
CITY UNIVERSITY OF HONG KONG

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Proximity and Mutual Funds' Asset
Allocation: Evidence from HSR Indirect
Connection in China

鄰近性與基金資產配置：來自中國高鐵
間接連接的證據

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ABSTRACT

This research investigates the impact of China's high-speed railway (HSR) expansion on mutual funds' asset allocation strategies, with a focus on indirect HSR connections. Over the past two decades, China has developed the largest HSR network globally, significantly reducing travel time and enhancing regional connectivity. While prior research has explored the economic benefits of transportation infrastructure, its implications for financial markets remain underexplored. This study addresses this gap by analyzing how the staggered introduction of HSR connections influences mutual fund investment behavior, particularly through reductions in information asymmetry and search costs.

This research employs a Difference-in-Difference (DID) methodology, leveraging the exogenous nature of indirect HSR connections as a natural experiment. Indirect connections are defined as instances where two cities become linked via an intermediate railway segment, enabling cost-effective travel without direct physical connectivity. By isolating the effects of these connections, the study mitigates concerns about endogeneity associated with urban development and railway planning. This research is conducted using a comprehensive dataset spanning 2007 to 2021, incorporating mutual fund portfolios, firm locations, and HSR network developments in China.

The findings reveal several key insights. First, mutual funds allocate more assets to cities connected by indirect HSR. Second, the effect of HSR on asset allocation is stronger in cities with greater information asymmetry, such as those with lower analyst coverage or limited public information. Reduced travel time facilitates on-site visits and face-to-face interactions, allowing funds to gather private, non-public information and improve their stock selection capabilities. Third, mutual funds achieve significant

excess returns from investments in indirectly connected cities, particularly through portfolios without prior holdings, highlighting their ability to discover undervalued securities in previously inaccessible markets. However, the study finds no significant impact on the operational performance of target firms, suggesting that monitoring is not a primary mechanism driving these outcomes.

This research contributes to the literature by demonstrating how transportation infrastructure, specifically HSR, improves information flows. It highlights the importance of geographic proximity in reducing information costs and influencing investment behavior. The findings underscore the potential of HSR in reshaping mutual fund strategies, enhancing market efficiency. These results have practical implications for policymakers and financial institutions, emphasizing the role of infrastructure development in bridging information gaps and promoting informed investment decisions.