What makes home bias abate? The evolution of foreign ownership of Indian firms

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Paper’s main findings

- Market value of shares owned by foreign investors rose from $11.5 billion (’03) to $151.3 billion (’07).
- Why did foreign ownership grow so dramatically?
- Use firm-level data to answer this question

Emerging-Market Investments

- Two rationales for investing in the stock markets of developing countries.
- First → low correlation of developing country stock returns with those of developed markets provides diversification opportunities that enable investors in developed countries to increase the expected return on their portfolio while reducing the risk.
- Second says that high rates of economic growth in emerging markets provide great absolute investment opportunities.

However, home bias

- Asymmetric information
- Market segmentation
- Behavioral biases

- Weights assigned to foreign investments lower than predicted by the ICAPM
- For India:

	March 2001	March 2007
ICAPM weight	0.42	1.53
Actual weight	0.04	0.24

Value of foreign ownership- A decomposition

$$F = g(1-p)M$$

F = value of foreign ownership of shares

M = market capitalization

p = fraction of insider holding

g= fraction of outsider holding held by foreigners

Table 4

Can we attribute the increase in insider ownership to a direct decline in foreign ownership? What about outsider ownership domestically?

- Need a theory to hang our hats on.

Fraction of outside ownership held by foreigners

- Is the null hypothesis that foreign investors as a class are country index investors justified?

- Top-down strategy?

- S&P investibility index + degree of openness

Fraction of outside ownership held by foreigners

- In order to be included in the IFCI, firms must pass 3 screens

  (1) legally investible

  (2) minimum size (investible market capitalization > $50 million)

  investible market capitalization is determined after applying the foreign investment rules and after any adjustments because of cross-holdings or government ownership.

  (3) liquidity (turnover > 20 million + trade on 50% of trading days)

  IFC Investible indexes are designed to measure the returns that foreign portfolio investors might receive from investing in emerging market securities that are legally and practically available to them.

Modeling foreign ownership

- Size variables (Log market capitalization) **+**
- Equity financing variables (Liquidity) **+**
- Historical (12 month return) **-**
- Offshore listing **+**
- Export to sales ratio **+**
- Age
- Capital intensity, asset tangibility **-**

- Non-linearity modeled using cubic orthogonal polynomial —Why?

Conclusion

- Flesh out details, add explanations.
- Main finding for increase in foreign holdings→ modified firm characteristics
- What are the policy implications of this finding? Why does this matter?
- Question being answered currently is: What determines foreign ownership?