
THE EFFECT OF FOREIGN DIRECT INVESTMENT AND FOREIGN PORTFOLIO INVESTMENT ON STOCK MARKET RETURN IN SAARC COUNTRIES.

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Abstract

The purpose of this study is to examine the influence of foreign direct investment (FDI) and foreign portfolio investment (FPI) on stock market returns (SMR) in SAARC member nations between 2014 and 2019. The World Development Indicators (WDI) and the global economy provided secondary data for this study. Numerous punitive procedures, like the Shapiro-Wilk w-test for determining data normality and the Breusch-pagan test for determining

heteroscedasticity, were utilised for robust data analysis. The findings reveal that all FDI and FPI had a low correlation with stock market returns; additionally, the low correlation indicates that the variables included in the current analysis did not exhibit multicollinearity. Diagnostic tests, including the Hausman test, revealed that the author should use the random effect model to analyse the data. The coefficient of FDI was shown to be negatively significant, meaning that increasing FDI reduces stock market returns. Growth in FPI, on the other hand, increased stock market returns. Additionally, the results suggested that the model as a whole is well-fitting.

Key words: Foreign direct investment, Foreign portfolio investment, Stock market returns, SAARC.

Introduction

In general, we think that funds always flow from those with a surplus to those who are less fortunate or have a deficit in achieving their wants and ambitions. Foreign direct investment, in general, is claimed to support economic growth (Amendolagine, Presbitero, Rabellotti&Sanfilippo, 2019). As a result, according to (Anagnostopoulos, Atesagaoglu, Faraglia, and Giannitsarou, 2019), cross-country stock markets have grown significantly during the last three years (Palma, 2016). Previous research has established the interdependence of various financial markets (Chevallier, Nguyen, and Uddin, 2018; Caporale, You, & Chen, 2019; Chien& Hu, 2015; Mohti, Dionsio, Vieira, and Ferreira, 2019; Mensi, Hammoudeh, and Kang, 2017), with a cause that businesses typically establish in the host economy through reference to stock market performance (Paramati, Ummalla&Apergis, 2016; Balli et al., 2015.).

Stock market performance reflects the host country's better mobilisation of resources, and it can be measured in a variety of ways, depending on the investor, such as market capitalization (Raza&Jawaid, 2012), price movements (Qiu& Song, 2016), market indexes (nordin, nordin& Ismail, 2014), and market returns (Hira, 2017).

FDI and stock market performance have been widely discussed in the past (Tsagkanos, Siriopoulos, &Vartholomatou, 2019; Malik, &Amjad, 2013; and Paramati, Ummalla, &Apergis, 2016), but unlike FDI researchers, only one study examined the link between FPI and stock market performance (Idowu, Raji, &Badru, 2018; Ullah et al., 2021). FPI is any country's investment activity that involves the purchase of money market instruments, bonds, stocks, or money for a shorter time period in a foreign country Ezeanyej& Maureen, (2019) in order to maximise profit (Aziz &Anwer, 2015). As a result, there is a need for the study to investigate the same issue in order to gain a better understanding and results. To promote FDI and FPI into SAARC countries, a central institution must be established. A joint initiative could be launched to increase investment in the SAARC region, either by entrepreneurs from SAARC member countries or by attracting FDI and FPI into SAARC countries.South Asia's backward regions may see its prospects for growth and development improve dramatically if foreign direct investment (FDI) and foreign portfolio investments (FPI) increase significantly. In the end, it

improves the quality of living for the poor and creates a large number of jobs. One of the most evident benefits that FDI and FPI provide is an increase in job creation and economic growth. It is one of the most significant factors in the state's development. African countries are attempting to attract FDI into their infrastructure in order to assist them accomplish their goals of enhanced infrastructure, technical advancement, industrial expansion, the elimination of poverty, and higher living standards (Mishkin and Eakins, 2009). In the context of global investment flows, FPI refers to financial assets and other securities owned by depositors in another nation, which are transferred across countries' borders for the advantage of the depositors. A reduction in health-related problems and a resolution to climate change challenges would be achieved naturally as a result of increased FDI and FPI in the manufacturing and service sectors.

Problem Statement

In SAARC, India's biggest economy has attracted the most foreign direct investment (FDI) in the last decade, followed by Pakistan, Bangladesh, and Sri Lanka (Kartal, M. T. 2020). Nepal and Bhutan, who are landlocked, have performed badly in this regard. War-torn Afghanistan's FDI performance is likewise exceedingly poor. Foreign Direct Investments (FDI) are more long-term than Foreign Portfolio Investments (FPI) (Khan, H. U., & Rahman, G., 2020).

As a result, raising foreign investment capital is a primary objective for emerging nations (Kurbanov, O. 2020). Each member nation's employment and poverty eradication will benefit from FDI and FPI. The overall record of SAARC nations in attracting FDI in comparison to Vietnam and Singapore is abysmal, according to a rational perspective. In addition to interest rates, equity investors think about the currency rate of emerging countries. Due to currency depreciation, foreigners are encouraged to spend more money in the host nation (Veeramani, S., Shukla, A., & Jamaleh, M. 2019). Since there is no previous study that examines how foreign direct investment (FDI) and foreign direct investment (FPI) are impacting this field in the SAARC nations, this research intends to address that information gap. These nations, on the other hand, have created a conducive environment for FDI and FPI by keeping interest rates high and weakening their own currency.

Literature Review

Endogenous Growth Theory

In the words of Anwar and Nguyen (2017) Endogenous growth is the belief that economic development is mostly the result of internal causes rather than external ones. According to the notion of "endogenous development," the most essential sources of economic growth are the accumulation of human capital, innovation, and knowledge. Knowledge-based economies, according to the notion of endogenous growth, also have positive externalities and spillover effects. According to the idea, long-term growth in an economy is mostly determined by strategic

decisions, such as increasing government support for R&D or education to increase growth incentives.

FDI Impact on Stock Market Return

Capital transfer from the country of origin to the country of destination may be used to define foreign direct investment (FDI). According to previous research, FDI has a favorable impact on the efficiency of the stock market (Asgari et al., 2010; Ali, 2014; Iqbal et al., 2012). Many factors influence the development of the stock market, including political stability, financial liberalization, the currency rate, and foreign direct investment (VE & ARTLAR, 2011; Atique et al., 2004; Bibi et al., 2014). Additionally, research reveals that the development stock market has a good impact on economic growth, as cited by (Personal & Archive, 2014; Garcia & Liu, 1999; Demirguc & Levine, 1996). The short-term association between FDI and stock market efficiency was identified using an autoregressive distributed model (ARDL) and data from the Bank of Ghana (Kwaku, 2014).

When it comes to foreign direct investment, Claessens et al., (2001) found that it was positively connected with capital levitation, list and trading. FDI also has a positive impact on the advancement of technology and the stock market. Anokye, (2008) found that foreign direct investment (FDI) has a significant impact on the growth of developing nations' stock markets.

The study is looking at the possibility that there is a basic trilateral link between the following:

- i) - FDI increases economic efficiency (Ang, 2009).
- ii) - The stock market benefits from economic growth (Carp, 2012). Because of this, foreign direct investment (FDI) has a positive impact on the stock market (Alfaro et al., 2010).
- iii) - FDI has a positive effect on the stock market as a result (Alfaro et al., 2010).

Studies in the area of international economics (Raza et al., 2013) have shown that FDI and stock market growth have a high and positive link when using regression models (proving that a correlation exists). In Ghana, Anokye (2008) found that FDI, stock market expansion, and nominal exchange rate all had a strong and positive relationship with economic development, using the co-integration approach developed by Engle and Granger. (Nazir et al., 2010; Khan et al., 2020) found that foreign direct investment (FDI) affects the efficiency of the stock market. Olasunkanmi & Corresponding, (2011) used annual data from 1980 to 2009 to determine the impact of Nigeria's stock market and FDI on economic growth. The long-term association between the variables was shown by the Co-mingling study. The results also show that FDI and the stock market have a favorable impact on economic development.

FPI Impact on Stock Market Return

FPI is defined by Ndanshau (2012) as a factor of global wealth sharing that arises from the movement of financial assets, such as cash, bond and stock across international borders in need

of return. In Nigeria, (Anayochukwu, 2012) studied the influence of FPI on the SMR and the link between FPI and SMR and inflation rate. FPI attraction in China is influenced by the stock market's success (Haider and Bekaert in 1998 and 2017; Bekaert et al., 2017; Shaikh et al., 2021). Anayochukwu, (2012); Carp, (2012); Hsu, (2013) these authors have analyzed the anomalous return following the liberalization of these studies claim that with the support of more foreign investors, a start-up firm, as well as existing enterprises, may easily generate equity more easily. Anti-FDI, FPI demands an immediate return on their investment in host nations. Perhaps a few more investors will arrive or exit the nation all of a sudden. Foreign capital outflows may have a significant negative impact on a catastrophe because of this. In order to curb the flow of people leaving the nation, certain governments were compelled to restrict processes (Anayochukwu, 2012). In India, Sahu&Dhiman (2011) use time series analysis to find a strong link between economic growth and stock market performance. Results from a Granger causality test indicate that the Bombay stock market is not causally related to economic growth. The growth of the Bombay Stock Exchange, they set up, is not indicative of India's economic progress. Using quarterly time series data, Hsing (2011) analyzes the correlation between Hungary's market capitalisation and the country's budgetary development. The effects of GDP on stock market efficiency are shown to be positive and statistically significant. With the exception of Shahzad&Iftikhar (2019), most writers have covered the topics necessary to identify the factors that positively affect stock market growth. Most of these examples illustrate how sensitive the stock market is to changes in fundamental economic indicators such as the exchange rate, interest rate, GDP, and pricing. Positive effects of FPI on the stock market and stock prices were found. Arif (2017) investigates the link between the performance of the KSM on the Karachi Stock Exchange and the spread of extremism in Pakistan. The findings of this analysis suggest that terrorism has had a detrimental effect on KSM.

FDI and FPI Impact on Stock Market

Liberalization in the financial sector has led to the elimination of barriers in the global financial markets. Consequently, capital flows have picked up speed (Devita&kyaw, 2009). Through increased financial flows led by the leader, and through foreign direct investment in the host country, developing nations can be transformed into developed nations with the resulting physical assets (Topaloglu et al, 2019). Through a panel data analysis, this study aims to determine the effect that foreign direct investment and foreign portfolio investment have on stock returns in the E7 countries (India, Brazil, Mexico, China, Indonesia, Russia, and Turkey). According to the argument put out by Abala, (2014), foreign direct investment (FDI) leaves its mark on host economies via several channels, influencing market structures and producing both competitive and employment outcomes. In their VAR analysis of the US stock market, Egly et al. (2010) find a positive correlation between FPI and market efficiency. Turkish Stock Market Association Is Founded to Promote Foreign Investment and Improve Stock Market Performance Erbaykal and Okuyan (2011) show a long-term positive relationship between these factors, even if no short-term relation is described. Applying variance decomposition analysis from 2005-

2011, Gbicioglu, (2012) analyzes the relationship between foreign inflow and index income. There is a positive link between SMR and FPI, as shown by Yilidz, (2012), who also explains the relationship between foreign funds, macroeconomic factors, and SMR in Borsa Istanbul. The stock market performance of various economic sectors is affected by a wide range of macroeconomic factors. Taking into account a wide range of industries and factors, several researchers have examined this phenomena. When looking at the previous behavior of stock prices, Mehr-Un-Nisa and Nishat, (2011) say that firm size and prior earnings per share are the most important indicators. GDP growth, interest rates, and the level of economic debt all have a significant impact on the direction of the index. Market to book value, share turnover ratio, and inflation are all potential factors in index outliers.

Methodology

The present section details the research strategy and methodology employed, including how the study's dependent and independent variables were measured. This study makes use of secondary quantitative data. This data was gathered throughout the years 2014-2019. Analysis in this study is both correlational and descriptive. All SAARC nations were included in our sample. Since stock markets only exist in India, Pakistan, Bangladesh, and Sri Lanka, these nations make up the sample for the current study. We created our panel data using secondary sources from the SAARC member nations (India, Sri Lanka, Pakistan, and Bangladesh). The information utilized in this analysis was gathered from a wide range of sources, including www.theglobaleconomy.com and www.data.worldbank.org.

Results and Discussion

Table 1

Shapiro-Wilk W Test for Normality

Variable	Obs	W	V	Z	Prob>z
U	24	0.932	1.423	0.755	0.355

The total number of observations in the shapiro-wilk test for normalcy is 24, and the corresponding probability value is 0.355. If the p-value is larger than the significance level, then the data is normally distributed and have not found any irregularities.

Table 2

Breusch Pagan /cook- Weisberg Test for Heteroscedasticity

Ho: constant variance

Variable: fitted value of SMR

Chi2	0.04
Prob	0.9233

The p-value for a test indicating a chi-square of 0.04 indicates a probability of 0.9233. If the p-value is more than 0.05, then the data shows no evidence of heteroscedasticity either.

Table 3*Pairwise Correlation*

	SMR	FDI	LFPI
SMR	1.0000		
FDI	-0.3199	1.0000	
LFPI	-0.1947	0.5499	1.0000

Results for the Pairwise Correlation are shown in Table 3. Taking a look at table 3, there is little to no correlation between any of the variables and the performance of the stock market. The pairwise correlation for FDI is -0.3199, while for LFPI it is -0.1947. Therefore, it can be concluded that the variables used in this study do not suffer from multicollinearity.

Table 4*Pool Regression Model*

Variable	Coefficient	t-Statistic	P-Values
FDI	-14.801	-2.08	0.037*
LFPI	1.773	0.78	0.433
C	-4.469	-0.10	0.92
R ²	0.200	Chi square	5.241
		P-value	0.073**

Table 5*Fixed Effect Model*

Variable	Coefficient	t-Statistic	P-Values
FDI	-18.505	-1.54	.141
LFPI	10.078	0.69	.5
C	-183.346	-0.58	.567
R ²	0.123	F-statistic	1.261
		P-value	0.323

Table 6*Random Effect Model*

Variable	Coefficient	t-Statistic	P.values
FDI	-15.701	-3.08	0.027*

LFPI	1.543	0.68	0.331
C	-4.468	-0.10	0.92
R ²	0.207	F-statistic	2.620
		P-value (F)	0.096**

Foreign direct investment is known as FDI. Foreign portfolio investment is referred to as FPI. *, ** stand for significance level at 5% and 10%, respectively. Coefficient of determination is referred to as R².

Table 7

Hausman (1978) Specification Test

	Coef.
Chi-square test value	0.212
P-value	0.737

In table 7, p value of 0.737 from the Hausman test indicates that the random effect model is the one to use. For this reason, the random effect model is to be examined, and a similar test was also employed by (Sritharan, 2015).

Table 8

Breusch and Pagan (Lagrangian Multiplier) Test for Random Effect

	Var	Sd = sqrt(var)
SMR	146.0013	12.0831
E	146.3061	12.09571
U	0	0

Test: var(u) = 0

Chibar2(01) = 0.00

Prob> chibar2 = 1.0000

The finding was confirmed by the p-value of, 1, which is consistent with the recommendation of the Breusch and Pagan lagrangian multiplier test. Thus, the authors utilized a multiple liner regression model to interpret these data; comparable tests were also utilized by these researchers (Ali et al, 2017).Consequently, based on the results of the Hausman test, the Breusch and pagan lagrangian multiplier test, the study's pooled regression test fits the data very well.

The results of a regression analysis between the stock market return (the dependent variable) and the other factors are shown in Table 6 (Foreign direct investment and foreign portfolio investment). Model goodness of fit and coefficient of determination are also included in this table. Foreign direct investment (FDI) is adversely significant, as measured by its coefficient value of -15.701 and its associated P-value of 0.027. To illustrate, if we increase FDI by 1 unit while holding all other factors constant, the stock market return will fall by 15.701 units.

The P-value of 0.331 for the FPI coefficient indicates that the foreign portfolio is statistically insignificant. To put it another way, a 1% increase in the FPI would result in a 1.54% rise in stock market return. Because the value coefficient of determination (R^2) is only 0.207, we can infer that the independent variables of interest (FDI and FPI) account for only 21% of the total variance in the dependent variable (stock market returns), while the remaining 79% is attributable to other, unaccounted-for factors.

We can infer that the whole model is well fitted. The results are in line with the study of Hartinah et al (2020).

Further Discussion

FDI and FPI are the most essential sectors for promoting economic progress in a country. The purpose of this research is to analyze how FDI and FPI have affected SMR in SAARC nations. Foreign direct investment (FDI) and foreign direct investment (FPI) both aim to do two things: generate new jobs and expand existing ones. The author used the Shapiro-Wilk w-test to ensure the normality of the data, and the results showed that the p-value was larger than the P-value, indicating that there was no problem with the data being abnormal. The Breusch-Pagan test was also used to ensure there was no heteroscedasticity issue, and its results similarly indicated that there was not. Foreign direct investment and foreign portfolio investment were utilized alongside another criterion for the association between stock market returns and these two types of investment. All forms of FDI and FPI were found to have a negligible effect on stock market returns, and the absence of multicollinearity was also confirmed by the data. Diagnostic tests such as the Hausman test and the Breusch-Pagan lagrangian multiplier test both point to the viability of the random effect model through which the author studied the data, and the viability of random multiple liner regression (Sritharan, 2015).

Consequently, the authors used a multivariate linear regression model to assess and make sense of the data. This finding is consistent with the findings of a similar study conducted in Nigeria between 1980 and 2009 by Isiaq and Oluwafemi (2011), who used the Unit Root test, Cointegration, and Error Correction Mechanism to conclude that FDI had a statistically significant effect on economic growth, demonstrating the link between extractive FDI and sluggish stock market returns.

Conclusion

Analysis of the impact of FDI and FII on stock market returns in SAARC nations is the focus of this research. Foreign direct investment (FDI) and foreign portfolio investment (FPI) are crucial to a country's economic growth and development. The major goals of foreign direct investment and foreign direct investment are to expand employment prospects and to boost the economy of the host country. The effects of foreign direct investment and foreign portfolio investment on the

stock market returns of SAARC nations are only one example of the many research conducted on these variables across a wide range of contexts and time periods.

This study uses panel data analysis to look at the impact of FDI and FII on stock market returns in a selection of SAARC nations (Pakistan, India, Sri Lanka, and Bangladesh) from 2014 to 2019. Using the breusch-pagan test for heteroscedasticity, the shapiro-wilk w-test for normality, the pairwise correlation test, the pool regression model, the fixed effect model, the random effect model, the hausman test, the Breusch and pagan lagrangian, and the pool regression model. Stock market returns in selected SAARC nations were analyzed, and the impact of foreign direct investment and foreign portfolio investment was analyzed using secondary data.

Limitation and Future Research Direction

When it comes to the impact of FDI on stock market return in SAARC countries, the government plays a pivotal role. To develop a long-term and short-term plan that is mutually beneficial with international investors and make sure the area is conducive to business so they're contented with their return on investment. Foreign direct investment (FDI) and foreign portfolio investment (FPI) bring fresh ideas and new chances for capital investment, and help to create new types of businesses, all of which contribute to the economic growth of the nations they are invested in. Finally, the link between these factors for various economic or trade organizations, such as the G7 or G11, could be investigated in future studies. Understanding the fundamental connections between these parts across many time scales may be the focus of future investigation.

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