fact that I have been studying this particular paper several times and certain parts of my current research project is based on their methodology, I have missed particular details (especially with regard to the statistic approach to the data evaluation).

After finalizing the pitch template, I understand the structure and content of the Kotter and Lela research study significantly better. Therefore, I would recommend to all researchers to utilize this pitch template reverse engineering technique for future research work especially in the research literature review phase.

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ⁱ This pitch has been created at <http://PitchMyResearch.com> using a template modified from Faff, Robert W., Pitching Research (11 Jan 2015), available at SSRN: <http://ssrn.com/abstract=2462059>