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Institutional Ownership Concentration, Organizational Decision-Making, and Liquidity Fragility: Evidence from Chinese Small-Cap Stocks

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Abstract

Purpose: This article examines whether the way institutional ownership is distributed matters for liquidity risk in small-cap equities. It focuses on a practical distinction that is often blurred in research and portfolio monitoring: a stock may have substantial institutional participation while still depending on only one or two large holders for most of that participation.

Design/methodology/approach: The study combines an integrative review of research on institutional herding, fund flows, investment horizons, common ownership and funding shocks with an embedded re-analysis of a Chinese A-share panel. The panel contains 1,434 fund-held small-cap stocks and 313,145 stock-day observations from August 2023 to June 2024. A two-way fixed-effects model tests whether pre-stress fund-holding concentration predicts low-turnover limit-down closes during the 2024 small-cap sell-off.

Findings: Higher pre-stress concentration is associated with a greater probability of a low-turnover limit-down close. A one-standard-deviation increase in the fund-holding Herfindahl index corresponds to a 0.076 percentage-point rise in the daily probability of that outcome. Total fund ownership and the number of fund holders do not show the same positive relationship. The evidence is consistent with a dominant-holder channel, although the data do not identify redemptions, coordinated selling or unexecuted orders directly.

Practical implications: Risk monitoring should compare ownership concentration with feasible exit capacity. Asset managers, listed firms and regulators can obtain a more useful stress signal by combining concentration measures with turnover, market depth, recent fund flows and the constraints imposed by price-limit rules.

Originality/value: The article recasts liquidity fragility as an organizational exposure. The relevant issue is not simply how much institutions own, but how decision authority and potential selling pressure are concentrated across asset-management organizations.

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Keywords: institutional ownership concentration; organizational decision-making; mutual funds; liquidity risk; small-cap stocks; A-share market

1. Introduction

Institutional investors are often described as a stabilizing force because they invest in research, monitor corporate managers and trade on information. That description is only part of the picture. Funds are also organizations with their own cash obligations, performance targets, risk limits, benchmark rules and reporting cycles. A portfolio decision made inside one asset-management firm can therefore become a large order in a stock whose normal trading capacity is limited.

This organizational perspective matters most when institutional ownership is concentrated. Two stocks can have the same aggregate fund ownership but very different risk profiles. In one, the position may be divided among many independent funds

with different mandates and liquidity needs. In the other, one large fund or a small group of related funds may control most of the institutionally held shares. The second stock is more exposed to a single decision process, even when its total institutional ownership is not unusually high.

The distinction is especially important for small-cap stocks. Their order books are usually thinner, normal turnover is lower, and a position that appears modest on a fund's balance sheet may still represent several days of market volume. When a large holder needs cash quickly, there may be too few natural buyers to absorb the sale without a sharp adjustment in price. In markets with daily price limits, part of that adjustment may appear as a limit-down close accompanied by unusually low turnover rather than as a fully completed trade.

This article asks a direct question: does the concentration of institutional ownership, rather than the overall level of institutional participation, help explain liquidity fragility during market stress? The question is examined in two ways. First, an integrative review brings together evidence on herding, fund-flow pressure, short investment horizons, common ownership, exchange-traded funds and intermediary funding shocks. Second, an existing panel of Chinese small-cap A-shares is used to test whether pre-stress fund-holding concentration predicts a low-turnover limit-down state during the 2024 sell-off.

The article makes three contributions. It treats ownership concentration as an organizational exposure rather than a purely statistical characteristic. It separates that exposure from the event that activates it, such as redemptions or funding pressure. It also shows why market design affects the form in which liquidity stress is observed. These points connect finance research with a broader management concern: how the concentration of decision authority can create operational and market risk when the surrounding system has limited capacity to absorb a rapid response.

2. Conceptual Background and Hypothesis Development

2.1. Ownership concentration as an organizational exposure

Aggregate institutional ownership measures the proportion of shares held by professional investors. It does not reveal how many independent decision makers control those shares. This omission is consequential because a fund is not merely an account name. It is part of an organization with common senior management, shared risk systems, similar valuation models and, in some cases, coordinated trading processes. Nominally separate portfolios may therefore react to the same signal at roughly the same time.

A dispersed holder base can reduce dependence on any one organization. Even when several funds sell, their reasons and timing may differ. Concentration has the opposite effect. If one holder controls a large share of the institutionally held float, a change in that holder's portfolio can produce a trade that is large relative to normal market activity. The exposure exists before any crisis begins; stress determines whether it becomes visible.

2.2. Institutional liquidity demand and correlated selling

Prior research shows that institutional trades are not independent. Wermers (1999) [14] documents mutual-fund herding, while Sias (2004) [11] finds that institutions respond both to the trades of other institutions and to their own previous trades. Herding is not necessarily irrational. Funds may receive similar information or use comparable models. From a liquidity perspective, however, the motive matters less than the possibility that several portfolios will demand the same trade at once.

Flow-based studies provide a clearer view of the trigger. Lou (2012) [10] identifies temporary price pressure associated with flow-induced trading. Jotikasthira *et al*. (2012) [8] show that funding shocks affecting developed-market funds can be transmitted to emerging-market positions. Etula *et al*. (2020) [6] find that predictable institutional cash needs around month-end generate selling pressure, trading costs and later reversals. In each setting, the pressure begins with the intermediary rather than the issuing firm.

The effect also depends on the type of holder and the liquidity of the security. Cella *et al*. (2013) [5] report that short-horizon institutions sell more aggressively during turmoil. Aragon and Strahan (2012) [3], using the Lehman bankruptcy as a funding-liquidity shock, find a larger deterioration in stocks that were already illiquid and were held by affected hedge funds. These findings suggest that institutional ownership cannot be classified as uniformly stabilizing or destabilizing. The holder's constraints and the stock's trading capacity jointly shape the outcome.

2.3. Common ownership, exit capacity and market design

Connections among portfolios provide another route through which pressure can spread. Antón and Polk (2014) [2] find excess return comovement among stocks linked by active mutual-fund ownership. Koch *et al*. (2016) [9] document greater commonality in liquidity among stocks with high mutual-fund ownership and relate that pattern to common owners and correlated fund-level liquidity shocks. Ben-David *et al*. (2018) [4] show that exchange-traded fund ownership can increase the volatility of underlying stocks through arbitrage activity. Although these studies use different outcomes and research designs, all point to the structure of ownership rather than its aggregate size alone.

The ability of the market to absorb an order can be described as exit capacity. It depends on normal turnover, order-book depth, the diversity of potential buyers and the capital available to liquidity providers. Illiquidity differs markedly across firms and is priced by investors (Amihud, 2002) [1]. Concentration should therefore be most consequential when it coincides with weak exit capacity. Daily price limits add a further condition: when the permissible price move is exhausted before selling pressure is cleared, the remaining imbalance may be reflected in a limit-down close with low completed turnover.

The preceding argument leads to the following hypothesis:

H1: Conditional on total fund ownership and the number of fund holders, greater pre-stress concentration of fund holdings is associated with a higher probability of liquidity fragility during a market-stress episode.

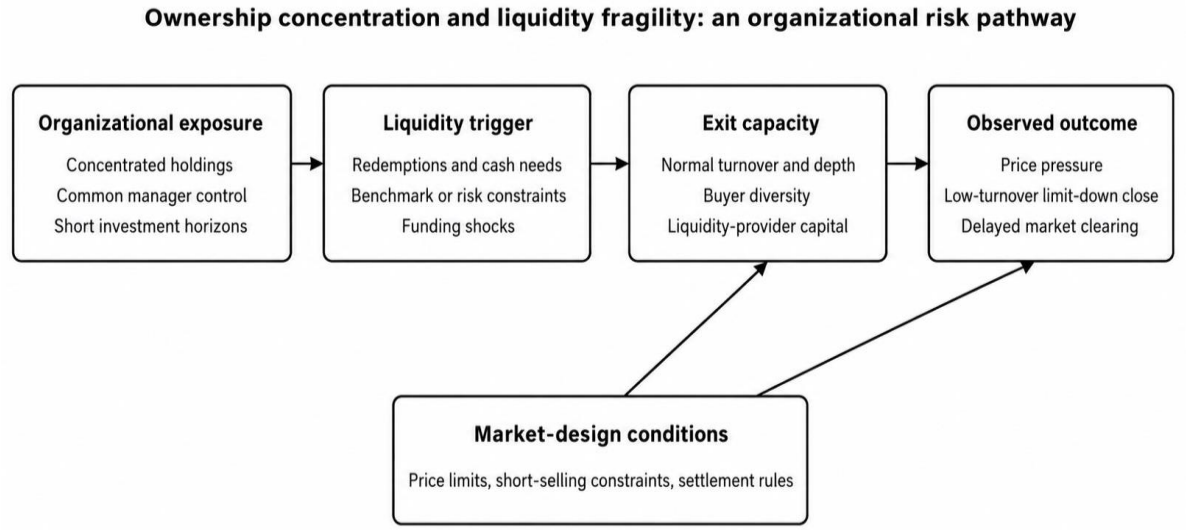
3. Research Design

3.1. Integrative review and triangulation

The research question crosses asset pricing, market microstructure, institutional investment and market regulation. An integrative review is therefore more suitable than a narrow review of one outcome variable (Torraco, 2005; Snyder, 2019) [13, 12]. The review is selective rather than meta-analytic. Studies were included when they directly examined institutional trades, investor flows, trading horizons, common holding links, funding shocks or liquidity

effects. The core empirical evidence comes from Wermers (1999) [14], Sias (2004) [11], Lou (2012) [10], Jotikasthira *et al.* (2012) [8], Cella *et al.* (2013) [5], Antón and Polk (2014) [2], Koch *et al.* (2016) [9], Ben-David *et al.* (2018) [4], Etula *et al.* (2020) [6], and Aragon and Strahan (2012) [3].

The triangulation follows the broad logic proposed by Jick (1979), while recognizing that different designs provide different levels of causal leverage. Trade-level studies and natural experiments speak more directly to the mechanism. The Chinese panel is used for a narrower purpose: it tests whether an outcome shaped by price limits is associated with ownership concentration in the direction implied by the wider literature. Agreement across methods strengthens interpretation; disagreement identifies limits to the proposed framework.



Note: Ownership concentration creates exposure; liquidity demands activate that exposure, while exit capacity and market design determine the observed outcome.

Fig 1: Ownership concentration and liquidity fragility: an organizational risk pathway.

3.2. Data, variables and sample

The embedded empirical analysis uses a previously assembled CSMAR panel covering August 2023 through June 2024. The sample contains 1,434 small-cap A-share firms reported as held by public mutual funds and 313,145 stock-day observations. Ownership variables are based on complete fund reports dated 30 June 2023, which precede the 2024 stress episode.

The dependent variable, LimitLock, equals one when a stock closes at its applicable daily limit-down price and turnover is below the stock's fixed pre-crisis median. The measure is designed to identify a price constraint accompanied by weak trading release. It does not reveal the length of the sell queue, the volume of unexecuted orders or the identity of the initiating seller.

The main ownership measure is FundHHI, a Herfindahl index calculated from the distribution of fund holdings within each stock. Alternative measures include the largest fund's share (Top1FundShare) and the combined share of the five largest funds (Top5FundShare). Total fund ownership and the logged number of fund holders are included to distinguish concentration from broad institutional participation.

3.3. Estimation strategy

The main specification is a two-way fixed-effects linear probability model. It interacts each pre-stress ownership measure with an indicator for the 2024 crisis period. The model includes stock fixed effects, date fixed effects, pre-crisis firm-characteristic interactions and lagged daily trading controls. Standard errors are clustered by stock and date.

The empirical comparison is deliberately specific. The analysis does not ask whether institutions in general improve or reduce market quality. It asks whether the distribution of fund ownership explains which stocks are more likely to enter a low-turnover limit-down state after the overall level of fund participation is held constant.

4. Results

4.1. Evidence from prior research

The literature points to a recurring sequence. Institutional investors receive a common signal or face a common liquidity need; their desired trades become correlated; and the market impact is larger when the affected stocks are difficult to trade. Herding studies establish that order decisions can move together. Flow and funding studies show that the trigger may originate outside the issuing company. Research on investment horizons and common ownership indicates that some organizational structures transmit shocks more readily than others.

The evidence does not imply that coordination is always harmful. Common trading may reflect information, and institutions can supply liquidity when their own constraints are mild. The fragile case is narrower: the volume and timing of desired sales exceed the market's short-run capacity to intermediate them. This interpretation is consistent with the mixed findings in the literature because it makes the effect conditional on both organizational pressure and market capacity.

4.2. Embedded evidence from the 2024 A-share episode

The Chinese panel provides qualified support for H1. A one-standard-deviation increase in FundHHI is associated with a 0.076 percentage-point increase in the daily probability of a low-turnover limit-down close. The event occurs on approximately 0.125% of crisis-period stock-days, so the estimated increment is material relative to the baseline even

though it is small in absolute terms.

The comparison with general institutional participation is important. The interactions for total fund ownership and the logged number of fund holders are negative or close to zero and are not statistically significant. The coefficient for Top1FundShare is positive at 0.062 percentage points, which is consistent with a dominant-holder channel. Top5FundShare does not display the same positive pattern. This difference suggests that the identity and weight of the largest decision maker may matter more than a broad measure of the largest five holders taken together.

Robustness tests support a cautious interpretation. The FundHHI result remains when daily trading controls are removed, when industry-by-crisis controls are added, when Beijing Stock Exchange firms are excluded and when alternative stock-level models are used. Statistical significance weakens in narrower event windows, with different turnover thresholds and after stricter data-quality screens. The evidence therefore supports an association, not a direct causal claim about forced selling.

Table 1: Concentration versus general fund participation during the 2024 crisis period

Variable × Crisis	Coefficient (pp)	Std. error	p value	Interpretation
FundHHI	0.076	0.038	0.044	Positive concentration effect
FundOwnership	-0.047	0.030	n.s.	No positive ownership-level effect
LogNumFunds	-0.012	0.023	n.s.	No positive fund-coverage effect
Top1FundShare	0.062	0.032	0.050	Consistent with a dominant-holder channel
Top5FundShare	-0.033	0.019	0.082	No parallel positive evidence

Note: Coefficients are percentage points because the dependent variable is LimitLock × 100. The main specification includes stock and date fixed effects, pre-crisis characteristic interactions, lagged trading controls and two-way clustered standard errors. n.s. = not statistically significant at conventional levels. Source: estimates from the previously constructed CSMAR panel.

5. Discussion

5.1. The ownership-concentration-exit-capacity framework

The combined evidence is best understood as a sequence. Ownership concentration determines how much potential selling is controlled by a small number of organizations. Redemptions, scheduled cash needs, benchmark adjustments, risk limits or funding shocks can activate that exposure. Exit capacity then determines whether the desired trades can be completed without severe market impact. Finally, trading rules shape the form in which the imbalance is recorded.

This sequence separates exposure from trigger. Concentrated holdings and shallow market depth generally change slowly. Fund outflows or funding disruptions can arrive abruptly. A stock may trade normally for months because the exposure remains dormant. Once a trigger occurs, the same ownership structure can become a source of fragility. This distinction also explains why aggregate fund ownership is an incomplete monitoring variable. A widely held stock may benefit from institutional research and trading while remaining less dependent on any single organization.

5.2. Implications for asset-management organizations

Portfolio managers should evaluate position size against stressed exit capacity rather than average daily volume alone. A holding that represents a small percentage of fund assets can still be large relative to the stock's tradable float and normal turnover. Internal liquidity reports can therefore combine the fund's own position with the market-wide concentration of institutional ownership. The relevant question is not only how quickly one portfolio can sell, but how many other portfolios may need to sell at the same time. Risk committees may also need to look beyond legal fund entities. Several funds managed by the same company can share research, senior oversight and risk constraints. Treating them as independent holders may understate correlated decision-making. A management-company-level view would provide a closer measure of genuine decision diversity.

5.3. Implications for regulators and listed firms

For regulators, a practical stress screen could combine FundHHI and the largest holder's share with normal turnover, order-book depth, recent fund flows and exposure to binding price limits. Such a screen would not predict every limit-down event, but it would identify stocks in which a small number of organizations control a volume of shares that may be difficult to place during stress.

Listed firms can also benefit from understanding the composition of their institutional shareholder base. Investor-relations teams commonly focus on attracting more institutional ownership. The findings suggest that diversity may be as important as the total percentage held. A broader base of holders with different mandates and investment horizons may reduce dependence on a single portfolio decision, although the present analysis does not test firm-level investor-relations strategies directly.

5.4. Limitations and future research

The main limitation is the absence of fund subscriptions, redemptions, transaction records and limit-down order queues. The panel cannot identify the initial seller, determine whether separate funds were coordinated or measure the amount of selling that remained unexecuted. The results should therefore be read as corroborative evidence for a concentration channel rather than proof of a fire-sale mechanism.

Future work should link fund flows to transaction-level data and identify common control at the management-company level. Fund suspensions, index reconstitutions, settlement reforms and changes to price-limit bands may provide stronger identification. Cross-market comparisons would also be useful. The same ownership shock may appear as a wider spread, a larger intraday return, a volatility increase or a limit-down lock depending on short-selling rules, dealer capacity and market design.

6. Conclusion

The debate over institutional investors is often framed too broadly. Institutions can improve information production and monitoring, yet they can also transmit liquidity pressure when their portfolio decisions become correlated. The evidence reviewed here suggests that the distribution of ownership matters separately from its total level.

In the 2024 A-share panel, pre-stress concentration of fund

holdings is positively associated with low-turnover limit-down closes, while total fund ownership and the number of fund holders are not. The result does not identify forced selling directly, but it is consistent with a dominant-holder channel in which organizationally concentrated decisions encounter limited exit capacity.

For management research, the wider lesson is that concentration creates risk when decision authority is centralized and the surrounding system cannot absorb a rapid response. For investors and regulators, the practical implication is equally concrete: ownership concentration should be monitored together with stressed trading capacity, not treated as an isolated statistic.

Data Note

The empirical estimates come from a previously constructed CSMAR stock-day panel and are used as secondary evidence. The analysis does not identify fund redemptions, common manager decisions, transaction-level sales or unexecuted order queues.

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