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Firm Characteristics and Foreign Institutional Ownership: Evidence from India

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Abstract: *The Government of India has taken various initiatives in recent years to improve its investment regime to attract foreign investments. The objective of this paper is to study the effect of firm characteristics on controlling stake and non-controlling stake of Foreign Institutional Ownership (FIO) in an emerging market - India. Binary and multinomial logistic regression models are applied to the dataset that cover financial years 2008 to 2014. A total of 496 publicly listed Indian non-financial firms listed on the two major stock exchanges of India (Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) as at March 31, 2014 were examined. Findings show that profitability, growth, size and risk of the firm significantly increase the probability of controlling stake of foreign institutional investors. Results also highlight that the stakes of foreign institutional investors would increase in relatively profitable, growing and larger firms. Additionally, there is a need for policy intervention to attract more and more foreign investment. With the series of reforms initiated by the Government of India, much more needs to be done to boost and maintain investor confidence.*

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1. Introduction

Studies indicate that developing economies like India suffer from shortage of internal sources of finance and thus, the need to attract external funding or capital in the form of foreign direct investment and foreign institutional investment among others. The pre-requirement for attracting external sources of finance is a well-developed capital market. In addition to corporate governance incentive when there is foreign investment in the stock market, the country can repeat benefits in the form of lower cost of capital, high profitability, high growth, larger size, higher market value and /or lower risk. These lenders may intervene and actively participate in corporate

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management of the firms in which they invest in. Such investments would also enable them to handle the problems of financial distress, if any, and help them in improving the company's overall corporate performance. Lenders may be a flexible, informal alternative to the market in corporate control or bankruptcy proceedings (Kang & Stulz, 1997). Lenders intervene in the firms depending on their investment objectives as well as their ability and willingness to govern them. Short term profits would not act as an incentive for longer term governance issues and especially if stakes are small with wide diversification in contrast to large stakes with concentration on fewer stocks (Charkham, 1994). Coombes and Watson (2001) found that the institutional lenders pay a premium for good governance. Thus, it can be assumed that substantial foreign shareholding in domestic firms are an incentive to participate and manage these firms leading to good governance of investee companies.

Empirical studies point to the relationship between ownership and corporate governance, therefore, in this study ownership is used as a corporate governance variable to examine the relationship between foreign shareholdings and firm characteristics. Ownership of a firm refers to the equity holdings of various shareholders, namely promoters, institutional investors, venture capitalists, government, individuals and mutual funds. Keeping in view that sound corporate governance framework is already in place in India, there is a need for active participation of institutional investors to ensure that the corporate governance framework is followed not only in form only but in spirit as well. The incentive to monitor is generally seen among the substantial shareholder. These substantial shareholdings would lead to lower cost of capital, high profitability, high growth, bigger size, higher market value and /or lower risk. Kumar (2004) reported that the average share of foreign shareholding in Indian listed companies was 10.84 percent whereas that of institutional owners was only 1.42 percent as at March 2000. He observed that the shareholdings of institutional investors do affect performance of firms in a non-linear fashion whereas that of foreign investors does not. Several studies have examined the types of ownership and firm characteristics but no study has been undertaken in which attempts to investigate the link between foreign institutional ownership (FIO) and firm characteristics in the Indian context.

Hence, the present study is highly relevant. To our knowledge, this is the first study that investigates the relation between the actual ownership pattern of FIO and various firm characteristics across major listed firms in India. This paper attempts to explore the relationship between the level of foreign institutional shareholdings and firm characteristics. It will answer the following research questions posed: First, how do specific characteristics of firms influence FIO stakes? Second, do different firm characteristics impact differently at various levels of FIO stakes?

To address the above research questions, the study uses binary and multinomial logistic regression. Findings show that firm characteristics play a very important role in reducing or aggregating the risk of investments. This research covered the period between end of financial year 2008 and end of financial year 2014 whereby findings indicated the relative share of Indian stock market owned by FIO has increased. The average FIO in Indian listed companies was nearly 14 percent of total market value of listed shares in March 2008 which rose to nearly 21 percent in March 2015. It is found chances of substantial foreign investments increase based on the profitability, growth, size and beta of the firm. This remains robust for different levels of FIO stake. Investors seek profitable, growing, highly valued and volatile stocks because they are expected to be well governed and regulated. Further, they can influence governance and thus reduce agency costs. In order to attract more FIO, strengthening and improving firm characteristics and market infrastructure is a must.

The paper has been organised as follows: Section 2 is literature review while Section 3 discusses data and the variables used in the study. Section 4 discusses main findings while Section 5 provides policy implications and concludes the paper.

2. Review of Literature

Globalisation and the need for capital as a result of financial crises have led to cross border investments raising the equity stake of institutional investors in the last few decades. Today, by virtue of their size, foreign institutional investors have emerged as an important mechanism of corporate governance. The UK's Cadbury Report (1992), the Greenbury Report (1995) and the Hampel Report (1998) have strongly emphasised the role of institutional investors in corporate governance. In some cases they contribute to the corporate governance structures of companies they invest in. Mallin (2004) reports that US institutional investors are much more active in corporate governance and they have influenced both UK institutional investors and UK companies. Some countries emphasise on the role of corporate governance in investee companies through a code of conduct, rules and guidelines among others. Strenger (2006) focused on the need for institutional investors to be exemplary in exercising their voting rights in their portfolio companies and the voting records should be disclosed on a regular basis. A positive effect of institutional shareholders on corporate performance in the absence of other large shareholders was observed by Short and Keasey (1997). The positive relationship between directors' ownership and performance is strengthened by curbing management discretion in the presence of institutional shareholders.

Eclectic theory, propounded by Dunning (1988), considered country-specific, company-specific and other variables relating to trade and foreign direct investment (FDI) as influencing foreign investment. This theory was later found to lack operational practicality due to consideration of too many factors. The company-specific paradigm relates to ownership, managerial effectiveness, structures, processes and technological advantages. The Investment Development Path (IDP) theory which is a criticism of Dunning's theory, linked a country's level of economic development, that is, its government policy framework with flows of inward and outward FDI (Nayak and Choudhury, 2014). Thus, one can infer that ownership, firm specific advantages and a country's level of economic development, that is, its government policy framework, are interrelated. Investment by foreign investors is dependent upon various firm specific characteristics and if a firm is perceived as valuable then it would attract more foreign investments. The various specific characteristics that are most important to owners can vary. Earlier studies have focused on foreign shareholdings and/or institutional shareholdings (Anderson, Jandik, & Makhija, 2001; Ko, Kim & Cho, 2007) but none on FIO.

Studies have also examined behaviour of foreign firms, factors that influence their investment decisions, and the determinants of foreign investment taking into account various macroeconomic variables such as gross domestic product, political risk, exchange rates, interest rates, law and order, corruption and property rights to name a few (Bekaert, Harvey & Lundblad, 2003; Henry, 2000; Patro & Wald, 2005; Mukherjee, Bose & Coondoo, 2002; Rajan & Zingales, 1995). Literature has also examined the relationship between foreign ownership and firm characteristics, firm value or firm performance. Foreign investors prefer stock with large capitalisation, low book to market ratio and high return on equity (Ko, et al. 2007). Moreover, firm size is significantly correlated to foreign ownership (Ko et al., 2007) and negatively related to long-term leverage (Gurunlu & Gursoy, 2010). Fu and Wu (2013) found that the relationship between foreign entry and the profitability of domestic firms is an inverted U shape in China which varies according to the ownership structure of domestic firms. The profitability and growth of domestic firms can be enhanced by small initial foreign shareholdings but a large share of foreign capital would reduce firms' profitability. This can be explained by the fact that foreign firms have strong ties with their home nations. They tend to ignore social causes, and their interests, beliefs, or attitudes would be for their private gains (Gollakota & Gupta, 2006). Huang and Shiu (2009) found positive association between foreign ownership and firm performance in Taiwan which may be due to two reasons. First, foreign institutional investors' ability to choose stocks to diversify their global portfolios called stock screening ability. Second, their

ability to influence management due to knowledge and capabilities they possess.

In another strand of literature, the impact of large or concentrated ownership on firm characteristics is studied. The shareholder group may include the promoter, family, institutional investor and foreign shareholder. The results are varied with some studies reporting no such relationship and others confirming a relationship in a biased setting. Zeckhauser and Pound (1990) suggested that large shareholders effectively monitor company operations depending on the nature of the industry in which the firm operates. Holderness and Sheehan (1988), McConnell and Servaes (1990) reported non-significant relationship between large shareholdings and company performance. However, combining large shareholdings and director ownership gives contradictory results (McConnell & Servaes, 1990). Goud Jr (2002) observed firm performance, measured by employment change, was strongly significant in all regressions ran on private, foreign, individual, collective farmers, managers and insider ownership indicating that private firms, foreign and individually owned firms outperform state-owned ones while state-owned ones outperform insider or collective farmers' firms. Dispersed private ownership is perceived to be suffering from free rider problem and hence, concentrated ownership is the solution. Further, ownership concentration by institutional investors has a significant and positive effect on firm profitability. Gibson (2003) found that corporate governance is ineffective in emerging markets for firms with large domestic shareholders. There was no relation between CEO turnover and firm performance. Han, Lee & Suk (1999) found weak effect of insider ownership on firm performance. No evidence was found for improvement in firm performance due to concentration of insider ownership.

A negative relation between large foreign ownership and stock price volatility was noted by Li, Nguyen, Pham & Wei (2011) in 31 emerging markets including India. It is believed that the strong commitment and potential monitoring role of concentrated foreign ownership would act as a stabilising agent in the emerging markets where there are persistent fears of outward flow of foreign capital. Such flows are vulnerable to lack of proper capital market infrastructure, laws and regulations. Further, large shareholdings are generally long term and stable in nature (Stiglitz, 1999). Choi, Cho & Sul (2014) concluded that distorted ownership structure affects foreign shareholdings negatively; on the contrary, concentrated ownership would increase foreign shareholdings. In light of the mixed results of previous studies, this paper investigates the relation between firm characteristics and FIO stakes in the Indian context.

3. Data and Variables of the Study

The sample companies for the study are listed on the S&P BSE 500 Index of the Bombay Stock Exchange (BSE) and Nifty 500 Index of the National Stock Exchange (NSE) of India as at March 31, 2014. Out of the 1000 companies included in the two indices, 252 common firms are included in both the indices, the financial firms and the firms whose relevant data were incomplete or cannot be acquired for more than one year of study were excluded. The final sample had 496 companies. Data was obtained from Prowess, a database of Indian companies, maintained by the Centre for Monitoring the Indian Economy (CMIE) and website of BSE, NSE and sample companies. The period of study is seven years, (from financial year 2008 to financial year 2014. The various determinants of ownership structure and capital structure are dividends, profitability, business risk, asset structure, liquidity, firm growth, size, advertising expenditure, capital expenditure, proxy Q, debt ratio or leverage, price, share turnover, year, return on assets, profitability, investment, capital intensity, liquidity, firm property, market risk, and intangibles assets (Fauzi & Musallam, 2015; Oak & Dalbor, 2010; Huang & Shiu, 2009; Al-Najjar & Taylor, 2008; Demsetz & Villalonga, 2001; Rajan & Zingales, 1995).

In order to investigate the relation between FIO and firm characteristics for Indian listed firms, the sample is further divided into controlling stake (CS) of FIO (more than equal to the average) and non-controlling stake (NCS) of FIO (less than the average) on the basis of the average FIO (9.81 percent). A total of 2042 observations and 1388 observations were from NCS and CS companies respectively.

Below is a summary of the independent variables used in the present paper. Leverage is total debt/total assets of firm. Return on total assets (ROTA) is Net profit /total assets. Asset structure is the fixed assets ratio: fixed assets/total assets. Growth is measured as market price per share/book value per share. Firm size is the natural logarithm of total assets as at end of the financial year. Market Capitalisation (MCAP) in Rs. million is calculated by multiplying the number of shares outstanding with the closing price of the stock as on the last day of the financial year. Beta is the measure of market risk. Sector is a categorical variable depicting the sector to which the firm belongs out of the total eight sectors, namely Basic Materials, Consumer Discretionary Goods and Services (CDGS), Diversified, Energy, Fast Moving Consumer Goods (FMCG), Healthcare, Industrials and Utilities, Information Technology and Telecom. Year is another categorical variable referring to the study period of seven years. The descriptive statistics are displayed in Table 1. Foreign institutional ownership (FIO) here refers to the shares held by foreign institutional investors and foreign venture capital funds. The average shareholding of FIO is 9.81 percent (with a standard

deviation of 9.98). The minimum value of leverage, asset structure, growth and market capitalisation is zero. The return on total assets vary between81.16 percent and 131.04 percent. Market capitalisation has a high standard deviation.

Table 1: Descriptive statistics

	Minimum	Maximum	Mean	Std. Dev.
CS/NCS	0	1	0.405	0.491
Leverage	0	8.556	0.225	0.240
ROTA	-81.160	131.040	8.105	10.057
Asset Structure	0	0.999	0.259	0.184
Growth	0	3262.940	88.007	176.147
Size	-0.398	7.254	4.364	0.737
Market capitalisation	0	4168662.820	90219.1	276030.656
Beta	-0.200	2.870	0.951	0.440

Note: CS/NCS refers to controlling stake and non-controlling stake of foreign institutional equity. ROTA stands for Return on Total Assets

4. Findings and Discussion

The following sections attempts to answer the following two questions. First, how do firm specific characteristics influence FIO stakes, controlling stake and non-controlling stake of FIO? Second, do different firm characteristics impact differently at various levels of FIO stakes?

4.1 Findings

4.1.1 Effect of firm characteristics on CS and NCS of FIO

According to Anderson et al. (2001), the investment of foreign capital is dependent upon specific characteristics of investee firms. In the case of poor corporate governance regime, the investors may increase their investment in order to own substantial stakes in the firm and thus control and govern it, or they may decide not to invest or reduce investments for fear of governance issues and high managerial agency costs. A binary logistic regression with CS and NCS as the dependent variable and other firm characteristics as control variables was run. One of the key assumptions of binary logistic regression is that only meaningful variables should be included as control variables which are checked by change in -2 Log likelihood statistics or difference between the two -2 log likelihood values denoted by Chi-square.

Further, no exact linear dependencies should exist among control variables (X) across the years under study and that the relationship between dependent variable (Y's) and X's should be non-linear or logistic (i.e., P (Y =1|X) = exp ($\Sigma\beta_K$ X_K) / [1 + exp ($\Sigma\beta_K$ X_K)]). This relationship was checked for leverage, return on total assets (ROTA), asset structure, growth, size, market capitalisation, beta, sector, year, return on capital employed (ROCE), return on net worth (RONW), standard deviation of ROTA, current ratio, opportunity, age and total returns. The results gave significant chi square p values for leverage, return on total assets (ROTA), asset structure, growth, size, market capitalisation, beta, sector and year. These nine variables were considered meaningful and non-linear.

Thus, our final logistic regression model is:

$$Pr (Y=1|X) = F (\beta_0 + \beta_1 x_1 + \beta_2 x_2 + ...+ \beta_K x_K)$$

The null hypothesis would be: H_0: $\beta_K = 0$, where k = 1. …9

The dependent variable Y is a dichotomous (0, 1) variable representing the two groups, CS companies (Y=1) and NCS companies (Y=0). The independent variables X_1, X_2, .., X_K include leverage, return on total assets (ROTA), asset structure, growth, size, market capitalisation, beta, sector and year. Table 2 provides the summary statistics for the key variables for the CS firms and NCS firms separately. The p value of t statistics of all the variables is statistically significant exhibiting that there is a difference in the two groups. Average growth and market capitalisation indicate that the firms with CS of FIO tend to have higher market value than those with NCS of FIO.

Table 2: Summary statistics for CS and NCS firms

Variable	**CS firms (N=1388)**		**NCS firms (N=2042)**		***t*-stat**	***p*-value**
	Mean	Std. Dev	Mean	Std. Dev		
Leverage	.21504	.17215	.23195	.27632	2.207	0.027*
ROTA	8.958	9.779	7.524	10.204	4.142	0.000*
Asset Structure	0.244	0.174	0.268	0.189	3.875	0.000*
Growth	127.367	197.015	61.253	154.860	10.492	0.000*
Size	4.58224	.595719	4.21596	.785916	15.504	0.000*
Market capitalisation	142024.348	354530.786	55005.731	198812.601	8.300	0.000*
Beta	1.003	0.401	0.915	0.461	5.886	0.000*

Note: ** and * denote the statistical significance at the 5%, and 1% levels respectively.

The first model in the logistic regression output is a null model, that is, a zero model with no predictors and only the intercept. The second model, known as the full model, includes the predictors. If the overall percentage, that is, percentage of cases for which the dependent variables was correctly predicted by the given model, increases for the full model as against that of zero model then the model is seen fit. The overall percentage in model zero was 59.5 percent which increased to 66.5 percent for the proposed model of the study. The Cox and Snell R^2 was 12.2 percent and Nagelkerke R^2 was 16.5 percent. It can be concluded that the model explains 12.2 percent to 16.5 percent of the variation in foreign institutional shareholdings. The wald statistic (Table 3) is significant for ROTA, growth, size, beta, sector and year. The statistically significant coefficients for ROTA, growth, size, beta, sector and year reject the corresponding null hypotheses and suggest that ROTA, growth, size and beta vary among firms with CS and NCS of foreign institutional investors. Moreover, the CS and NCS of foreign institutional investors in these firms vary across sectors and year. This indicates that ROTA, growth, size, beta, sector and year are significantly related to the probability of CS of foreign institutional investors. The effect of leverage, asset structure and market capitalisation is not significant. The effect of ROTA, growth, size and beta is positive which indicates that increased ROTA, growth, size and beta is more likely to achieve a CS of FIO. The odds ratio higher than one signifies that the probability of a CS occurring with a unit increase in ROTA, growth, size and beta is higher than the probability of NCS at the original values of ROTA, growth, size and beta. This probability is highest for size (2.153) and smallest for growth (1.002) with probability of profitability and growth nearly the same. The leveraged companies are 18 percent less likely to have a CS of FIO. Sector has a highly significant overall positive effect indicating that increasing affluence is associated with increased odds of achieving CS. The results indicate that the probability that a firm has CS of FIO increases for firms operating in all sectors except Consumer Discretionary Goods and Services in relation to the basic materials sector, which was considered as the reference category. The odds ratio indicate that companies in energy sector are 4.103 times more likely than those from basic materials sector to achieve CS of FIO while those in the Consumer Discretionary Goods and Services sector are about 1.298 times more likely to achieve CS of FIO than those from basic materials sector but that is insignificant. Most importantly, controlling for other control variables has changed the association between year and CS. The overall association remains significant but the size of coefficients and the associated odds ratio for most of the years has changed substantially. The statistic is significant for the year ended 2009 and 2010 only and the odds ratio is less than one signifying that the probability of CS occurring with each subsequent year is less than the probability of NCS for the year 2008. Despite this, as the

investment by FIO increases over the years, they would move from NCS to CS, significantly influencing the management, performance and valuations of these firms (Anderson et al., 2001).

Table 3: Results of binary logistic regression

Variable	Coefficient	Wald	*p*-value	Exp (B)
Leverage	-.194	.621	0.431	.824
ROTA	.017	11.779	0.001***	1.017
Asset Structure	-.081	.127	0.721	.922
Growth	.002	33.375	0.000***	1.002
Size	.767	106.930	0.000***	2.153
Market capitalisation	.000	.026	0.872	1.000
Beta	.528	28.836	0.000***	1.696
sector		78.525	0.000***	
sector (1)	.261	1.859	0.173	1.298
sector (2)	.623	11.052	0.001***	1.864
sector (3)	1.412	42.037	0.000***	4.103
sector (4)	.631	8.866	0.003***	1.880
sector (5)	.773	17.307	0.000***	2.165
sector (6)	1.119	27.084	0.000***	3.062
sector (7)	.417	3.317	0.069*	1.517
year		12.023	0.061*	
year (1)	-.042	.087	0.768	.958
year (2)	-.378	6.789	0.009***	.685
year (3)	-.265	3.595	0.058*	.767
year (4)	-.168	1.509	0.219	.845
year (5)	-.176	1.679	0.195	.838
year (6)	.003	.000	0.985	1.003
Constant	-5.027	150.692	0.000***	.007

Note: *, ** and *** denote the statistical significance at 10%, 5%, and 1% levels respectively.

4.1.2 Effect of firm characteristics at different levels of FIO stake

The effect of firm characteristics on FIO may change at various specific threshold points (Sarkar & Sarkar, 2000; McConnell & Servaes, 1990). Moreover, in the dataset, a large variation in the actual aggregate percentage shares held by foreign shareholders both across sectors and time was noticed, hence an alternative approach was followed wherein various threshold levels for foreign shareholdings were set and an ordered logit model was also estimated. The model failed the test of proportional odds and hence the multinomial logit model was estimated. The total number of observations was reduced to 3000 after deleting 430 observations with FIO up to 0.15 percent. Applying Thumb rule 2 (Bowerman, O'Connell, Murphree, 2013) five threshold levels for FIO are used in the model: between 0.15 percent and up to 2.5 percent (652 observations), between 2.5 percent and up to 5 percent (408 observations), above 5 percent and up to 10 percent (576 observations), above 10 percent and up to 15 percent (460 observations), above 15 percent and up to 20 percent (369 observations), and above 20 percent and up to 57.44 percent (535 observations). The likelihood ratio test was significant. The Cox and Snell R^2 was 20.6 percent and Nagelkerke R^2 was 21.3 percent. The estimates exhibit a similar pattern. For the first threshold level, above 2.5 percent and up to 5 percent, only size and beta is significant. For the second threshold level, above 5 percent and up to 10 percent, together with size and beta, growth is also significant. Beyond that, for all threshold levels together with size, beta and growth, ROTA is also significant. The impact of size is the highest and continuously rises whereas the impact of risk is also rising barring last two threshold levels. The impact of all variables is positive with an exception of impact of leverage which is negative and insignificant at all levels. The main difference, however, is that the impact of asset structure was positive and significant exceptionally only for above 15 percent and up to 20 percent threshold level. The sectors which were significant were diversified, energy, health care, industrials and utilities for FIO above 15 percent. The time dummy is insignificant up to 15 percent FIO. The financial year 2009 has been significant beyond the 15 percent threshold level suggesting that foreign investment over 15 percent started coming from this year itself.

Table 4: Results of multinomial logistic regression with reference category - more than 0.15 percent to 2.5 percent (652 observations)

	More than 2.5 percent to 5 percent (408 observations)		**More than 5 percent to 10 percent (576 observations)**		**More than 10 percent to 15 percent (460 observations)**		**More than 15 percent to 20 percent (369 observations)**		**Above 20 percent and up to 57.44 percent (535 observations)**	
Variable	Coefficient	*p*-value	Coefficient	*p*-value	Coefficient	*p*-value	Coefficient	*p*-value	Coefficient	*p*-value
Leverage	-.513	.184	-.294	.394	-.242	.520	-.685	.115	-.189	.613
ROTA	.005	.511	.005	.496	.015	0.030**	.019	0.014**	.015	0.030**
Asset Structure	.162	.641	.083	.792	-.231	.511	.773	0.047**	-.399	.256
Growth	.001	.195	.003	.000*	.003	.000*	.004	.000*	.004	.000***
Size	.679	.000*	.691	.000*	.806	.000*	1.256	.000*	1.314	.000*
Market capitalisation	.000	.347	.000	.456	.000	.552	.000	.084	.000	.756
Beta	.490	0.001*	.492	.000*	.572	.000*	.923	.000*	.885	.000*
Constant	-4.879	.000*	-4.482	.000*	-6.129	.000*	-10.546	.000*	-10.115	.000*
Time Dummy	Not significant		Not significant		Not significant		2009,2010,2011 significant		2009 significant	
Sector Dummy***	Information Technology and Telecom		Not significant		Energy, Healthcare		Diversified, Energy, Healthcare, Industrials and Utilities			

Note: *** Only significant sectors are mentioned, ** and * denote the statistical significance at the 5%, and 1% levels respectively.

4.2 Discussion

The picture that emerges from the study is that investment by foreign institutions depends on firm profitability, growth, size and risk. Less profitable, less market value of stock, small and medium sized firms with less volatile stocks are less likely to attract CS of FIO. Foreign institutional investors would prefer to invest in profitable and bigger firms whose stocks are representative and more volatile than the market. These investors are backed by strong analytical teams who work hard to achieve their investment objectives. These objectives could be short term operating gains or tapping long term growth opportunities. The Indian economy, among other developing economies of Asia, offers higher growth. This can be explained by the fact that since November 2013, there has been consistent and sizeable investments by FIO in Indian stock market which is expected to continue with the easing of various restrictions on foreign investments by the government. The Indian government's initiatives to improve its investment regime for foreign investors would stabilise foreign investment capital inflows. The results of the study are consistent with Garavito, Iregui & Ramirez (2014) who found that FDI increases with the size of the firm and decreases with the volatility of real exchange rates, confirming risk aversion of investors. This is confirmed by Kang and Stulz (1997). The study found that foreign investors hold disproportionately more shares in manufacturing firms with good accounting performance, low leverage, high market to book value ratios and low unsystematic risk. In summary, results of the present study show that FIO is consistently and strongly biased towards major listed stocks which are well traded and highly valued in stock market, suggesting that these stocks offer less restrictions to foreign investors. Foreign investors would have lesser obstacles to holding shares in larger firms. These stocks are well known internationally which could be due to their export sales or depository receipts abroad. Another important aspect is that stocks that are well traded in the market appeal to foreign institutional investors, because they can easily exercise the exit option, if need be. These investors have knowledge and ability to select such stocks. At the same time, foreign ownership concentration would require a certain threshold level of institutional development to be an effective corporate governance strategy, (Heugens, Essen & Oosterhout, 2009) namely relating to strong macro governance environments and market infrastructure (Reenu & Sharma, 2015) with minimum political risk (Knill, 2013). The higher the political risks, the less diversification internationally and vice versa by foreign investors. Increase in political risks leads to investment in liquid stocks by foreign investors (Ko et al., 2007).

5. Conclusion and Policy Implications

Various economic theories have suggested that open markets and investment regimes are particularly powerful instruments to attract foreign investment (Talamo, 2011). In this paper, empirical evidence on the determinants of FIO for firms listed on two major stock exchanges in an emerging economy, India, confirms validity of these theories. The paper had showed how firm characteristics impact on FIO and at various levels of shareholding. Average FIO in the sampled firms is 9.81 percent which confirms the existence of a substantial home bias, similar to the findings of Kang and Stulz (1997). Despite reduction in barriers to foreign inward investment and a consistent increase in foreign capital inflows since 1990's, they are still limited and restricted to selected sectors. Findings of this study show that firm profitability, growth, size and risk positively and significantly impact FIO in Indian public listed companies with almost similar results for different levels of FIO stake. It is worth noting that size of the firm and market risk have the most impact for all levels of investment decision by foreign institutional investors. However, growth of the firm impacts FIO beyond 5 percent stake and profitability impacts FIO beyond 10 percent stake. Out of the seven sectors, two sectors, namely diversified and industrials and utilities, are more likely to attract FIO above 15 percent whereas energy and health care would attract FIO above 10 percent.

We conclude that firm characteristics play an influential role in attracting FIO and thus, improving firm characteristics and market infrastructure would contribute to greater FIO Small firms which are either diversifying their businesses or operating in growing sectors like health care can attract FIO. In the long term, more capital injection in the firm would increase investments in assets and thus, profitability (Knill, 2013). The study concluded that foreign portfolio investment increases access to finance for small listed firms in all 43 countries (including India) through developed capital markets and freeing up of domestic capital by reduction in domestic issuance and an increase in foreign capital. In addition to firm characteristics, investment by foreign investors is influenced by country and firm level corporate governance (Choi et al., 2014). Costs and benefits of monitoring are dependent upon external conditions prevalent in an economy (Li et al., 2006). Foreign ownership levels can be treated as a proxy for the extent to which foreign institutions are active monitors of firm management (Huang & Shiu, 2009) and enhance corporate governance practices of the firm in which they invest in by promoting international standards of accountability and expertise to help reduce a firm's cost of capital or increase its stock price. Another corporate governance aspect is the level of legal protection. Strong legal protection of shareholders makes ownership concentration inconsequential and therefore redundant. Finally, in jurisdictions where

owners can easily gain benefits from the corporations they control (with weak legal protection of investors), the focal relationship becomes weaker, presumably on account of minority shareholder expropriation.

Foreign institutional investors are both objects and subjects of corporate governance. These investors can be instrumental in improving corporate governance regime in India. Furthermore, results of the present study shows several implications for corporate policies. First, Indian listed firms must start thinking of encashing the valuation benefits associated with global risk sharing between foreign and domestic investors. The "global risk-sharing hypothesis" suggests that the firm could improve firm valuation and hence lower their cost of capital by attracting more foreign investments in their firms and through reducing the proportion of shares held by domestic investors (Chan et al., 2009). Second, foreign institutional investors from countries with strong shareholder protection and corporate governance regimes affect corporate governance mechanisms of firms they invest in leading to improvements in firm valuation and termination of poorly performing management or Chief Executive Officers (Aggarwal, Erel, Ferreira & Matos, 2011). Lastly, the analysis points towards the need for policy intervention to attract more foreign investment in listed firms in Indian stock markets to boost the country's economic growth. The Government has already introduced a series of reforms in recent years but much more needs to be done to maintain investor confidence in the country's economy. Future research should to include macro-economic and sector specific variables to investigate the determinants of FIO in Indian listed firms as well as the change in FIO capital over time.

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