Role of FDI in Stock Returns: A Case of Pakistan

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Author’s contribution

Author AUH designed, analysed, interpreted and prepared the manuscript.

Original Research Article

ABSTRACT

This article examined the influence of FDI on the stock returns of the Pakistan market. Pakistan is an emerging economy of Asia and has attracted good FDI. The study used secondary data that has been taken from different reliable sources. The data for FDI is taken from Pakistan Statistical bureau and for the data of stock returns, we used yahoo Finance. The data has been collected from 2005 till 2914. After employing the regression analysis, we noticed that there is a positive association between stock returns and FDI in the case of Pakistan. This study facilitates the policymakers of how the foreign direct investment for the development of the emerging country like Pakistan. This is the reason that Pakistan is attracting more and more FDI by offering flexible policies.

Keywords: FDI; stock returns and Pakistan; emerging markets; Asia.

1. INTRODUCTION

Schutz [1] defined growth as the sustained rise in quantity and or quality of the goods and services produced in an economy. An extensive definition of FDI is provided in 1996 by the Organization for economic co-operation and development (OECD) which states that the FDI reflects the objective of obtaining a lasting interest in a resident entity in one economy (direct investor) other than that of the investor(direct-investment enterprise). Emphasis is on the role of FDI played in the development of the economy by acting another factor input of production [2].

Another definition is also provided by the International Monetary fund (IMF, 1993, section 359). IMF defines foreign direct investment as an “investment that effects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy... The lasting interest implies the existence of a long-term relationship between the direct investor and the foreign enterprise and a significant degree of influence by the investor on the management of the enterprise”.

Based on definitions mentioned above foreign direct investment is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency (world bank 1996). Such investments may take the form
of either “greenfield” investment (also called “mortar and brick” investment) or merger and acquisition (M & A), which entails the acquisition of existing interest rather than new investment.

While considering FDI as an investment most developing country’s key source of generating income is FDI, because it is an element used in strategy for economic development, an amalgamation of capital, technology, marketing and management. Interestingly, most dynamic international resource flows to developing countries, particularly important because it is a package of tangible and intangible assets because firms deploying them are important players in the global economy. It affects growth and development by complementing domestic investment and by facilitating trade and transfer of knowledge and technology.

2. LITERATURE REVIEW

Hisham examined FDI and immigration: a regional analysis. He took the data of 10 source countries to the 50 US states. He argued the risk of foreign investment through increased information flows and a built-in market. By using the econometric model, he comes to know that relationship is positive and immigration does lead to FDI. He assess the impact of migrant networks on foreign direct investment at a regional level. He tests the effect of migrant networks on FDI by using econometric model. To conclude, immigration creates a positive externality for both the receiving and sending country.

Kalim et al. [3] examined Do macroeconomic variables play any role in the stock market movement in Ghana. He took data from the period of 1991.1 to 2007.4 through the co-integration test and vector error correction models. By using vector error correction models, analyse lagged values of interest rate, and inflation have a significant influence on the stock market. The inward direct investments, the oil prices and the exchange rate demonstrate weak influence on price changes. To conclude, the establishment of lead-lag relation indicates that DSI is not informational efficient concerning interest rate, inflation inward FDI, exchange rate and world oil.

Owusu [4] examined, analyzing the effect of macroeconomic variables on stock market returns: evidence from Ghana. He took data from the period January 1992 to December, 2008, carrying 204 monthly observation. The methodology is Ordinary least square estimation model in the context of Box-Jenkins time series and applied proxy for Ghana stock market return adopting econometric technique is beat possible technique. He investigate the relationship between macroeconomic variables and stock market return. To conclude, whole research may provide some insight to corporate managers, investors and policymakers, concluding words of Owusu et al.

Sezgin et al. examined Relationships between stock markets and macroeconomic variables: an empirical analysis of the Istanbul stock exchange. He took data from the ISE index. He investigate the relationships between returns and macroeconomic variable. By using the causality test, he finds unidirectional relationships between macro indicators and ISE index. To conclude, changes in the stock market index do affect interest rates.

Chiu [5] examined, An empirical analysis of the market and industry factors in stock returns of U.S Aerospace industry. He took data of monthly returns of these companies for the period from January 1982 through December 1991 regressed against six market and industry variables multi-index CAPMs to explore the relationships of five U.S aerospace companies stock returns to selected market and industry variables. By using, regression analysis of employing unanticipated changes in independent variables to provide confirmatory evidence. Aerospace stock returns are positively related to the market returns represented by the S&P 500 index and Department of Defense expenditures. To conclude, in an efficient market, only the unanticipated changes in macroeconomic variables would affect securities prices i.e [6,7,8,9,10].

Haddad et al. [11] examined Capital inflows and the real exchange rate: Can financial development cure the Dutch disease. He uses a dataset of annual information on 84 countries during the period 1990-2006. By using linear panel dynamic data model, he examines the robustness of results to the inclusion of other potentially important fundamentals such as income per capita (income) and changes in the government balance over GDP (GB). The main implication is the destabilisation of macroeconomic management due to a sizeable appreciation of the real exchange rate. To conclude, the impact of capital inflows on the real
exchange rate can be significantly reduced by the use of a more flexible exchange rate regime. Inflows should be lower in countries with a higher level of financial development.

Xing [12] examined the impact of FDI and financial sector development on economic growth: empirical evidence from Asia and Oceania. He uses panel data methods on a sample of 44 Asia and Oceania countries from the period 1996-2005. Financial sector development is an important precondition for foreign direct investment (FDI) to enhance economic growth in the Asia-Oceania region. To conclude, the complementary growth impact of FDI and financial sector development is most important for least developed countries, and in stimulating economic growth in Asia and Oceania countries, because there is a range of initiatives for enhancing the financial sector, attracting FDI and developing human capital discussed in this paper.

Hermes et al. [13] examined Foreign direct investment, financial development and economic growth. He took dataset from the period 1970-1995 of 67 LDCs. The methodology follows the voluminous growth regression. FDI may help to raise economic growth in recipient countries. Empirical investigation suggests that these countries should first reform their domestic financial system before liberalising the capital account to allow for enlarged FDI inflows. To conclude, Sub-Saharan African countries have very weak financial systems, and consequently, FDI does not contribute positively to growth.

Maher et al [14] examined Economic evaluation of a foreign direct investment in Pakistan. She took time series data on Pakistan’s imports and exports from the period 1973-2004, to study the impact of FDI. To check the stationary of analysed used data, he applied the Unit roots (ADF test). FDI has played a vital role in the economic growth in Pakistan. To conclude, the results of the export model show that FDI has a negative relation with real exports in the short run and positive relation in the long run because export model estimations indicate that with one per cent increase in FDI, real export decreased by -0.08 per cent n the short-run and increase by 1.62 per cent in the long run.

Udoh et al [15] examined Exchange Rate Volatility, Inflation Uncertainty and Foreign Direct Investment in Nigeria. He took data from period between 1970 and 2005. By using the GARCH model, the estimation results show that exchange rate volatility and inflation uncertainty exerted a significant negative effect on foreign direct investment during the period. As infrastructural development, the appropriate size of the government sector and international competitiveness are crucial determinants of FDI inflow to the country. To conclude, International competitiveness, as shown in this study, is an important incentive for FDI inflow.

Ariff [16] examined The Malaysian financial crisis: Economic impact and recovery prospects. He analyzes Malaysia’s recovery prospects in the future as well as to highlight some of the key challenges facing Malaysia on the road to sustained recovery. The crisis has shown that rapid and high economic growth is largely not sustainable in the long run, particularly if it is not accompanied by an equal buildup of governance institutions at the firm and national levels. Total factor productivity, rather than input-driven growth, will be a key source in the future. To conclude, additionally, with better regulation systems in place, systematic risk in the economy is likely to be reduced.

Sayeeda [17] examined “Comparative economic performance and stock market performance: Some evidence from the Asia-Pacific region”. She took data from the period, 1993-2009, of 14 Asia-Pacific countries. By using MSCI returns, GDP growth and HDI to rank and correlate the overall performance of 14 Asia-Pacific countries. Overall, the results indicate no significant relationships between a country’s stock market returns and its GDP growth. To conclude, the results suggest that for balanced and sustainable well-being, economic growth in the less-developed countries need to be matched by concomitant improvements in social welfare, income distribution, transparency and accountability.

Islami et al [18] examines, Interdependence between foreign exchange markets and stock markets in selected European countries. He took monthly data from the period of June 2008. By using Granger causality tests, he finds out that an unambiguous result that the direction of causation, from the stock market index to the foreign exchange market is a surprise. He analysed four cohesion countries and four accession countries to examine any potential links between the nominal stock market index and nominal exchange rate. To conclude, for Slovenia, Hungary, Ireland, Spain and Greece merely short-term links resulted.
3. MATERIALS AND METHODS

To complete this study, we took the data of FDI from the Statistics Bureau of Pakistan from 2005 to 2014. Stock market return is measured through the KSE-100 Index. We used the Yahoo finance database to collect the stock return data.

We measure the relationship with the help of simple regression model which is as follows:

\[ SR = \alpha_1 + \beta_1 FDI + \epsilon_1 \]

In this model, stock returns (SR) is a dependent variable while FDI is the independent variable.

4. RESULTS AND DISCUSSION

By running the regression, we obtained the following results:

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<th>Regression statistics</th>
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<td>R-Square</td>
<td>0.58</td>
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<td>Adjusted R Square</td>
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<tr>
<td>Standard Error</td>
<td>0.45</td>
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<td>Observations</td>
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<td>Regression</td>
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<table>
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<tr>
<th>Coefficients</th>
<th>Standard error</th>
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<th>P-value</th>
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<tr>
<td>Intercept</td>
<td>0.28</td>
<td>0.15</td>
<td>1.85</td>
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<tr>
<td>FDI</td>
<td>0.34</td>
<td>0.25</td>
<td>1.37</td>
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From the following results, we can conclude that the overall model is insignificant. But there is a positive relationship between the FDI and Stock returns. The overall model is significant, and the explanatory power of the model is good enough. Moreover, we found that there is a positive association between the stock return and FDI as expected. The results remained the same as the rest of the studies in the literature.

Theoretically, it is true because there are infinity factors which affect the stock market. We cannot measure all the factors. FDI has a greater impact on the stock market returns.

5. CONCLUSION

Pakistan's private sector has developed and matured significantly on the back of the overall improved macroeconomic environment and strengthened business conditions marked by privatisation and liberalisation of the economy.

The enabling environment for private sector development needs to be further strengthened within an improved policy and regulatory framework that consists of a defined industrial policy, competitive policy, an investment policy, and stronger and capacitated regulatory institutions in key sectors of the economy. A key constraint to private sector growth is the critical infrastructure deficit, particularly in the power sector. Pakistan provides good protection to investors but lacks efficient contract enforcement structures which complicate and increase the cost of doing business.

Privatisation has been the most important component of the Government's strategy for invigorating economic growth, attracting investment, and creating opportunities for the private sector. In addition to strategic sales where management control is divested, the Government has used privatisation to develop, broaden and deepen domestic capital markets. For this reason, the Government has sold minority shares via the stock market in selected...
companies before or after the transfer of management control. Listing and selling companies in the local stock exchanges are likely to give a much-needed boost to the stock markets and help tap into domestic and foreign savings. Listing companies in the stock exchange will also improve corporate governance, as companies will be forced to comply with the stringent reporting.

The privatisation program also played a major role in the development of the capital markets by using domestic and foreign stock exchanges for divesting equity of public sector enterprises. Major assets remaining on the privatisation list include two of the largest exploration and production companies in the oil and gas sector, that is, the oil and Gas Development Company Limited (OGDCL) and Pakistan Petroleum Limited (PPL), as well as the Pakistan State Oil Company Limited (PSO). Also slated for privatisation are key assets in the power sector such as electricity distribution companies and a power generation company, besides several heavy industrial units and prime real estate properties.

The success yardstick for privatisation continued to be the successful divestment of an entity and not its continued post-privatization service delivery. Another major factor that appears to have negatively impacted the privatisation program is the lack of continuity, stability and institutional memory at the Privatization Commission (PC) itself. After almost six years of well-managed operations, the PC saw, within a year, three different ministers at its helm and at least four secretaries. The PC has also witnessed a very high turnover in its consultants during the same period. At the same time, PC’s communication with stakeholders suffered as public perceptions of the privatisation process and its transparency turned negative.

COMPETING INTERESTS

Author has declared that no competing interests exist.

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15. Udoh E, Egwulikide FO. Exchange rate volatility, inflation uncertainty and foreign
