What are the Challenges and Problems Facing China's Outward Portfolio Investment: Evidence from the Qualified Domestic Institutional Investor Scheme

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Summary

Since their inception in late 2007, Qualified Domestic Institutional Investor (QDII) funds, which help Chinese investors to invest in overseas financial markets, have experienced significant portfolio losses and persistent fund outflows. While these losses are large in absolute terms, QDII funds, on average, performed better than Chinese A-share funds, but slightly worse than a group of foreign mutual funds. Our study focuses on the QDII industry, and asks three interrelated questions: 1) why have there been large fund outflows from the industry? 2) What explains QDII funds' poor performance? And 3) why have QDII funds been so heavily exposed to the Hong Kong market?

Our empirical analysis shows that the persistent outflows were primarily a result of disappointing fund performance, which can in turn be explained by the deficiency of knowledge required of QDII fund managers in investing in foreign capital markets and managing global portfolios. Regarding QDII funds' large asset allocation in the Hong Kong market, we show that this 'Hong Kong bias' is broadly consistent with the well-documented 'home bias' in cross-border portfolio investment, but is greatly exacerbated by the lack of global investing experience of QDII managers.

Despite these challenges, we argue that further liberalisation of China's capital account should encourage more domestic capital to venture abroad for investment opportunities, creating a favourable backdrop for the future development of the QDII industry. What the industry needs to do now is to address some of its internal problems (such as improving the professional quality of the managers), so that it can better play its part in China's financial market liberalisation and economic transformation.