

Annual Report (2007-2008)

by

The K.J. Luke Chair of International Finance and Banking

July 2008

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During the academic year, 2007-2008, the Luke Chair accepted a job offer from the Sungkyunkwn University (SKKU) of Korea to serve as the dean of its Business School from August 1, 2008. Before accepting this job offer, the Luke Chair consulted Mr. Warren K. K. Luke, president and chief executive officer of the Hawaii National Bank, Dr. V. Vance Roley, dean of the Shidler College of Business, and Dr. David McClain, president of the University of Hawaii, on his move which may involve a major change in his academic career. Under their advice, the Luke Chair requested a two-year leave without pay from the University of Hawaii. Even though it was a very difficult career decision, the Luke Chair decided to accept the challenges and opportunities of making the SKKU Business School a world-class academic institution.

This report summarizes the Luke Chair's annual activities during the past academic year, July 2007 - July 2008. This report is structured as follows:

- I. Academic Research Work
- II. Outreaching Activities
- III. Teaching Activities
- IV. Service Activities

I. Academic Research Work

A. Managing Editor of the *Pacific-Basin Finance Journal*

1. New Editor Agreement

Under the new Editor Agreement with Elsevier North-Holland, the Luke Chair began his fourth 5-year term, 2007-2012, as the Managing Editor of the *Pacific-Basin Finance Journal*.

2. Current Status of *the Journal*

A total of 33 manuscripts were published in 5 issues since July 2007. The acceptance ratio remained at around 7-8%.

<u>Issue No.</u>	<u>No. of Ms. Published</u>
Issue 16.4 (2008):	7 manuscripts
Issue 16.3 (2008):	8 manuscripts
Issue 16.1 and 2 (2008):	9 manuscripts
Issue 15.5 (2007):	4 manuscripts
Issue 15.4 (2007):	5 manuscripts
5 issues:	33 manuscripts

In addition, 22 articles have been accepted to be published in the future issues.

3. ***Pacific-Basin Finance Journal* Research Excellence Awards**

Two academic papers recommended by the Program Co-Chairs of the 2008 Asian Finance Association Annual Meeting held on July 6-9, 2008 received the *Pacific-Basin Finance Journal* Research Excellence Awards:

- “Beyond Cash Flow and Voting Rights: Valuation and Performance of Firms in Complex Ownership Structures” by Heitor Almeida, University of Illinois at Urbana-Champaign; Sang Yong Park, Yonsei University; Marti Subrahmanyam, NYU Stern School of Business; and Daniel Wolfenzon, NYU Stern School of Business
- “Share Issuance and Cross-sectional Returns: International Evidence” by Robert David McLean, University of Alberta, Jeffrey Pontiff, Boston College, and Akiko Watanabe, University of Alberta

4. **Special Issues**

- i. A special issue is planned to publish selected papers from the 2008 China International Conference in Finance (CICF) held on July 3-5, 2008 in Dalian, China. The annual CICF has been organized by the MIT Sloan School and Tsinghua University Business School. The following professors agreed to serve as guest editors of this special issue:
 - Dr. Jiang Wang of MIT
 - Dr. Charles Cao of Penn State University
- ii. A special issue on “**Asian Market Microstructure Issues**” will be published in the early part of 2009. Selected papers and keynote address paper by Dr. Avanidhar Subrahmanyam, the Goldyne and Irwin Hearsh Chair in Money and Banking, University of California at Los Angeles, presented at the 2nd Asian Market Microstructure Conference hosted by the University of Sydney will be included in the special issue. Dr. Carol Comerton-Forde of the University of Sydney serves as the guest editor for this issue.
- iii. A special issue focusing on “**Behavioral Finance**” was released (Issue No. 15.1-2). Dr. John Nofsinger of Washington State University and Dr. Kenneth Kim of University of Buffalo served as the guest editors.

5. **Editorial Board**

Forty-four Associate Editors representing 12 countries are on the Editorial Board. Due to the changes of affiliations by some Associate Editors, the updated geographical distribution is shown below. At present, no associate editors are from Indonesia, Malaysia, Philippines, and Thailand.

Geographical Distribution and Total Number of Associate Editors

United States:	25
Canada	3
Hong Kong	3
Singapore	3
Australia	2
Japan	2
China	1
Israel	1
Netherlands	1
New Zealand	1
Taiwan	1
<u>United Kingdom</u>	<u>1</u>
Total	44

B. Academic Research

During the past academic year, the Luke Chair had nine papers either published or accepted for publication.

Academic Papers Published or Forthcoming

"Why Do Foreign Investors Underperform Domestic Investors in Trading Activities? Evidence from Indonesia" (co-authored with Sumit Agarwal, Sheri Faircloth, and Chunlin Liu) forthcoming in *Journal of Financial Markets*.

"How Does the Call Market Method Affect Price Efficiency? Evidence from the Singapore Stock Market" (co-authored with Rosita P. Chang, Gregory R. Stone and Tony Ning Tang) forthcoming in *Journal of Banking and Finance*.

"The Returns to Value and Momentum Strategies in Asian Markets" (co-authored with Stephen Brown, Daphne Du, and Liang Zhang) forthcoming in *Emerging Markets Review*.

"The Return to Value *Strategies in Asian Stock Markets*" (co-authored with Stephen Brown and Liang Zhang) forthcoming in *Emerging Markets Review*.

"*Abnormal Returns with Momentum/Contrarian Strategies using Exchange Traded Funds*" (co-authored with Jack C. DeJong, Jr.) forthcoming in *Journal of Asset Management*.

"Investor Demand for IPOs and Aftermarket Performance: Evidence from the Hong Kong Stock Market" (co-authored with Sumit Agarwal and Chunlin Liu) *Journal of International Financial Markets, Institutions & Money* 18, 176-190.

"Additional Evidence on the Substitution between Shareholder Monitoring and Regulation: The Japanese Banking Experience During the Late-1980s" (co-authored with Kenneth Kim and Sang-Hyop Lee), 2007, *Journal of Economics and Business* 59, 466-486.

“Earnings Management Behaviors under Different Economic Environments: Evidence from Japanese Banks,” (co-authored with Sumit Agarwal, Souphala Chomsisengphet, and Chunlin Liu), 2007, *International Review of Economics and Finance* 16, 429-443.

“Relationship between Bank Monitoring and Firm Value Creation: A Survey” (co-authored with G. Hwan Shin) *Institutional and Policy Reforms to Enhance Corporate Efficiency in Korea* (Lee-Jay Cho, Somi Seong, and Sang-Hyop Lee, editors), (Seoul: Korea Development Institute, 2007), 91-106.

At present, the Luke Chair has six papers under review at different stages and eight papers under final revision for future submission to academic journals.

Academic Papers under Review

“Return Reversals, Idiosyncratic Risk and Expected Returns” (co-authored with Wei Huang, Qianqiu Liu, and Liang Zhang) under review by *Review of Financial Studies* (4th Revision is under review).

“The Impact of Interbank and Capital Market Competition on Relationship Banking: Evidence from the Japanese Experience” (co-authored with Donald R. Fraser and G. Hwan Shin) under review by *Journal of Money, Credit and Banking* (The editor requested for “revise and resubmit”).

“Momentum and Contrarian Returns in Asian Markets” (co-authored with Daphne Yan Du and Stephen Brown) under review by *Journal of Investment Management* (The editor requested for “revise and resubmit”).

“Competition for NASDAQ Order Flow under the New Order Handling Rules” (co-authored with Ning Tang)(1st Submission to *Journal of Financial Intermediation*).

“An Analysis of the Magnet Effect under Price Limits” (co-authored with Yan Du and Qianqiu Liu) under review by the *International Review of Finance* (1st submission).

“Foreign Institutional Ownership and Stock Market Liquidity: Evidence from Indonesia” (co-authored with Jianxin Wang) under review by *Journal of Banking and Finance* (1st submission)

Manuscripts Completed or Under Revision

“The Impact of Short Sales on the Speed of Price Adjustment: Evidence from the Hong Kong Stock Exchange” (co-authored with Crystal Xiaopei Chen).

“Dispersion of Beliefs, Individual and Institutional Trades, and Stock Returns,” (co-authored with Wei Li and Steven Shuye Wang).

“Quote Competition, Preferenced Trading, and Market Quality around Decimalization” (co-authored with Wei Huang and Ning Tang).

“Market Sentiment, IPO Valuation and Underpricing” (co-authored with Cynthia J. Campbell, Yan Du and Ning Tang).

“Inside Blockholdings and Earnings Management in Initial Public Offerings” (co-authored with Kyoko Nagata and Toyohiko Hachiya).

“Earnings Management and the Performance of Seasoned Equity Offerings: Evidence from Japanese Issuers” (co-authored with Liming Guan, Daoping He, and Kyoko Nagata).

“Extreme Downside Risk and Expected Stock Returns” (co-authored with Victor W. Huang, Qianqiu Liu, and Feng Wu).

“Why CEOs File Bankruptcy in Delaware?” (co-authored with Gregory R. Stone)

Paper Presentations

The following papers were presented by either the Luke Chair or by his co-authors at academic conferences:

1. “Why Do Foreign Investors Underperform Domestic Investors in Trading Activities? Evidence from Indonesia” (co-authored with Sumit Agarwal, Sheri Faircloth, and Chunlin Liu) presented at the 2008 Global Finance Journal, May 18-20, 2008, Hangzhou, China.
2. “Market Sentiment, IPO Valuation and Underpricing (co-authored with Cynthia Campbell, Daphne Du, and Tony Ning Tang) presented at the 2008 FMA European Conference, June 4-6, 2008, Prague, Czech Republic
3. “Foreign Institutional Ownership and Stock Market Liquidity: Evidence from Indonesia” (co-authored with Jianxin Wang) presented at:
 - The 2008 China International Conference in Finance, July 3-5, 2008, Dalian, China
 - The 20th Asian Finance Association Annual Meeting, July 6-9, 2008, Yokohama, Japan
4. “How Does the Call Market Method Affect Price Efficiency? Evidence from the Singapore Stock Market” presented at:
 - University of Hawaii Economics Department (September 28, 2007)
 - Monash University (March 19, 2008)
 - Central University of Finance and Economics (May 19, 2008)
 - Korea University (June 4, 2008)
 - Malaysian Finance Association Annual Meeting in Kuching, Malaysia (June 5, 2008)
 - Malaysian Securities Commission (June 24, 2008)
5. “Return Reversals, Idiosyncratic Risk, and Expected Returns” (co-authored with Victor Huang, Qianqiu Liu, and Liang Zhang) presented at:
 - Peking University Gwanghua School of Management (May 20, 2008)

Summer Research Award

The Luke Chair was a recipient of a 2008 Shidler College of Business Research Grant (\$13,000) on the basis of his research productivity in the academic year 2007-2008.

Other Academic Activities

1. The 2nd Annual Microstructure Meeting at the University of Sydney

The Luke Chair participated in the 2nd Annual Microstructure Meeting held on March 14, 2008 at the University of Sydney. Dr. Douglas Foster of Australian National University and the Luke Chair served on the two-person review committee for 15 papers submitted to this conference. At this one-day conference, six papers were presented including the keynote address paper presented by Avanidhar Subrahmanyam, the Goldyne and Irwin Hearsh Chair in Money and Banking at UCLA Anderson School of Management.

2. Monash University

The Luke Chair was invited by the Faculty of Business and Economics of Monash University on March 17-19, 2008. Monash University has two main campuses, Caulfield and Clayton, near Melbourne. The number of students in Business and Economics areas is 7,000 and the finance area alone has 70 fulltime faculty members. Almost 60% of the students are from Asia (China, Hong Kong, Taiwan, Singapore, and Indonesia).

The Luke Chair's activities at Monash University included: (i) a paper presentation; (ii) research forum; and (iii) a series of research meetings with faculty members and Ph.D. students. He presented a paper "How Does the Call Market Method Affect Price Efficiency? Evidence from the Singapore Stock Market" (co-authored with Rosita P. Chang, Gregory R. Stone and Tony Ning Tang) at the finance seminar on March 19. The seminar was attended by approximately 30 faculty members and Ph.D. students. On the morning of March 19, Dr. Robert Faff of Monash University and the Luke Chair were the research forum speakers for Ph.D. students and faculty members. The Luke Chair met many faculty members and Ph.D. students to discuss their current research work.

3. National University of Malaysia (Universiti Kebangsaan Malaysia)

The Luke Chair served as a visiting research professor at the National University of Malaysia during the month of June 2008. His role was to advise faculty members of the Graduate School of Business. The GSB was awarded M\$25 million endowment to make it a major research institution in the region. His activities included: (i) a presentation on "How to Create a World-Class Academic Institution"; (ii) special lecture on "The Subprime Mortgage Crisis from the Financial Market Perspectives"; (iii) interaction with faculty members on their research work; and (iv) assessment of the MBA and Ph.D./DBA programs.

4. Renmin University

During the 10-day period, May 21-31, the Luke Chair was invited by Renmin University of China to give a series of lectures to its Ph.D. students. He delivered five lectures during this period, focusing on research topics he is currently involved with. He also interacted with a number of faculty members in the finance area of Renmin University.

II. Outreaching Activities

To strengthen working relations with the public and private sector institutions and to increase the visibility of the University of Hawaii, the Luke Chair's outreaching activities were conducted in dual capacities, the Luke Chair and the Executive Director of the Asia-Pacific Financial Markets (FIMA) Research Center. His outreaching activities are grouped into two categories: (i) the programs of the Asian Shadow Financial Regulatory Committee (ASFRC); and (ii) policy research and delivery of speeches for public and private sector institutions.

A. Asian Shadow Financial Regulatory Committee

The ASFRC is a group of independent experts on economic and financial markets policy issues relevant to the Asia-Pacific region. ASFRC members are independent of any of the members' affiliated institutions. The policy recommendations of ASFRC are its own. Typically, ASFRC tries to translate concepts drawn from academic literature into concrete policy recommendations. This committee is a part of the Global Shadow Financial Regulatory Committees which include the committees of United States, Europe, Japan, Latin America, and Asia. ASFRC members meet twice a year to study, critique, and make recommendations on policy issues affecting the region as well as individual economies. The UH FIMA Research Center serves as the Secretariat of ASFRC.

During the past academic year, three ASFRC meetings were held:

- The 7th ASFRC Meeting in Hong Kong
- The 8th ASFRC Meeting in Jogjakarta, Indonesia
- The 9th ASFRC Meeting in Tokyo, Japan

1. The 7th Meeting: *Reinterpretation of Global Trade Imbalances*

The 7th meeting of the ASFRC was held in the Hong Kong University of Science and Technology Executive Seminar Room in Central, Hong Kong on July 2 - 4, 2007. The theme of this meeting was "A Reinterpretation of Trans-Pacific Trade Imbalances." K.C. Chan, Professor of Finance and Dean of the School of Business and Management, Hong Kong University of Science & Technology, and Professor Leslie Young, Professor of Finance and Executive Director, Asia-Pacific Institute of Business, Chinese University of Hong Kong were the co-hosts of the Hong Kong meeting.¹

¹ KC Chan was appointed as the Secretary of Financial Services and the Treasury of the Hong Kong Government as of July 1, 2007. Because of this appointment, he can no longer serve on ASFRC until he steps down from the position.

The ASFRC concluded that public discussion of global trade imbalances is based on an outdated model of international trade that ignores the critical role of multinational corporations (MNCs). The trade imbalance between the United States and China is largely a statistical artifact and has little bearing on the capacity of the United States to sustain its standard of living. After heated debates over the two-day period, the ASFRC came to the following conclusions and its position statement which is attached to this report as Appendix A:

The Luke Chair believes that the 7th ASFRC meeting provided a new interpretation of trans-Pacific imbalances by highlighting the critical role of MNCs, which had not been done in the past.

The Luke Chair completed his three-year term as the chair of the ASFRC and the torch was passed on to Maria (Corina) Socorro Gochoco-Bautista, Professor of Economics, University of the Philippines. On the basis of her request, her term will be for one year.

2. The 8th Meeting: *Financial Globalization and its Effects on Local Markets*

The 8th ASFRC meeting was held in Yogyakarta, Indonesia on January 11, 2008. The Luke Chair was unable to participate in the meeting due to conflicts with his teaching schedule. The ASFRC position statement on the impact of globalization on local markets is attached as Appendix B.

3. The 9th Meeting: *Sovereign Wealth Funds*

The 9th ASFRC meeting was held at the University of Tokyo on July 4-5, 2008. The theme of the meeting was “The Role of Sovereign Wealth Funds (SWF)” and this meeting was attended by the Japan Shadow Financial Regulatory Committee members. The position statement was issued by the ASFRC. The statement is attached to this report as Appendix C.

Dr. Sang Yong Park of Yonsei University was elected as the new chair. The future ASFRC meetings will be scheduled as shown below:

- May 6-7, 2009 in Xiamen, China
- October 24-25, 2009 in Seoul, Korea
- May 2010 in Singapore
- October 2010 in Bangkok, Thailand

B. Public and Private Sector Institutions

The Luke Chair continued his policy research work and delivered speeches for a number of public and private sector institutions to increase the visibility of the Shidler College of Business and the University of Hawaii’s Asia-Pacific Financial Markets Research Center.

1. The 9th Seoul International Financial Forum

The 9th Seoul International Financial Forum was held in Seoul on April 16 -17, 2008. The theme of this Forum was “Global Perspective on Investment Banking

Business.” The UH Asia-Pacific Financial Markets (FIMA) Research Center is one of three co-organizers that include: the Financial News and ABN-AMRO. This is the fifth year the FIMA Research Center participates in the Forum as a co-hosting organization.

Approximately 500 people from the local banking, insurance, and securities industries participated in the Forum. Keynote addresses were delivered by:

- Mr. Man-Soo Kang, Minister of the Strategy and Finance
- Dr. Changyong Rhee, Vice Chairman of the Korean Financial Services Commission
- Mr. Jung-hwan Lee, Chairman of the Korea Exchange
- Mr. Henry Jones, Board Member of CalPERS
- Mr. Jong Chang Kim, Governor of the Korean Financial Supervisory Service

As a lead speaker of Session 3 “The Subprime Mortgage Crisis and Its Impact on Regulatory Issues,” the Luke Chair delivered a speech “The Subprime Mortgage Crisis: An Overview.” For this session, the Luke Chair invited the following speakers to discuss various aspect of the crisis:

Dr. Catharine Lemieux, Senior Vice President, Chicago Fed
Dr. Violeta Ciruel, General Manager, ING Bank
Mr. Leo Wah, Senior Vice President, Moody’s (Hong Kong)
Miss Li Li, Managing Director, Kamakura Corporation

2. Seoul National University College of Law Seminar

The Luke Chair was an invited speaker at the Seoul National University’s College of Law research seminar on April 15 (Tuesday), 2008. He talked about financial market integration in Asia focusing on Asian bond market initiatives spearheaded by the ASEAN+Three (China, Japan and Korea). About 50 faculty members and graduate students attended this seminar.

3. Korea Advanced Institute of Science and Technology

At the request of President Nam-Pyo Suh of the Korea Advanced Institute of Science and Technology (KAIST), the Luke Chair served as the chairman of a task force during the period from October 1 to November 21, 2007 to prepare business and strategic plans for the KAIST Graduate School of Global Finance to be created in the near future. KAIST wishes to create a world-class, preeminent research-focused graduate program modeled after the MIT Sloan School and the Hong Kong University of Science and Technology Business School. The list of task force members is shown below:

Chair

- Dr. S. Ghon Rhee, K. J. Luke Distinguished Professor of Finance, University of Hawaii

Members

- Dr. Soonhoon Bae, Vice President, Korea Advanced Institute of Science and Technology
- Dr. Stephen Brown, David S. Loeb Distinguished Professor of Finance, New York University
- Dr. Kee H. Chung, Louis M. Jacobs Professor of Financial Planning and Control, State University of New York at Buffalo
- Mr. Terry Cross, Founder of Windward Associates
- Dr. Kooyul Jung, Dean of KAIST Graduate School of Finance
- Dr. Jun-Koo Kang, MSU Federal Credit Union Chair in Financial Institutions & Investments and Professor of Finance, Michigan State University
- Dr. Bong Soo Lee, Professor and Patty Hill Smith Eminent Scholar Chair in Finance, Florida State University
- Dr. Jae Kyu Lee, Professor of Information Management Systems and Electronic Commerce and Dean of the KAIST Incheon Initiative, Korea Advanced Institute of Science and Technology
- Dr. Avanidhar Subrahmanyam, Goldyne and Irwin Hearsh Chair in Money and Banking, University of California at Los Angeles
- Dr. Sheridan Titman, Walter W. McAllister Centennial Chair in Financial Services, University of Texas at Austin

The task force report was completed but not attached to this report due to its proprietary nature. A brief summary of the task force's recommendations include that the KAIST spearheads the creation of five finance clusters in enhancing the relevance of finance research and education to the challenges facing Korean financial market regulators, policy makers, and the financial services industry. These five clusters will provide the infrastructure that is necessary for the government's goal of creating a North-East Asian financial hub. As an integrated manager of the five finance clusters, KAIST will undertake four critical roles: (i) a bridging role in linking government, financial services industry, and academia in the global and regional communities; (ii) a catalyzing role in defining best practices for the Korean financial market environment; (iii) a facilitating role in promoting academic and policy research and in disseminating research findings to global, regional, and Korean stakeholders; and (iv) an educating role in training finance professionals to meet the demand from the Korean financial services industry. The five finance clusters include:

- Cluster I: KAIST Graduate School of Global Finance
- Cluster II: Global Outreach Program: Government and Industry
- Cluster III: Regional Outreach Program: Academic Institutions
- Cluster IV: Outsourcing Program: Domestic Institutions
- Cluster V: Outsourcing Program: International Academic Institutions

4. The Third International Finance Conference

Dr. Yung Joon Lee, Professor of Economics of Pusan National University, Dr. Choong Young Ahn, Professor of Chung-Ang University, and the Luke Chair served as co-chairs of the Third International Finance Conference which was held on November 5, 2007 in Pusan, Korea. The UH FIMA Research Center was one of four co-hosts of this conference along with Pusan National University's International Financial Forum, the

Korea Institute for International Economic Policy, and the Korean Regional Finance Association.

The theme of the conference was “the Asian Bond Market and the Financial Market Development for APEC Countries.” The following keynote speakers delivered their speeches:

- Mr. In Kang Cho, Director General for Financial Policy, Korean Ministry of Finance and Economy
- Mr. Kun Ho Hwang, Chairman of Korea Securities Dealers Association

At the conference, the Luke Chair presented “An Overview of Asian Bond Markets.” Approximately 100 attendees from the local securities and banking industry and faculty and graduate students from the Pusan National University attended the Conference.

III. TEACHING ACTIVITIES

A. Teaching

During the Spring semester of 2007, the Luke Chair taught two undergraduate sections of FIN314 “Investments.”

B. Supervision of Ph.D. Dissertation Work: Dissertation Chair

The Luke Chair has been continuing his involvement in the Ph.D. dissertation research by the finance-area Ph.D. students in his capacity as dissertation chair. During the academic year, the following Ph.D. students completed their dissertation research under the Luke Chair’s guidance.

- Jack De Jong:

Dissertation Topic: Exchange Traded Fund
Final Defense: August 2007

Jack De Jong joined the School of Travel Industry Management of the University of Hawaii as Assistant Professor upon completion of his Ph.D.

- Liang Zhang:

Dissertation Topic: Asset Pricing Issues of Penny Stocks
Final Defense: August 2008 (expected)

Liang Zhang will join the University of Melbourne as of September 2008.

Both Iris Zuo and Feng Wu successfully defended their dissertation proposals.

- Iris Zuo:

Dissertation Topic: Stock Price Manipulation

- Feng Wu:

Dissertation Topic: Downside Risk and Stock Returns

2. External Examiner

The Luke Chair will serve as an external examiner of the Ph.D. dissertation entitled “The title of the thesis is “ASEAN Trade and Exchange Rate Patterns: Possibility Towards Adopting A Common Currency” by Mr. Cho Cho Wai of the University of Malaya.

IV. SERVICE ACTIVITIES

The Luke Chair’s internal and external service activities are geared to the promotion of academic research work.

A. External Service

1. The 19th Annual Meeting of the Asian Finance Association

A. The Background of the Meeting

The 19th Annual Meeting of the Asian Finance Association (AsFA) was held on July 4 - 7, 2007 in Hong Kong. The Meeting was hosted by the Chinese University of Hong Kong and attended by approximately 250 participants. The reason for the small turnout was due to the change of host institution. Originally, the meeting was supposed to be held in Singapore with the Singapore Management University serving as the host. But, SMU pulled out at the last minute and the Chinese University of Hong Kong had to jump in as a white knight.

B. Luke Chair’s Role at the Meeting

The Luke Chair served as a Program Committee member of this Meeting and he presented two papers “The Impact of Short Sales on the Speed of Price Adjustment: Evidence from the Hong Kong Stock Market” (co-authored with Crystal Xiaopei Chen) and “How Does the Call Market Method Affect Price Efficiency: Evidence from the Singapore Stock Market” (co-authored with Rosita P. Chang, Gregory R. Stone, and Tony Ning Tang). The first paper on the speed of price adjustment was honored by a research excellence award at the Conference Dinner on July 7. The ASFRC organized a special session at the Meeting to introduce its activities and position statement on global trade imbalances. As a board member, the Luke Chair also attended the AsFA Board meeting.

Victor Wei Huang and Rosita P. Chang also participated in the Meeting. Victor presented his academic paper and Rosita attended the AsFA Board Meeting. Keynote speakers included:

- James Mirrlees, 1996 Nobel Laureate in Economics, Cambridge University
- Franklin Allen, the Nippon Life Professor Economics, University of Pennsylvania

- Randall Morck, University Professor of the University of Alberta
- Jay Ritter, the Joseph B. Cordell Eminent Scholar, University of Florida

C. *Pacific-Basin Finance Journal*

At the request of the Conference Program Chairs, the following three papers were awarded PACAP Research Excellence Awards. The authors of these papers were recognized at the Conference:

- The Effect of Board Structure on Firm Value in an Emerging Market: IV, DiD, and Time Series Evidence from Korea:

Bernard S. Black, University of Texas Law School
Woochan Kim, KDI School of Public Policy and Management

- The effect of cross listing on the sensitivity of managerial compensation to firm performance:

Bin Ke, Pennsylvania State University
Oliver Rui, Chinese University of Hong Kong
Wei Yu, Chinese University of Hong Kong

- Information Based Trade, PIN Variable, and the Portfolio Style Differences: Evidence from Tokyo Stock Exchange Firms:

Keiichi Kubota, Musashi University
Hitoshi Takehara, Waseda University

2. **The 20th Annual Meeting of the Asian Finance Association**

A. ***The Background of the Meeting***

The 20th Annual Meeting of AsFA was held on July 6-9, 2008 in Yokohama, Japan. The Meeting was co-hosted by the Nippon Finance Association with the theme “The Mission of Financial Studies in Globalized Economy.” Professor Eduardo S. Schwartz, the California Chair in Real Estate and Land Economics of the UCLA Anderson School of Management, and Professor Kenneth J. Singaleton, the Adams Distinguished Professor of Management and a Senior Associate Dean for Academic Affairs at the Stanford University Graduate School of Business were the two keynote speakers.

In addition, the following professors served as invited speakers:

- Jiang Wang, the Mizuho Financial Group Professor at MIT
- Guofu Zhou, Olin Graduate School of Business of Washington University
- Sheridan Titman, the McAllister Centennial Chair in Financial Services at the University of Texas-Austin
- Michael L. Lemmon, Wasatch Advisors Professor at the David Eccles School of Business, University of Utah

- Jerome B. Detemple, Everette W. Lord Distinguished Faculty Scholar at Boston University
- Roger G. Ibbotson, Yale School of Management

B. Luke Chair's Role at the Meeting

The Luke Chair's role included: (i) presentation of two papers; (ii) served as a session chair; (iii) served on the Conference program committee; and (iv) participation in the AsFA Board Meeting. The following two papers were presented:

- "Foreign Institutional Ownership and Stock Market Liquidity: Evidence from Indonesia" (co-authored with Jianxin Wang) presented by Jian-xin Wang, University of New South Wales
- "Return Reversals, Idiosyncratic Risk and Expected Returns" (co-authored with Wei Huang, Qianqiu Liu, and Liang Zhang) presented by Qianqiu Liu

On behalf of the University, Rosita P. Chang and Qianqiu Liu also participated in the Conference.

3. The Ohana Pacific Bank

The Luke Chair has been serving as an outside director of the newly established Ohana Pacific Bank. This bank is a state-chartered bank and began its operations from June 1, 2006. This Bank serves ethnic minority business owners (Koreans, Chinese, Filipinos, Vietnamese, and Indonesians) in Hawaii. Because his time will be severely limited with the full-time work as the dean of SKKU Business School, he resigned from the directorship as of August 2008. Dr. Rosita P. Chang will replace him as an outside director.

4. National University of Malaysia

The Luke Chair has been serving as an External Assessor for the Department of Finance and Banking of the Faculty of Business and Accounting, January 2007 – April 2008.

B. Internal Service: University and College Committee Work

The Luke Chair has been actively involved with the University-level committee as well as the Shidler College of Business committees.

- University Research Council (2005-Present)
- Review Committee for the Shidler College of Business Endowed Chair Professors (2007)

**Appendix A:
Asian Shadow Financial Regulatory Committee**

Asian Shadow Financial Regulatory Committee

***A New Perspective on Global Imbalances: the Role of
MNCs***

**Statement No. 8
Hong Kong, July 5, 2007**

Abstract

The global imbalances that threaten to provoke major international trade conflicts may be a statistical artifact, arising from an outmoded accounting for international trade that ignores its present domination by multinational corporations. Regional governments should update their international accounting; the first step would be to mandate the disclosure of data on the ownership and control of multinational corporations and the terms of their transactions amongst subsidiaries.

STATEMENT

Public discussion of global trade imbalances is based on an outdated model of international trade that ignores multinational corporations (MNCs). That outdated model postulates firms owned and located in one country, i.e., with clear national identities, which export goods to other countries. A country's current account would then indicate its ability to sustain its living standards.

However, international trade today is largely a by-product of MNC operations. Since the 1980s, MNC affiliate sales have been a more important way to penetrate export markets than traditional cross-border exports. Sales of MNC affiliates in their host countries are about 2 times their exports of goods and services. For US MNCs, affiliate sales in host countries are about 3 times their exports. About half of all international trade in goods and services is by MNCs. More than half of MNC international trade is internal: affiliates in one country trade finished and unfinished goods, services and intangibles with the parent and sister affiliates (Zeile, 2003).

The core of an MNC is a set of soft skills in management, sourcing, branding, marketing, technology, logistics and finance. These skills have no clear national identity, or legal domicile. Ownership and capital structures are flexible and respond to local political and business conditions. Tax differentials alone do not drive investment decisions, although tax and legal expertise is mobilized to ensure global tax efficiency by booking profits in low-tax jurisdictions. This is achieved by manipulating the terms of trade and of loans amongst affiliates, and the fees charged for intellectual property, trademarks and brands. Ownership of these intangibles is located in affiliates domiciled in tax havens to minimize exposure to tax and litigation. Profits booked there are typically recycled into new investments in other countries.

The following issues are raised by the role of MNCs in international trade.

The Country Running a Large Trade Surplus May Derive Little Benefit From It

Today, MNCs coordinate complex supply chains that pass through many countries. Consequently, the exports of final products often embody the value added by many different countries. Under current trade accounting practices, the entire value of the finished product is included in the exports of the nation of the final-stage producer, which might add the least value. Case in point: China, the last stop in a multi-stage pan-Asian production system that dominates global manufacturing. Since the 1990s, China has been importing advanced components from Japan and South Korea; other components from Hong Kong, South Korea, and Taiwan; yet other components and subassemblies from Southeast Asia. So China runs a trade surplus with the West but a trade deficit with the rest of Asia. In effect, China aggregates the trade surplus of East Asia with the U.S. and Western Europe, takes the political heat, but captures relatively little of the value that it adds to final products.

MNC Activity Distorts the Meaning of International Trade Accounts

MNC affiliate sales within their host countries are not included in trade balances, but are counted in host country GDP. MNC affiliate sales from the host country to other countries are counted as exports of the host country. This accounting practice overstates

the current account surplus of a country like China with heavy inward foreign direct investment (FDI). This surplus would be reduced if sales outside China by affiliates of foreign-owned MNCs were excluded from its exports and sales within China by affiliates of foreign-owned MNCs were included in its imports. The trade accounting system overstates the current account deficit of a country like the US, with heavy outward FDI. This deficit would be greatly reduced if sales outside the US of overseas affiliates of US MNCs were included in US exports and sales back to the US of overseas affiliates of US MNCs were excluded from US imports.

A nation's international accounts should record changes in its capacity to deliver future income to citizens and to meet international obligations. So, it should include the income of overseas branches of US-owned MNCs in US national income and their sales abroad from US exports, but exclude their sales to the US from US imports. It should exclude the income of US branches of foreign-owned MNCs from US national income and their sales abroad from US exports, but include their sales to the US in US exports. These arguments assume that foreign branches of US MNCs are taxable by the US government and are thus part of its capacity to meet its international obligations. However....

Transfer Pricing and Corporate Tax Avoidance

If an MNC earns profits in a foreign jurisdiction that deducts taxes, then those profits are not subject to US taxes until repatriated. This is an incentive for "transfer pricing": setting prices for transactions within the MNCs to shift profits out of the US to subsidiaries in low-tax jurisdictions, followed by complicated offshore transactions that defer the US tax burden indefinitely (Desai *et. al.*, 2003). The vitiation of corporate taxation by transfer pricing was confirmed by the US General Accounting Office (2004), which reported that, of those US-controlled corporations with assets of at least \$250 million (representing 93 percent of all corporate assets reported to the IRS), more than 60 percent paid no federal taxes between 1996 and 2000. Those untaxed corporations received \$3.5 trillion of revenues. 71 percent of foreign-based firms operating in the U.S. during that period paid no U.S. taxes.

Christian and Schultz (2005) estimate that MNCs are shifting \$87 billion of pre-tax income out of the U.S. each year - net of income shifted into the country. Pak and Zdanowicz (2002) conclude that MNCs used transfer pricing to avoid \$53.1 billion in taxes during 2001, up from \$35.7 billion in 1998. Sullivan (2004) inferred that US-based MNCs have shifted about \$75 billion a year to foreign subsidiaries. Over the preceding 12 years, their profits booked to foreign jurisdictions more than tripled — from \$89 billion in 1993 to \$298 billion in 2004. Such bookings surged from \$8.5 billion to \$25.2 billion in no-tax Bermuda and from \$13.4 billion to \$26.8 billion in low-tax Ireland.

China, today the largest recipient of FDI, is another major victim of transfer pricing. Li and Paisley (2007, p. 26) report that "the tax revenue statistics show that 35 percent to 40 percent of foreign investment enterprises were in a loss-making position from 1988 to 1993. For 1994 and 1995, the percentage increased to between 50 percent and 60 percent. Between 1996 and 2000, 60 percent to 70 percent of foreign companies reported losses. The Chinese Government estimates that 60 percent of the reported losses by these companies is attributable to transfer pricing maneuvers." The high and rising percentage of firms reporting losses over the period 1988-2000 invites skepticism, given the flood of FDI into China over the same period. We conjecture that one major

attraction was the high profits that could be siphoned out untaxed via transfer pricing: China's State Administration of Taxation has only 20 transfer pricing specialists to oversee 330,000 foreign invested enterprises (Chung (2007)).

Worldwide, the scope for transfer pricing within MNCs is vast. The US Census Bureau reports that in 2005, related party trade accounted for 47 percent (\$776 billion) of US imports and 31 percent (\$283 billion) of US exports. Related party trade accounts for increasing shares of US trade with Pacific Rim Countries such as Taiwan, China and Korea. However, even these figures may understate the phenomenon, given the obscure ownership of many international trading companies. The tax havens of Hong Kong, British Virgin Islands, the Caymans and Samoa accounted for 50.18 percent of investment into China in 2005, 55.70 percent in 2006 and 61.95 percent in the first quarter of 2007.² Much of this is Chinese capital on a "round trip" via the tax havens to exploit China's tax concessions to foreign enterprises. The related parties have every incentive to use transfer pricing to shift profits out of China.

Aggregating National Trade Current Accounts Implies World Trade with Mars

Another indicator of the limitations of BOP accounting is the large discrepancies reported by the IMF Committee on Balance of Payments Statistics when it aggregates the current accounts reported by all countries. For example, the first line of the table below indicates that in 2005, the world as a whole ran a current account surplus in goods of US\$53 billion, which would require interplanetary trade!

2005 world current account balance	US\$ (billion)
Goods	+53
Transportation	-84
Travel	+40
Government services	-39
Other services	+95
Reinvested earnings	+115
Portfolio and other investment income	-130
Other direct investment income	-47
Current transfers	-24
Aggregate	-27

Some Conjectures

The above considerations point to the following conjectures:

- (i) The trade imbalance between the US and China is largely a statistical artifact, and has little bearing on the capacity of the US to sustain its standard of living.
- (ii) Appreciation of the yuan would not have a significant impact on China's current account surplus. Such appreciation would have little effect on a MNC's overall

²See <http://www.mofcom.gov.cn/aarticle/tongjiziliao/v/200704/20070404572808.html>, the website of China's Ministry of Commerce

profitability, given the reduced yuan costs of their inputs from the rest of Asia. The MNC could readily offset the effects of the yuan appreciation by cutting the yuan prices of internal sales to their US subsidiaries.

- (iii) If international transactions were booked at arms-length prices and MNCs refrained from tax arbitrage, then the US Treasury could collect substantial additional revenue to reduce its budget deficit — and indirectly its current account deficit.
- (iv) The recent surge in China's current account surplus is largely the byproduct of MNC transfer pricing to book profits in China to speculate on a yuan appreciation, on China's stock market and on real estate. The resulting rise in China's reported current account surplus raised expectations of further yuan appreciation, which led to more manipulation of transfer prices in a destabilizing feedback loop.
- (v) The possibility of booking profits to offshore subsidiaries in jurisdictions with weak disclosure requirements exposes minority shareholders to massive expropriation by controlling shareholders via related party transactions.
- (vi) Reported growth rates in a country's GDP and trade balance do not indicate the growth of economic opportunities for its citizens; that would require identifying who owns the income generated.

More Transparent International Trade Accounts

While the above propositions would re-orient major debates in international economics and finance, the statistical basis for evaluating them is weak. US law now mandates the collection of relevant data by its Bureau of Economic Analysis (BEA), a unit of the US Department of Commerce. This has allowed the BEA to develop an ownership-based framework for the current account, which indicated that the 2003 US trade deficit was overstated by \$118.9 billion or 24 percent. Another finding was that in 2004, US MNCs earned \$315 billion profits overseas, an increase of 24% over the previous year and about half the current account deficit of the US.

Asian countries should emulate the US drive for transparency in MNC operations in order to clarify the distribution of the gains from international trade and investment. Greater transparency would also allow a more realistic, and more constructive, view of MNC operations. For example, countries could better evaluate the likely impact of tax incentives and weigh the benefits against the foregone tax revenue. They might well find that the key to attracting FDI is not tax concessions, but improvements in their infrastructure, workforce, managerial skills and business environment.

We recommend that Asian governments update their international accounts; the first step would be to mandate the disclosure of data on the ownership and control of MNCs, and the terms on which they book internal transactions in trade and finance and payments for intangibles located offshore. MNCs ought to be willing to provide such data for research purposes, as researchers can help dispel hostile speculation, pinpoint weaknesses in corporate governance and highlight the critical skills that MNCs bring to their host countries.

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Appendix B: Asian Shadow Financial Regulatory Committee Statement No. 9

Jogyakarta, January 12, 2008

Financial Globalization and its Effects on Local Markets

Financial globalization results from opening capital markets to cross border capital flows. Institutional developments associated with financial liberalization include improvements in the system of financial regulation, such as more transparent accounting and disclosure standards, the adoption of a better macroeconomic policy regime, such as more responsible fiscal policy and an exchange rate regime compatible with more open capital accounts, improvements in the legal system such as clearer bankruptcy procedures, etc. The benefits of financial globalization include greater economic efficiency arising from the better allocation of capital, access to cheaper capital and high return savings instruments, greater liquidity, portfolio risk diversification and consumption smoothing. Many economies in Asia liberalized their financial markets beginning in the early 1990s. In contrast with the situation two decades ago, Asia today is a net exporter of capital to developed countries. Asian savings, reflected in large current account surpluses, are largely intermediated in global financial markets and then return to Asia in the form of predominantly private capital flows. Indeed, many studies point out that economies in Asia are more integrated with global financial markets than they are with regional financial markets. The extent of regional financial integration is evidently mainly due to increased regional trade integration. Asian currencies are generally experiencing appreciation relative to the US dollar. Asian economies appear to be operating in a benign environment without any apparent threat of another financial crisis in the foreseeable future.

Nevertheless, there are risks associated with financial globalization that may adversely affect outcomes for economies in Asia. The potential risks from financial globalization are further exacerbated when coupled with financial innovation. Financial innovation gives rise to new instruments, such as structured financial products that allow securitization and bundling and unbundling of risks, which in turn enhances the liquidity of these financial instruments. This induces very high leverage and interconnectedness among financial products and financial markets. The combined effects of these could substantially increase local market volatility, possibly leading to financial crisis.

Moreover, two prevailing features of foreign financial institutions in emerging market investments may exacerbate the potential risks discussed above. The first is the asymmetric incentive structure of investment managers. Fund managers and traders in global financial firms often receive six to seven figure annual bonuses when their risk taking strategies succeed, but may simply quit their jobs when they fail. Such an incentive structure tends to encourage excessive short-term risk taking. The second feature is the tendency of foreign institutions to lump all emerging markets into one asset

class. Foreign investment firms increase their investments in emerging markets in order to pursue opportunities for higher return in a low interest environment. When the competition among these investment firms lowers the spreads between yields on emerging market investments and their funding costs, they raise the size of their bets to maintain the same amount of absolute returns. Since many firms follow the same practice and exhibit herding behavior, asset price bubbles tend to develop. If one country's asset bubble bursts, the likelihood is high that investors will dispose of emerging countries' assets simultaneously, as these are regarded as belonging to one asset class, which may result in adverse price reactions across all emerging markets.

Emerging economies should seek to mitigate risks stemming from two types of adverse impacts of financial globalization: one from financial innovation and the other from the investment and management practices of global financial firms. First, regulators should not hastily allow the introduction of new financial instruments that are of the structured type with very high leverage but whose inherent risks are opaque. The decision to do so should be based not only on the skills of regulators themselves, but also on the financial maturity of domestic investors. Second, the government should deter excessive reliance on leverage. Derivatives, which play an increasingly prominent role in financial innovation and financial globalization, have inherently high leverage content. If leverage is used in financing investments with derivative content, the economy could become very vulnerable to financial shocks. Third, regulators should require foreign investing institutions to disclose the ultimate owners of these at the time of registration. By knowing the owners' identity and their investment and management practices, financial regulators could then better understand the incentives and potential impact of foreign investors on local markets. Fourth, governments in the Asian region should actively promote regional bond market initiatives such as ABF (Asia Bond Fund) and ABMI (Asian Bond Market Initiative) so that the surplus savings from the region could be more efficiently invested in the region through regional intermediaries that have more sound incentive structures.

Over the past five years, Asian financial markets have performed superbly in terms of growth and return. This has created a sense of euphoria among investors (and perhaps regulators as well) and attracted enormous flows of capital into the region. As a result, risks embedded in these external capital flows have intensified. This is precisely the time for policymakers to rethink their assumptions about the optimality of the situation in Asia today. They need to revisit and learn the important lessons from past financial crises here and elsewhere in the world. More importantly, policymakers today need to adopt a risk management approach to policymaking in order to reduce the risk of the occurrence of financial crisis and mitigate the adverse effects of financial globalization on local markets.

Appendix C: Shadow Financial Regulatory Committees of Asia and Japan

**Joint Statement
Tokyo, July 7, 2008**

Making Sovereign Wealth Funds Mutually Beneficial

Summary

Many surplus countries are setting up Sovereign Wealth Funds. Their increase in number and size, and their move into equity investments have provoked fears, not only in developing countries but also in Western countries. The solution currently proposed by the IMF is to commit the Sovereign Wealth Funds to a code of best practice. This would not address the fundamental problem: distrust of foreign powers in commercial decisions. However, the fears could be alleviated if sovereign investment were channeled via a number of competing “Mutual Wealth Funds”, each with diverse sovereign investors. Such collective investment vehicles would insulate sovereign investment from the control of any particular country.

1. Foreign exchange reserves in surplus countries now far exceed what they require for import cover and exchange rate stabilization. The low returns on US Treasury securities and fear of US dollar depreciation have led to a search for investments with higher returns. For this purpose, many countries have established Sovereign Wealth Funds (SWFs). Since global imbalances are likely to grow for the foreseeable future, SWFs are likely to become even more prominent.

2. The increasing number and size of SWFs and their shift to equity investment have created tensions. Western democracies welcome foreign investment in their bonds, and investment in their companies by private foreign companies and by state-linked entities controlled by democratic governments. But suspicion and fear have greeted investment in Western companies by entities controlled by states such as China, Russia, and the Gulf Petro-powers — which run the largest surpluses.

3. Concerns about SWFs include:

- a) Manipulation of corporate policies to advance the sovereign investor's geopolitical agenda
- b) Foreign control of strategic assets
- c) SWF extraction of commercial secrets
- d) SWF abuse of market power
- e) Meddling by inefficient state bureaucracies

4. The only proposals to address such concerns that countries are likely to accept consist of requiring SWFs to commit to a code of best practice. An example is the recent agreement between the US Treasury, Singapore and Abu Dhabi, which is likely to form the basis for the code that the IMF is scheduled to deliver in October 2008. However, even if an SWF is committed to such a code, it is unlikely to alleviate the concerns, since politicians in recipient countries could always detect a geopolitical agenda in any large commercial decision. The basic problem is a fundamental distrust in any entity controlled by a foreign power. This distrust is likely to be extended to the foreign power's commitment to the code of conduct.

5. Then, what is a credible mechanism by which an SWF can commit to a code of conduct? We propose that SWFs invest a portion of their funds through a "Mutual Wealth Fund" or "MWF" whose ownership and governance structure would make it credible so that all its investors would operate purely on the basis of commercial principles. The MWFs would have:

- A charter that commits them to transparency and good corporate governance, for example, the code of conduct to be proposed by the international working group led by the IMF
- Professional managers supervised by a board that represents SWF shareholders
- A limit on the percentage of shares held by the SWF of any individual country, or group of countries with similar economic and political interests, such as oil exporters

An MWF with these features would have heterogeneous ownership and would set investment policies collectively, but would leave them to be implemented by independent professional managers. This would prevent any single country or group of similar countries from controlling managerial decisions to suit itself. This should alleviate the concerns listed in paragraph (3). Further reassurance would be provided if each country allocated its surplus across several MWFs led by independent managers. The MWFs would have to compete for SWF investment on the basis of investment performance;

they would have to compete for investment opportunities on the basis of their transparency and record of political independence.

6. An MWF could be launched at the initiative of a reputable investment management company, a group of surplus countries, or by a neutral country with no SWF, such as Japan. MWFs would differ from existing mutual funds by investing for the long-term, rather than competing on the basis of relative quarterly performance to attract and retain retail investors. MWFs would differ from the current outsourcing of sovereign asset management to investment companies by (i) sourcing funds from a variety of countries and pursuing only long-term objectives that are collectively agreed and (ii) committing to transparency and good global citizenship.

7. MWFs may provide attractive vehicles for countries with large surpluses that seek to recycle them for high long-term returns without controversy, as well as for countries with smaller surpluses that lack the experience and institutional infrastructure for sovereign investment. The credibility of an MWF would be enhanced by participation from SWFs of neutral “global citizens” like Norway and New Zealand.

8. Rising energy prices and global imbalances require economic cooperation between surplus and deficit countries, but the growing prominence of SWFs has created political tensions between them. The MWF proposed here would provide a useful vehicle for cooperation, as they would operate on sound economic principles, yet diffuse political tensions.