

Foreign Institutional Investors, Controlling Shareholders and Market Timing

Evidence from India

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Motivation

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- Exporting good governance (Aggarwal, Erel, Ferreira, Matos, 2011)
- What about emerging markets?
- Twin agency problems (Stulz, 2005)
- Study interaction of FIIs with controlling shareholders in emerging markets

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- Do financial markets overestimate the gains from FII shareholding?
- Highlight the role of information asymmetry in emerging markets and its implication for efficient allocation of foreign investments

Main Findings

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- Disconnect between short-run market reaction and long-term performance

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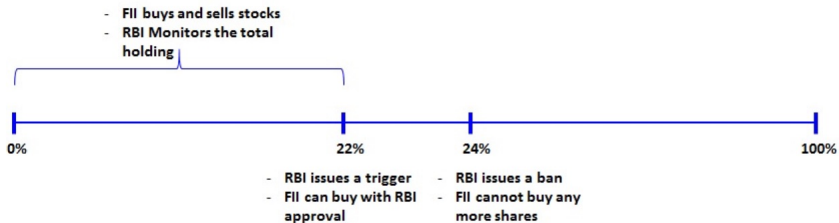
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 - ▶ RBI monitors FII stockholding and imposes restrictions (Trigger) when such holdings reach within 2% of the existing ceiling or prohibits further purchase (Bans) when the holdings reach the statutory ceiling

Event Timeline



FI Holding →



Empirical Design

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- Event study

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 - ▶ Board approval dates

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- Long-run stock performance following FII Limit increase (BHAR)
- Panel regression with year and firm fixed effects
 - ▶ Standard errors are clustered by firm

$$Y_{it} = \beta FII Limit_{it} + \gamma' X_{it} + \alpha_i + \eta_t + \epsilon_{it} \quad (1)$$

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 - ▶ Prowess - Board related measures, acquisitions

Summary Statistics

Variable	FII Limit Firm	Typical Firm
Market Equity	23.98	10.85
Assets	47.71	11.69
Market to Book (MB)	3.50	1.60
Capital Expenditure (%)	14.00	7.00
Cash (%)	11.00	7.00
Book Leverage (%)	27.00	31.00
ROA (%)	17.00	6.00
Dividend Payers (%)	78.00	49.00
Insider Ownership (%)	44.50	52.08
FII Ownership (%)	16.46	3.15

Ownership Changes

Variable	Δ FII	Δ Promoter	Δ DII
FII Limit	4.85***	-2.68***	-0.38
Log Assets	-1.20***	-0.21	-0.19*
Capex Ratio	1.20*	0.74	0.88
Cash Ratio	2.03**	-0.41	-1.14
Leverage	0.31	-1.63	-0.39
ROA	0.87***	0.48	-0.08
Log MB	0.76***	-0.84***	0.31**
Promoter Ownership	0.02**	-0.03**	0.02*
Dividend Payer	0.334**	0.267	0.062
Year FE	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
N	17,036	17,128	17,071

Short run effect of FII limit increase

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- RBI Approval

window	obs	CAR	t-stat
$[-2, 2]$	229	1.20***	2.58
$[-1, 1]$	229	1.17***	3.16
$[0, 1]$	229	1.34***	4.54

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- Board Approval

window	obs	CAR	t-stat
$[-2, 2]$	74	1.47***	1.95
$[-1, 1]$	74	1.65***	2.57
$[0, 1]$	74	1.00***	2.04

Long run effect of FII limit increase

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- Market Adjusted BHAR

window	obs.	BHAR	t-stat
$[-24, 0]$	195	468.50***	2.87
$[-12, 0]$	195	171.70***	1.64
$[0, 12]$	205	-3.90	-0.75
$[0, 24]$	209	-20.13***	-3.01

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- Fama-French 12 Industry Adjusted BHAR

window	obs.	BHAR	t-stat
[-24, 0]	195	335.10**	2.07
[-12, 0]	195	124.60	1.19
[0, 12]	205	-45.18***	-7.05
[0, 24]	209	-112.10***	-10.67

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 - ▶ ROA (Industry-adjusted)

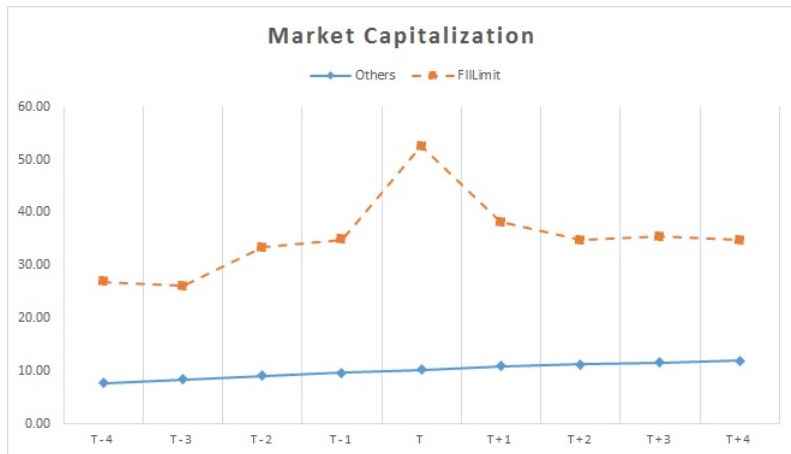
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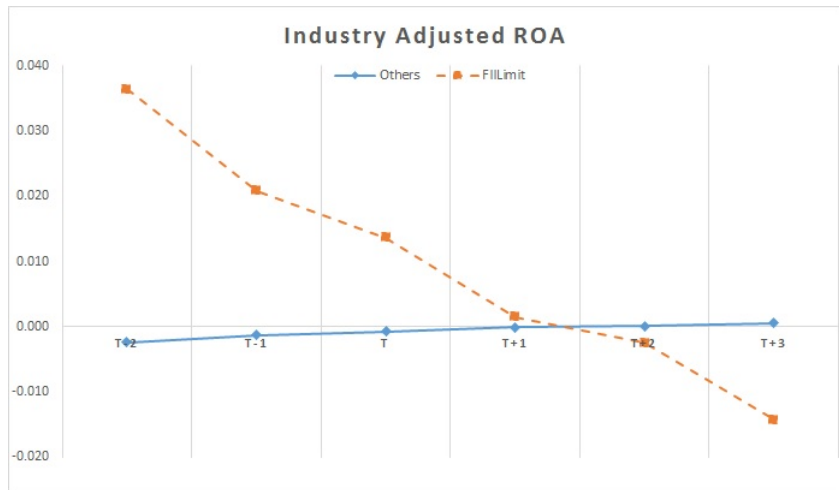
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- Mean and median tests

Market Capitalization



Return on Assets



FII Limit and Acquisitions

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- Use overpriced stock as currency to acquire real assets

	All	Within Group	Outside Group
FII Limit Dummy	0.13***	0.06****	0.100***
Log MB	0.02***	0.01***	0.01***
Log Assets	0.03***	0.02***	0.01***
Leverage	-0.02**	-0.03***	-0.00
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	19, 476	19, 476	19, 476

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- Information asymmetry and ownership structure has tremendous implications for foreign investments in emerging markets
- Study also raises questions on relying on short-run event studies, especially in markets characterized by opaque firm-specific information