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Mersin University

Graduate School of Social Sciences

Business Administration

THE IMPACT OF INSTITUTIONAL ENVIRONMENT AND CORPORATE
GOVERNANCE ON FOREIGN PORTFOLIO EQUITY INVESTMENT:
A LONGITUDINAL STUDY

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MASTER'S THESIS

Mersin, 2015

DECLARATION OF OAT

I solemnly declare that my thesis study, titled "The Impact Of Institutional Environment And Corporate Governance On Foreign Portfolio Equity Investment: A Longitudinal Study" was independently authored by myself in accordance with academic ethic and traditions and using solely the referred sources and support.

Date

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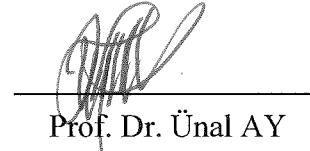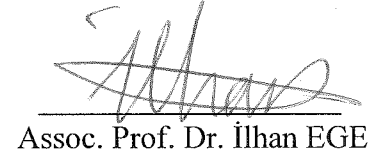
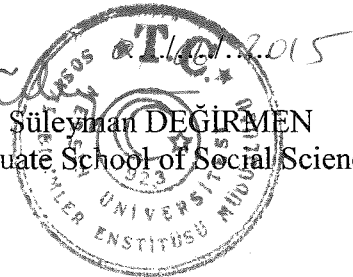| Successful	Unsuccessful		
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ABSTRACT

THE IMPACT OF INSTITUTIONAL ENVIRONMENT AND CORPORATE GOVERNANCE ON FOREIGN PORTFOLIO EQUITY INVESTMENT: A LONGITUDINAL STUDY

There has been a significant increase in the volume of global portfolio equity investment in the form of both equity and debt in the last fifteen years. In addition, this form of investment has become a major source of financing for many countries. Thus, it is important to understand the conditions under which this investment increases in a country. Extant literature has focused on market size and efficiency in the receiving country, trade openness, distance from the source country and legal institutions as factors that attract portfolio equity investment. In this study, I analyzed the impact of both institutions and quality of corporate governance in the receiving country on portfolio equity investment that this country receives. I argued that portfolio equity flows into a country would be higher if the institutional environment in that country provides for protection of property rights, freedom from corruption, court independence, efficiency in government and bureaucracy, and a secure environment for transactions. Moreover, I argued that the quality of corporate governance is also a major factor that attract portfolio equity investment. I tested my arguments on a large sample consisting of a longitudinal dataset for 76 countries for the years between 1990 and 2014. The results of my analyses provide strong support for the argument that portfolio equity investment is related to both institutional environment and corporate governance. That is better institutions attract foreign portfolio equity investment.

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INTRODUCTION

There has been a significant increase in the volume of global portfolio equity investment in the form of both equity and debt. As Uppal (1997:3) argues, since "foreign portfolio equity investment has become a major source of external financing for many countries, it is important to understand the conditions that encourage international portfolio equity flows". One important determinant of international portfolio equity investment is the country level institutions. Institutions can be defined as the rule of the game that determine economic performance through their effect on incentives (Acemoglu, Johnson, and Robinson, 2005:7). Good institutions are expect to influence economic development through the promotion of both real and equity investment. Good institutions promote investment in factor accumulation, innovation and thus lead to efficient allocation of resources.

Since institutions functions as the rules of games in a country and are powerful determinants of the ability of countries to advance economically, it is important to know relationship between qualities of institution in a country and portfolio equity investment inflows of that country. Literature suggests that legal institutions are important factor in attracting higher level of foreign equity portfolio investments. For instance, Poshakwale & Thapa (2011) argued that investor protection is related to international equity investment. Cao & Ward (2013) argued that country's foreign portfolio equity investment positively related to rule of law, constrains of executives and property rights protection of that country. While Portes& Rey (2001) argued that portfolio equity inflows of a country dependent on its market size, openness, and efficiency of transactions and distance. My study goes beyond this and focuses on the quality of all institutions (both public and private, legal and non-legal) in a country**.** Since some international portfolio investment is

in the form of equity investment in publicly held companies, the quality of corporate governance is also likely to be another determinant of the amount of international portfolio equity of flows.

The main purpose of this research is to investigate the relationship between the portfolio equity investment inflows into a country and the quality of its public institutions (institutional environment) and private institutions (corporate governance). Therefore the study should answers the following questions: How ineffectiveness of government institutions of a country affects the foreign portfolio equity investment? Does the corruption affect the portfolio equity investment inflow of a country? Do the countries with high Law enforcement attract more foreign portfolio investment than with weak ones? Do the countries with better property rights protection attract foreign portfolio investment more than those with bad property rights protection? Is there any relation between foreign portfolio equity investment and practicing corporate governance principles of a country? Does the ethical behavior of a companies of a country affect foreign portfolio equity investment inflow of that country? And how instable security conditions of a country affects to its foreign portfolio equity inflows?

In order to answer to these research questions, I conducted a regression analysis of a large panel data set on portfolio equity inflows of 76 countries. In my analyses, I examined empirically the effects of quality of both public and private institutions on portfolio equity investments. The data in my sample comes from World Economic Forum and Heritage Foundation and range from 1990 to 2013. My findings suggested that all institutional variables I assessed, are positively related to portfolio equity investment and statistically are significant.

Looking through my research process, I can summarize at least three aspects that make this study valuable. First it will explore new investigations and discussions because, it is very few or there is no previous studies combine public institution, private institutions and foreign portfolio equity investment. Second it underlines the institutions those more relate to foreign portfolio equity investment. Third it will be benefit for countries or companies those demand to attract foreign portfolio equity investment. Fourth it is partially necessary to complete master degree.

In order to understand the linkage between the portfolio equity investment inflows of a country to quality of its public institutions institutional environment and private institutions my thesis is organized as follows: Chapter 1: I first conducted a literature review, in which I am going to introduce both the concepts of public institutions, private institutions and foreign portfolio equity in terms of historical roots, definitions and related concepts reviews the literature of institutions and portfolio equity investment. Specifically it focuses topics of institutions and investment incentives, institutions and foreign portfolio equity investment, corporate governance and investment incentives, agency problem corporate governance and mechanisms of control, the principles of effective corporate governance, indicators of strong corporate governance, good corporate governance and investment, corporate governance and foreign portfolio equity investment. In chapter 2: after I reviewed the previous studies, this chapter focuses my arguments about how institutions may relate to portfolio equity investment of a country. It provides 7 hypothesis. Chapter 3: describes sources of data, definitions of variables, basic model of the research and measurement and scaling. Chapter 4: is concerned with the empirical investigation of my dataset constructed as part of the work for this thesis. I explained relevant empirical findings regarding relationship between

portfolio equity investments of a country to quality of its institutions. Chapter 5: this chapter is about conclusion of my study. It summarizes my study as generally, what I was searching for and empirical findings.

1. LITERATURE REVIEW

This section concerns the previous studies related to my topic and concepts. Specifically it focuses topics of institutions and investment incentives, institutions and foreign portfolio equity investment, corporate governance and investment incentives, agency problem corporate governance and mechanisms of control, the principles of effective corporate governance, good corporate governance and investment, corporate governance and foreign portfolio equity investment.

1.1. Institutions and Investment Incentives

This section describes what is meant by institutions, types of institutions, how institutions encourage the human to put their money in risk. The section also discusses how the institutions affect the future of societies. Finally, the section discusses research on the relationship between institutions and foreign portfolio equity investment.

1.1.1 Institutions

There are many definitions about institutions in the literature; some of them will be discussed in this section. Institutions are generally defined as structures that humans impose on their economic and social interactions. In his 1993 Nobel Prize speech, Douglas North stated that "institutions are the humanly created constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self-imposed codes of conduct), and their enforcement characteristics." These institutions define the incentive structure present in society.

Similarly, Acemoglu, Johnson, & Robinson (2005) and Menard & Shirley (2005) argue that institutions are the rules of the game in a society. This rules constrains interaction among individuals. This definition shows that three important features of institutions. First, unlike geographic factors, which are outside of human control, they are humanly devised causes of economic development. Second, they are the rules of the game that shape human behavior and interaction. Third that they create effects through affecting people's incentives, (Acemoglu & Robinson, 2008).In this setting individuals as well as organizations are the players.

1.1.2. Types of Institutions

Institutions can be classified as public and private. The most important institutions that influence the societies are public institutions. The public institutions can be classified in different ways. In this study, I classify public institutions into two parts: political and economic institutions. Each category has its own sub institutions.

1.1.2.1 Political institutions

The Political institutions of a society provide the platforms and rules for individuals to interact with each other. Therefore, they facilitate to determine the allocation of what is scarce: financial and natural resources, better facilities and services, access to advanced technology. People compete for high positions in the social hierarchy. Society generally have many different social positions. Some positions are high ones, are allowed with authority and privilege and linked to leadership roles, while others are not. The allocation of positions in the public hierarchy is crucial in shaping economic outcome of a society. Individuals with different positions interact with each other (Wu, 2014).

1.1.2.2 Economic Institutions

I have already seen in the literature the definitions of the institutions and defined as the rule of game. The economic institutions are part of these institutions. Wiggins & Davis (2006) defined the economic institutions as strong systems of recognized and rooted social rules and agreements that structure community exchanges. They defined a narrower than other definitions by saying that economic institutions are those institutions that perform economic functions, and includes three sets of institutions: The first set of economic institutions establishes and protects property rights; the second facilitates transactions; and the third permits economic co-operation and organization (Wiggins & Davis, 2006).

Figure 1.1 Classification of Economic Institutions

Institution	Function	Examples
Property Rights	Normally establishes rights, decide between competing claims, inform non-owners & police	The example of these sub institution include: Inheritance law Intellectual property rights: patents, copyright
Reciprocracy institution	Facilitates transactions, establishes rules of exchange, respect for contracts, provide information Reduce or re-allocate risk.	Weights, measures, standards, Contract law; dispute arbitration Public information on markets Physical provision & organization of markets (for example, stock exchanges, futures markets) Banking conventions, instruments (letters of credit) Auditing & accounting conventions Insurance companies.
Co-operation & Organization	Allows the interactions within Organizations, the Collective action & cooperation (in labor, price negotiation) and realizing economies of scale and managing diseconomies of scale	The sub institutions include: Laws on limited Liability & bankruptcy Competition policy, Regulations on cooperatives, charities, and civil associations Auditing &accounting conventions Employment regulations.

Source: Wiggins, S., & Davis, J. (2006). Economic institutions. London: Research Programme on Improving Institutions for Pro-Poor Growth, IPPG Briefing, 3.

Societies will prosper economically when they have good economic institution. The institutions may encourage or discourage the economic growth in a society. Lack of property rights protection in a country damages the investment, because no one will invest in human or physical capital without incentives or adopt more efficient technologies. Another reason why economic institutions are important is that these institutions determine the allocation of scarce resources in an economy, the profit from using these resources, and the residual control rights on revenues. When economic institutions such as free markets are absent or dysfunctional profit opportunities remain unexploited and resources are misallocated (Acemoglu, Johnson, & Robinson, 2005:5). Figure 1.1 presents the classification of economic institutions.

1.1.3. Institutions and Incentives

Acemoglu, Johnson, & Robinson (2005:7) clarified how political institutions influence the economic performance. They argued that political institutions and the distribution of resources in an economy determine economic institutions as well as economic performance. A bad political institutions provide bad property rights protection. For example if as a results of political institutions power to make decisions get centralized or is held by few individuals, economic institutions that protect property rights and provide equal opportunity for the rest of the population will deteriorate. So, political institutions determine the distribution of political power. This in turn affects the choice of economic institutions. This structure therefore presents a natural theory of a hierarchy of institutions, with political institutions determining economic institutions, which then determine economic results (Acemoglu, Johnson, & Robinson, 2005).

Knack & Keefer (1995:2) suggested that without property rights protection, the economic growth is impossible, by saying the institutions that protect the property rights are crucial to economic growth and investment. Absence of secure property and contractual rights discourages investment (Knack & Keefer, 1995).This means the countries with a higher protected property rights get higher economic growth than those with weakness of these institutions.

Economically developed countries have more developed institutions, especially legal and financial institutions compared to underdeveloped institutions in developing or emerging economies. Scheele & Jittrapanun (2012:5) suggested what kind of problems are suffering the developing and under developing countries. The most problems of these countries include lower savings, weak financial institutions, underdeveloped financial markets, unclear property rights and underdeveloped and unpredictable legal systems. On the other hand, fully developed institutions can reduce transaction costs by reducing uncertainty for individuals. Kaditi (2013:2) argued that basic factors those determine health and stable macroeconomic of a country are solid laws and well-defined property rights, sound political and economic institutions, and efficient regulation of the economy.

The countries with bad institutions or governance normally have bad image. Because of their poorly regulated institutions they have unattractive reputation for the investors. Like these countries uncertainty is high, companies do not prefer to invest in countries where physical and financial infrastructure is poor, regulations are weakly enforced and the legal system is ineffective (Mishra & Daly, 2007:4).

Beck & Levine (2002:29) examined the bank-based, market-based, financial services, and law and finance theories of financial structure. Industries that are heavy users

of external finance grow faster in countries with efficient legal systems. The findings of this study show that effective contract enforcement mechanisms foster new firm formation and more efficient capital allocation.

The study by Keefer & Knack (1997) provides important contribution to the literature of institutions and development. Their study focuses on the problem of an inadequate legal, political and regulatory framework. Deficiencies in the institutional structure may reduce overall investment and ability of a country to absorb technological innovations. Without adopting properly, countries may grow more slowly than expected. They hypothesized that the ability of poor countries to improve their economic conditions is partially determined by their institutional environment in which economic activity occurs. To investigate above hypothesis they employed various indicators of institutional quality, such as measures of the prevalence of the rule of law, the pervasiveness of corruption and the risk of expropriation and contract denial.

When property rights protection is weak, firms are likely to make improper adjustment to advances in technology. More secure property rights and appropriate government policies increases the incentives to adopt technologies that increase wealth and profits. Keefer & Knack (1997) concluded that, using evidence of this study, that institutions are powerful determinants of the ability of countries to advance economically.

1.1.4 Institutions and Foreign Portfolio Equity Investment

Portfolio equity investment can be defined as an "investment that is made for securing income or capital gains growth rather than to gain control of an enterprise". Portfolio equity investment is normally held in many companies in order to diversify risk (Gran, Westbrook, Mansley, Bass & Robins, 1998).

Importance of Foreign Portfolio Equity Investment:

The difficulty and cost associated with debt financing is one factor that increases the importance of funds that are generated through equity investment (Errunza, 2001:7).The International Institute for Environment and Development also described and listed some paybacks of foreign portfolio investments. Foreign portfolio equity investment help improve the liquidity and efficiency of financial markets, encourage good practices of corporate governance in countries where investment is made (Gran, Westbrook, Mansley, Bass & Robins, 1998).

How institutions may relate to foreign portfolio equity investment? I have discussed above how good institutions encourage generally investment and the economic growth of a societies. The institutions are those causes that some countries became poor and some other rich. Foreign portfolio equity is one type   investment so, if I say institutions encourage the people to make investment, they also encourage making foreign portfolio equity investment.At same time, in the literature I found several studies supporting this idea. For example, the empirical evidence of Uppal (1998:20) emphasized how legal institutions and legal enforcement are importance for the equity in flows. Equity flows investment depends upon a healthy private sector, which in turn requires an appropriate institutional environment.

Uppal (1998) suggested possible improvements in order to attract the foreign portfolio investment. The major areas he underlined include conductive political and legal environment, advanced capital markets and strong financial institutions, effective enforcement of market regulations, and institutions that help effective dissemination of market information. The conclusion of this study emphasized the importance to develop

above institutions, specifically developing countries, if they want to attract the foreign portfolio investment but the limitation of this study is that focused some of developing countries.

The study by Cao & Ward (2013) proposes a positive relationship between measures of property rights protection and inflows of portfolio investments. The portfolio investors need information about, which countries is more suitable to invest. Normally investors want to collect information of some countries in order to take decision of which country will be invested. It is not easy to collect all information of hundreds of countries, instead of that the portfolio investors look specific information about some institutions of the countries such as rule of law of the country, constrains of executives and property rights protection. This means foreign portfolio investors take their decisions by looking country's rule of law, constrains of executives and property rights protection.

The literature suggests that democratic countries have an advantage in attracting portfolio investments. Cao and Ward (2013) argue that portfolio investors prefer to invest democratic countries because of two reasons; first, the portfolio investors prefer to invest in countries with better property rights protection. This is often occur in countries with democratic institutions. Second, foreign investors are likely to reason that democracy and property right protection goes hand in hand, given that the same domestic conditions often causes both lasting democracies and property rights protection. However, they assumed that only democratic countries could have high property rights protection.

The quality and enforcement efficiency of legal institutions are important policy of attracting higher level of foreign equity portfolio investments. The empirical evidence of Poshakwale & Thapa (2011) confirm that investor protection measures,

particularly those that are specific to foreign investments, are an important determinant of international portfolio equity investments. This evidence confirms that foreign investors prefer investing in markets that have stronger foreign investor protection rights. It is true that investor protection one of the important institutions, but they ignored other institutions or gave less considerations.

Normally institutions are positively relate to foreign portfolio investment as previous studies indicate, and legal institution is more related to foreign portfolio investment as the empirical evidences of these studies shows. Most of the researchers underlined the importance of legal institution when they discuss this issue. Except Cao & Ward (2013) argued that country's rule of law, constrains of executives and property rights protection are more related to foreign portfolio investment. Portes & Rey (2001) their study of determinants of cross-border equity flows, underlined Market size, openness, and efficiency of transactions and distance as a determinants of an equity inflows. But their study is limited 14 countries.

1.2. Corporate governance and Investment Incentives

This section discusses separation of ownership and control, agency problem and corporate governance as a mechanism to mitigate agency costs. I also discuss the literature on the relationship between good corporate governance and foreign portfolio equity investment.

1.2.1 The agency problem: separation of ownership and control

The history of Corporate Governance date back to 1932 when Berle and Means presented their work titled The Modern Corporation and Private Property that emphases on the separation of ownership and control in large American corporations. By way of the

firms grew, it became problematic for the original owners to keep their majority as stockholders, and shares became dispersed among a large number of small shareholders. Managers interests, as Berle and Means confirmed, were not essentially in line with those of the shareholders. Jensen and Meckling (1976) described agency theory as relationship between as an agreement under which one or more owners employ another person(manager) to do some activities on their behalf which relate to giving or delegating the decision making rights to the manager. The managers always do not act in the best interest of the owners, therefore shareholders can control the opportunism of the managers by incurring monitoring costs and designing appropriate incentive for the managers. McColgan (2001) when he was explaining areas where conflicts of owner and manager arise underlined that moral hazard, earning retention, risk aversion and time horizon. The shareholders monitoring costs ascend from actions intended to control the manager's favoritism. Managers incur Bonding expenditures because of their actions that they want to assure owners not take certain actions. After monitoring and bonding costs by the owners and managers, there will still be a costs caused by the disagreement from decisions taken by the managers and the interests of shareholders (Laiho, 2011:5).

According to agency theory, the firm is a nexus of contracts that designed to mitigate the agency problem. Contracts are incomplete every time some may focus only on the agent's behavior, and others focus on interest of shareholders. Contracts should minimize the agency costs otherwise will be considered as inefficient ones. Owners and managers sign a contract that describes the duties of, how the fund will be managed and how profits are shared among managers and shareholders. They would sign a complete contract that tells exactly what the management in all situations of the world, and how the profits are distributed. The problem is that, it is impossible to forecast future contingencies

and describe exact. All complete contracts are technologically infeasible. Therefore shareholders and managers design residual contract rights those solve the above problem and this contract suitable to in future circumstances those currently unpredictable, (Shleifer&Vishny, 2002).

Managers can expropriate the funds of the investors because of their control rights (discretion) over how to allocate. They can use different ways to expropriate the funds, such transfer pricing. For instance, managers can set up independent companies that they own personally, and sell the output of the main company that they run to the independent firms at below market price (Shleifer&Vishny, 2002).Owners incur monitoring costs in order to control the behavior of the agency. Auditing and remunerations costs are popular one in this issue, and may include firing cost of management, (McColgan, 2001).

Note that the essence of the agency problem is the separation of management and finance or ownership and control. The shareholders need specialized human capital (managers) to generate professionally returns on their money. The managers need the money of owners, since they either do not have enough capital of their own to invest. But how owners know or, are got granted that if their capitals not stolen or wasted on unattractive projects?

1.2.2. Corporate governance: mechanisms of control

Agency problem damage the assets of the firms or reduces returns of the stockholders, since the managers may expropriate the funds or may take some decisions based on their interests easily because of their discretion. So, it is necessary to solve the agency problems. Agency problems can be reduced by using controlling mechanism of

corporate governance. In this section first provides some definition of corporate governance and then discusses the control mechanisms of corporate governance.

1.2.2.1. Definition of corporate governance

According to OECD (2004) corporate governance is concerned with the systems of laws, regulations, and practices that will promote enterprise, ensure accountability and activate performance. According, Richard, Kevan, & Steve (2011) "Corporate governance is concerned with the structures and systems of control by which managers are held accountable to those who have a legitimate stake in an organization". All the definitions reflect that the corporate governance is a tool that facilitates control of a power or decision making of a management. Management has decision making discretion and how they run the organization, outsiders of the organization demand the way they can see what is going on, inside the organization or how the managers are behaving.

1.2.3 Corporate governance practices around the world

The way of corporate govenance is practiced in a country depends on whether it has market-based system or bank-based system. Shareholders have difference roles according to these systems. Markets are fairly more essential in the Angl-Saxon economis, whereas financial institutions, especially banks, are rather more important in the rest of the world. In bank-based systems, invidual stockholders are less likely to hold corporate debt and eqiuty directly. Instead owneship in bank based systems passes through financial intermediaries. In the USA, a significant portion of households' portfolios is held directly in equity, such as common stocks. As a result individual stockholders can possibly play an important role in corporate governance. Compared to the United States, direct eqiuty holdings are smaller in Europe and much smaller in Japan. Tus, Japanese individual

stockholdersare less able to play a significant role in corporate governance (Brealey, Myers & Allen, 2011).

According to Brealy, Myers & Allen (2011), in US and UK, where the market based system is dominant, equity financing is an important source of firm finance. This makes stock markets an important part of corporate governance. On the other hand, in Germany and Japan, where the bank based system is dominant, a large portion of the equity investment and other financing is made by large and institutional investers and banks, making individual investors less important in corporate governance.

In the US and Japan ownership is dispersed across many small individual investers whereas in Japan, a significant portion of shares are concentrated within the keiretsu. Thus, individual Japanese stockholders have little power in corporate governance. Similarly, due to the concentration of equity onwership by banks and corporations, European stockholders have little voice in corporate governance. USA and UK laws put stockhoders' intesrest first because in these countries, the financial objective of corporations is to maximize the stockholder value. The influence and power of a stokholder usually depens on their equity percentage. Managers and board of directors in US corporations have a fiduciary duty to stockhoders. On the other hand, in Germany, the management is superseeded by a a supervisory board. This board includes representatives from both employees and shareholders (Brealey, Myers & Allen, 2011).

In the rest of the world, corporations are usually controlled by wealthy families or the state. For instance, in may developing countries conglomerates are an important aspect of the economy and these conglomerates are controlled by famly grups. This result in concenteated ownership, which on one hand could lead to value maximizing decision

making and on the other hand could lead to tunneling if the institutional environment does not protect minority shareholders.

1.2.4 Indicators of strong (good) corporate governance

When it comes the indicators of strong corporate governance, finance literature focuses on several factors. First *independent directors*: in order to become more effective the board should be independent from the internal management. As the number of independent directors in a board increases, the board becomes more effective in monitoring management and removing poorly performing chief executive officer. Second *independence of committees*: the independence of the different committees of the board such as audit, nomination, and compensation committees is crucial for the good governance. The independence of these committees enhance the transparency and reduce making decisions in favor of the management. Third *Board size*: as literature shows the size of the board is important forthe quality of corporate governance. Research indicate that larger size decreases the functionality of the board of directors. For instance, some researchers found that as board size increases firm value decreases. Fourth *Board meetings*: in order to find quick recovery in some situations boards should meet more frequently (Khanchel, 2007).

1.2.5 Good corporate governance and equity investment

This section describes how good corporate governance relates to investment attraction at the firm level. Good corporate governance means a set of institutions (rules, procedures, regulations and mechanisms) that is conducive to wealth creation, growth and the efficient utilization of resources. These institutions are necessary to run a firm successfully help the firm achieve its goals (Tapanjeh, 2006). For instance, companies with

good corporate governance are able to rise revenues more quickly, raise capital cheaply and increase profitability in the long term. Not all corporate governance practices are effective in creating efficiently running organization. Poor or inefficient corporate governance practices weakens company's potential and create financial difficulties (Todoric, 2013).

Todorovic (2013), in his study of the impact of corporate governance on firm performance showed that companies with better practice of corporate governance are more profitable. Thus he recommend that if companies want to increase their competitiveness and performance, survive in the global environment and attract investors around the world, they must integrate corporate governance principles and standards into their decision making and strategy process. But this study is based on a limited sample of 19 companies in one country.

Leuz, Lins, &Warnock (2010) studied whether foreign investors invest less in firm with poor governance using a sample of 4,409 firms from 29 countries. They found that firms located in countries with poor corporate governance regulations and outsider protection receive less foreign investment.

The existing literature indicate that corporate governance tools of the companies encourage foreign financiers to invest in companies with better corporate governance practices. Many studies document that there is positive link between corporate governance mechanisms and stock return. The stock markets in some East Asian countries have positive reactions to strong corporate governance. The purchasing the investment portfolios with good corporate governance get higher returns than purchasing those with bad corporate governance. The investors prefer to purchase stocks of companies executing

strong corporate governance practices. The weak corporate governance mechanisms have negative effects on companies. Prior studies found that firms with bad corporate governance structure are likely to have financial difficulties and may thus go bankruptcy, (Chang, Chang & Wei, 2008).

In this study of the role played by corporate governance structures in fund managers' decisions of allocating resources across investment alternatives, Das (2014) found that fund executives tend to invest more in companies with better governance and control structures. This finding suggest that information asymmetry between investors and managers plays an important part in the investment decisions of foreign investors. As argued by Abu-Tapanjeh (2006) many studies linked the better performance of a company with its good corporate governance.

Todorovic (2013) investigated the cumulative foreign holdings of investors from United States of America with investment in different companies in 29 countries and found that USA investors prefer not to invest in companies with high level of insider ownership, which creates governance problems. His study focused on the domestic and foreign investments of US institutional investors; the empirical result shows that the US institutional investors strongly prefer to invest in well-governed firms. These studies show that corporate governance is a crucial element for improvement of shareholders' confidence, enhance of competitiveness and improvement of economic growth.

The literature show that fund managers prefer to invest the firms with governance structures that increase the efficiency of information acquisition and reduce monitoring costs. Also, according this argument the firm-level and country-level corporate governance supplement one another. The literature show that investment decisions of fund

managers are influenced by how independent and efficiently structured boards are (Das 2014). The suggestion provided in his study provides to enhance understanding of the importance and roles of different features of corporate governance. The study suggested; the administration of companies considering to increase foreign investors should put more emphasis on improving board characteristics and auditing mechanism.

Todorovic (2013) described how good corporate governance is crucial for owners, companies, and other stakeholders. He argued that good corporate governance is tool that can be used for prevention of corporate fraud and scandals. At the same time efficient corporate governance enhances the reputation of a firm and makes it more attractive to financiers, suppliers, customers and other stakeholders of the firm. For capital providers and investors an important factor when making an investment decision is the extent to which corporate governance principles (such as public disclosure of information, protection of shareholder rights and equal treatment of shareholders) are implemented.

According previous studies theoretically and empirically show that good corporate governance is positively related to firm's financial performance and stockholder value, and good corporate governance reduces the risk of the firms. It is the signal of lower agency more attractive to investors, suppliers, customers and same time it is a device that helps to prevent corporate scandals, fraud, and potential civil and criminal liability of companies. Combining all these terms means good corporate governance creates environment that attracts the investors.

1.2.6 Corporate governance and foreign portfolio equity investment

The issue of corporate governance and foreign portfolio investment is not so rich in the literature. However, Das (2014) shows how corporate governance and foreign

portfolio investment relate to each other, He argued that foreign investors are interesting companies practice audit qualities and disclosure. He also argued that Board characteristics, audit issues and portfolio equity investment of the companies are related to each other. The monitoring costs are relate to the level of information asymmetry linked with the firm's tasks.

There is empirical evidence that firms with better accounting practices attract more foreign capital. Foreign investors prefer to invest in companies that voluntarily follow accounting principles espoused by the International Accounting Standard Board. Moreover, institutional investors are more likely to invest in firms with strong corporate disclosure practices because such firms require lower monitoring costs. Firms that score high on audit quality will be able to attract more foreign investors, (Das, 2014). In the literature it is clear that all foreign participants would demand timely and quality information on corporate activities and performance, minority investors' protection, as well as adequate market and trading regulations. Foreign portfolio equity investment will necessitate development of new institutions and services; encourage transfer of technology and training of local personnel (Errunza, 2001).

2. HYPOTHESIS

Keefer & Knack (1997) explained the functions and importance of property rights legal. Functions of The property rights institution defines and protects the rights of a company or person to an asset, to the revenue generated by the assets, and duties, responsibilities and rights among the individuals of a society. How these rights secure dependent on quality of the political and legal institutions of a country. Citizens of some countries feel that their property rights are protected while some others lost their assets without protection.

According to Knack & Keefer (1995) the property rights protection is essential to economic growth and investment. Lack of property rights protection and contractual rights enforcement demotivates investment of a country. This means that countries with a better protection of property rights experience higher economic growth than those with weak institution. When property rights or policy environment of a country are not sound, firms/ individuals are likely to make less efficient adjustment to changes in technology or management policies. More secure property rights and sound policy governments increases the incentives of businesspersons to adopt those techniques that make best use of long run profits.

Poshakwale &Thapa (2011) suggested that attraction of international equity portfolio investments depends on the quality and enforceability of legal protections available to investors. The previous studies show that democracy draws foreign investment because with democracy comes property rights protections. By the same token, countries characterized by a non-functioning democracy with low levels of property rights protections are less able to draw foreign investment than autocratic regimes.

Cao & Ward (2014) argued that portfolio investors prefer the investment in countries with better property rights protection. Normally democratic countries have strong legal institutions those give the citizens' rights to elect the one who will lead them and protect their properties from other individuals and government. Therefore, democracies increase inward portfolio equity investments though better property rights protection, so I predict that foreign portfolio investors prefer to invest countries with better property rights protection.

H1: The better the perception of property rights protection in a country, the higher is the net inflow of portfolio equity investment into that country.

Normally corruption is the signal of bad governance or weak institutions. Corruption here, means companies/ individuals cannot obtain government services unless they pay bribes to government officers. Wei &Shleifer (2000) argued that foreign investment has negative relationship with corruption. Corruption generally harms the economic growth according to Javorcik& Wei (2009) Corruption is obstacle that harms property rights protects of a country and countries with high level of a corruption do not attract foreign investors. Also it is too cost to do a business in a corrupted country. Therefore I argue that, countries with high corruption cannot attract foreign portfolio investment.

H2: The lower the perception of corruption in a country, the higher is the net inflow of portfolio equity investment into that country.

Strong rule of law means that a country has high quality institutions of contract enforcement, such as the police and the courts. The rule of law deals with how management accept and implement the laws of the country. The most important topics

include: the quality and clearness of the court systems, and the enforceability of agreements. The countries with a strong rule of law, citizens have good protection for themselves and assets, (Cao& Ward, 2014). Rule of law is the one of the factors that play an important role when it comes attracting foreign investment (Mishra & Daly, 2007).

It can said to be that the rule of law is pillar for economic growth of a country because the foreign investors need a reliable legal system that protects their properties. Good governance supports way that capital become more productive (Evans, 2002). Based on these arguments, I hypothesize that foreign portfolio investors prefer and more reliable countries those with strong rule of law.

H3: The lower the perception of undue judicial influence in a country, the higher is the net inflow of portfolio equity investment into that country.

The Effectiveness of government organizations show that the quality of administration, the competence of civil servants, the quality of public service delivery and the reliability of the government's commitment to its policies. The quality of the bureaucracy deals with tools for staffing and training, independent from interventions, and political pressure, (Vijayaraghavan & Ward, 2001). Aron (2000) argues that quality of bureaucracy, property rights, and political stability and economic growth are positively related. The empirical results of Busse &Hefeker (2007) show that there is a positive relationship between the quality of bureaucracy and investment inflows of a country. They argued that countries with high quality of bureaucracy are stable and changing of the administration do not affect the policies of the country extremely. Poshakwale & Thapa (2011) argued that Countries with weak bureaucracy cannot control effect, because a change in administration affects policymaking and functions of the government agencies.

Kaditi (2013) argues that the early literature of the developmental state posited that a powerful, competent, and protected state bureaucracy is necessary to initiate reforms necessary for attracting private investments and promoting economic growth. Therefore the effectiveness and quality of bureaucracy of a government administration attract foreign portfolio investment.

H4: The higher the perception of government efficiency in a country, the higher is the net inflow of portfolio equity investment into that country.

Security is key for development of a society. Oriakhi & Osemwengie (2012) defined as security as presence of happiness and peace in a society, and the safety and protection of human and physical resources. As Oriakhi & Osemwengie (2012) explained, military and/or political and economic resources are used to maintain and enhance the security a nation. This results in unity, happiness, protection of national values, the democratic process and mechanism of governance. They suggested that insecurity does not only include communal crisis, ethnic and religious violence, and political conflict but also includes the existence of natural disasters such as floods, earthquakes. Normally Insecurity has an enormous economic, socio and physical cost. Also they argued apart from the loss of lives, attack on people and their property is likely to have negative consequences with respect to investment behavior of individuals.

Insecurity may influence the stock markets of a country, because insecurity has negative relationship with stock prices, sales and purchase of the shares. This may increase market volatility if the investors' perception of the security of the stock market is not favorable. Insecurity may also cause reallocation of economic resources from highly

productive sectors to less productive ones. Without security there is low likelihood of meaningful growth and development in a country, (Oriakhi & Osemwengie, 2012).

The literature shows that the lack of security reduces foreign investment inflow, and foreign portfolio equity investment is part of foreign investment so, there should be positive relation between security and foreign portfolio equity investment. The frequently conflicts among a groups in a country whether they are religious or ethnic ones harms the investment of that country. The literature shows that the countries with high degree conflicts has negatively impacted to their development. Foreign investor when they evaluate the investment profile of a country, they give their considerations ethnic tensions and other conflicts those happen in that country. Today security is one the important determinants of capital flows, (Busse & Hefeker, 2005).

H5: The higher the perception of security in a country, the higher is the net inflow of portfolio equity investment into that country.

As argued Bard, Drew & Kennedy (2012) evidences are increasing those show positive relationship between returns to ethics and corporate social responsibility, especially in emerging countries. Today the importance of business ethics increased, know day's executives normally study their business ethics courses in the MBA programs. The topics of ethical decision making, ethical orientations, and corporate social responsibility are popular in the business schools.

Everyone can do business and success by behaving ethically. There is no denying that every person can success by doing moral. Ethical firms may build good dignity in their community. Because of that good reputation they gained in their society, it gives them financial rewards after long time. Normally every ones behave ethical, if it

align with his/her interests. Investors prefer put their money companies behaving ethical, they believe that like these firms will get acceptance and loyalty of their community and all their stakeholders that lastly turns into financial rewards.

Hurst (2004) argues the stockholders and customers have the most prior when the impact of a company activities. Shareholders are providers of the capital, which works with the firm or is the fuel of the firm while customers are those generate for the business income. Management   of a firm should give the attention the impact of those groups. For example customers may stop buying the product of a company, if they see as unethical or irresponsible one while investors may stop to invest like this firm. This finally may cause death of the company.

The empirical results of Berrone, Surroca & Tribó (2007) indicate that the transparence of ethical issues in thee a company has positive relationship to the satisfaction of the stakeholders. The literature shows that behaving ethically and practicing good corporate governance positively impact the performance of a company. The employees is another group those have important impact in a company. Firms with strong corporate social responsibility may attract more talented human capital. They also enjoy committed, trustful and loyalty employees that positive relate to customer service and quality of the product.

As shows the empirical evidence of Tsoutsoura (2004) there is positive relationship between corporate social responsibility and financial performance. Companies those are more socially responsible gain good brand image and reputation in the society. After gaining that good reputation, company may enjoys many benefits such easily attract outside capital, finding other partners and loyalty of the consumers. However the socially

responsible companies enjoy with good reputation, image and attraction capital and trading partner. At the same time as shows the empirical evidences of an above studies corporate social responsibility positively related to financial performance. Based on the literature and empirical evidences of previous studies the ethical behavior of a company increases employee commitment, satisfaction, trust and commitment of the stakeholders, shareholder's value and general performance of the company, then I hypothesize that:

H6: The better the perception of average corporate ethic in a country, the higher is the net inflow of portfolio equity investment into that country.

Information sharing is crucial for markets. Sometimes releasing of wrong information causes market failure specifically capital markets. In this century as shows literature, financial crises and corporate failures caused by with transparent or at least contributed. At same time, information sharing plays an important role evaluation, calculation of risks, selection of suitable project and its monitoring, (Vishwanath & Kaufmann, 1999).

Information flows are an important element of international investments. The foreign investors avoid to invest companies with information asymmetry and they rely on firm with more independent boards or external auditing. Countries with better legal protections and good governance focus on things like; transparent financial reports and high quality accounting standards, external auditing, (Francis, Khurana, & Pereira, 2003). Companies those loyal to practicing good governance such as high quality auditing and information disclosure, attract foreign investment more than firms with no this behavior. The evidence of this study shows that foreign investors rely on companies those practice accounting standards of United States of America, (Das, 2014).

The different countries around the world have different legal systems specifically investor protection.   Good investor protection, minority shareholders protection and law enforcement are incentives for outside investors. Accounting standards and reporting are important for   investors in order to evaluate the companies. The countries those like to promise the investor protection specially dispersed ownership ones focus to develop their financial markets, accounting standards and quality of the auditing, (Francis, Khurana, & Pereira, 2003).Based on these studies, I hypothesize that:

H7: The better the perception of average corporate accountability in a country, the higher is the net inflow of portfolio equity investment into that country.

3. DATA AND METHOD

3.1. Sample

In order to test my hypotheses, I combine country level data on public and private institutions obtained from the World Economic Forum with macroeconomic indicators and portfolio equity investment data that I obtained from World Bank for 76 countries. Table 1 presents the years and sources of data for the measures that are used in this thesis. Note that although the data I have on my independent variable spans the years from 1990 to 2013, data on most of institutional variables is available only for the years between 2006 and 2012. Thus most of my analysis is based on sample of data consisting of country-years observation ranging from 213 to 477.

3.2. Empirical Model

The theoretical framework I proposed in the previous section argues that portfolio equity investment would be higher in countries where:

    i)   There is stronger property right protection

    ii)   There is ethical decision making and lack of corruption in government

    iii)   There is a lack of undue influence in the government and courts

    iv)   There is a high level of efficiency in governmental decision making and bureaucracy

    v)   The is high level of security

    vi)   Corporations behave ethically, and

vii)   Corporate governance is characterized by high level of corporate accountability.

Items i through v characterize the strength of public institutions. The remaining two items characterize the strength of private institutions, or corporate governance. To test this framework, I specify the following empirical model.

$$PEI_{it} = \beta_0 + \beta_1(Institutions)_{it} + \beta_2(lnGDP)_{it} + \beta_2(lnListed)_{it} + \beta_3(SPindex)_{it}$$
$$+ \beta_4(Inflation)_{it} + \beta_5(Investment)_{it} + e_{it}$$

Where subscripts i and t, stand for country and year, respectively. *PEI*(the dependent variable) and *Institutions* represent net portfolio equity investment and my institutional variables, respectively. These are the main variables of interest in this study. The remaining variables are control variables. Finally, *e* is the error term. Below, I explain the measurement of these variables.

3.3. Dependent Variable

The dependent variable in my model is *portfolio equity investment (PEI)*. According to World Bank (http://data.worldbank.org), portfolio equity investment in a country "includes net inflows from equity securities other than those recorded as direct investment and including shares, stocks, depository receipts (American or global), and direct purchases of shares in local stock markets by foreign investors, all in US dollars" (World Bank, 2015). This variable is positively skewed with a kurtosis of 89. This suggest that a significant portion of the observation are concentrated around the mean. Moreover, there are many observation that are recorded as zero. About half of the observations take values that are equal to or less than zero. For, instance, the median value of this variable is 0. And, 516 of the total number of observation takes values that are below zero. Ordinary

least squares regression where this variable is used as the dependent variable may not provide reliable estimate. For this reason, I transform this variable into a categorical one based on the percentiles of net portfolio equity investment. The categorical variable, which we call PEI, takes the value of 0 if net portfolio equity investment is 0 or below 0. For values of net portfolio equity investment that are between the 51st and 60th percentiles, between the 61st and 70th percentiles, between 71st and 80th percentiles, and between 91st and 100th percentiles, PEI takes the value of 1, 2, 3, 4, and 5, respectively. So, my dependent variables is an ordered categorical variable that takes values between 0 and 5.

3.4. Independent Variables

The main independent variables in my model concerns those that are related to public and private institutions. I use World Economic Forum's Competitiveness Index data and measures to proxy the variables that are related to public and private institutions in my model. This index measures public and private institutions based on sixteen and five attributes of the institutional environment, respectively, through country surveys of samples of executives in each country that is included in the index. Then the index combines the measures of these attributes to obtain aggregate measures of the institutional environment. I use these aggregates as measures of my institutional variables.

Strength of property right protection (property rights) is measured as the weighted average of property right and intellectual property right protection. Property rights is assessed on a scale from 1 (=extremely weak) to 7 (=extremely strong) with the following question: "In your country, how strong is the protection of property rights, including financial assets?" Intellectual property protection is assessed on a scale from 1 (=extremely weak) to 7 (=extremely strong) with the following question: "In your country,

how strong is the protection of intellectual property, including anti-counterfeiting measures?"

Ethic and lack of corruption in government (inverse corruption) is measured by the weighted average of diversion of public funds, public trust in politicians, and irregular payments and bribes. Diversion of public funds is assessed on a scale from 1 (=very commonly occurs) to 7 (=never occurs) with the following question: "In your country, how common is the diversion of public funds to companies, individuals, or groups due to corruption?" Public trust in politicians is assessed on a scale from 1 (=extremely low) to 7 (=extremely high) with the following question: "In your country, how would you rate the ethical standards of politicians?" Irregular payments and bribes is assessed on a scale from 1 (=very common) to 7 (=never occurs) with an average score across the five components of the following executive opinion survey question: "In your country, how common is it for firms to make undocumented extra payments or bribes in connection with (a) imports and exports; (b) public utilities; (c) annual tax payments; (d) awarding of public contracts and licenses; (e) obtaining favorable judicial decisions?"

*Undue influence in government and courts (**inverse undueinfluence**)* is measured by the weighted average of judicial independence and favoritism in decisions of government officials. Judicial independence is assessed on a scale from 1 (=heavily influences) to 7 (=entirely independent) with the following question: "In your country, to what extent is the judiciary independent from influences of members of the government, citizens, or firms?" Favoritism in decisions of government officials is assessed on a scale from 1 (=always show favoritism) to 7 (=never show favoritism) with the following question: "In your country, to what extent do government officials show favoritism to well-connected firms and individuals when deciding upon policies and contracts?"

*Efficiency in governmental decision making and bureaucracy (**government efficiency**)* is measured by the weighted average of wastefulness of government spending, burden of government regulation, efficiency of legal framework in settling disputes, efficiency of legal framework in challenging regulations, and transparency of government policymaking. Wastefulness of government spending is assessed on a scale from 1 (=extremely inefficient) to 7 (=extremely efficient in providing goods and services) with the following question: "In your country, how efficiently does the government spend public revenue?" Burden of government regulation is assessed on a scale from 1 (=extremely burdensome) to 7 (=not burdensome at all) with the following question: "In your country, how burdensome is it for businesses to comply with governmental administrative requirements (e.g., permits, regulations, reporting)? Efficiency of legal framework in settling disputes is assessed on a scale from 1 (=extremely inefficient) to 7 (=extremely efficient) with the following question: "In your country, how efficient is the legal framework for private business in settling disputes?" Efficiency of legal framework in challenging regulations is assessed on a scale from 1 (=extremely difficult) to 7 (=extremely easy) with the following question: "In your country, how easy is it for private businesses to challenge government actions and/or regulations through the legal system?" Transparency of government policymaking is assessed on a scale from 1 (=extremely difficult) to 7 (=extremely easy) with the following question: "In your country, how easy is it for businesses to obtain information about changes in government policies and regulations affecting their activities?"

Security is measured by the weighted average of business cost of terrorism, business cost of crime and violence, organized crime, and reliability of police services. Business cost of terrorism is assessed on a scale from 1 (=to a great extent) to 7 (=not at

all) with the following question: "In your country, to what extent does the threat of terrorism impose costs on businesses?" Business cost of crime and violence is assessed on a scale from 1 (=to a great extent) to 7 (=not at all) with the following question: "In your country, to what extent does the incidence of crime and violence impose costs on businesses?" Organized crime is assessed on a scale from 1 (=to a great extent) to 7 (=not at all) with the following question: "In your country, to what extent does organized crime (mafia-oriented racketeering, extortion) impose costs on businesses?" Reliability of police services is assessed on a scale from 1 (=cannot be relied upon at all) to 7 (=can be completely relied upon) with the following question: "In your country, to what extent can police services be relied upon to enforce law and order?"

Ethical corporate behavior (ethic in corp.) is assessed on a scale from 1 (= extremely poor—among the worst in the world) to 7 (= excellent—among the best in the world) by the following questions: "In your country, how would you rate the corporate ethics of companies (ethical behavior in interactions with public officials, politicians, and other firms)?"

Corporate accountability (accountability in corp.) is measured by the weighted average of strengths of auditing and reporting standards, efficacy of corporate boards, protection of minority shareholders' interests and strengths of investor protection. Strength of auditing and reporting standards is assessed on a scale from 1 (= extremely weak) to 7 (= extremely strong) by the following questions: "In your country, how strong are financial auditing and reporting standards?" Efficacy of corporate boards is assessed on a scale from 1 (= management has little accountability to investors and boards) to 7 (=management is highly accountable to investors and boards) by the following questions: "In your country, how would you characterize corporate governance by investors and boards of directors?"

Protection of minority shareholders' interest is assessed on a scale from 1 (= not protected at all) to 7 (=fully protected) by the following questions: "In your country, to what extent are the interests of minority shareholders protected by the legal system?" Strength of investor protection is assessed on a scale from 0 (= worst) to 10 (=best) by the combination of three indexes: the Extent of disclosure index (transparency of transaction), the Extent of director liability index (liability for self-dealing), and the Ease of shareholder suit index (shareholders' ability to sue officers and directors for misconduct).

3.5. Control Variables

It is likely that larger economies receive higher level of foreign portfolio equity investment. Thus, my empirical model includes *lnGDP*, the natural log of gross domestic product in a country in US dollars, as a control for the size of the economy in a country. Also, the number of companies listed on the stock exchange is likely to attract larger amount of portfolio equity investment. Thus, in my empirical model the variable *lnListed* controls for the number of companies listed on the national stock exchange. *S&P Global Equity Index* is the Standard and Poor's Global Equity Index. This index covers approximately 11000 securities from 83 countries and measures the US dollar price change in a country's stock market. I include this variable a control in my empirical model as it indicates how well the equity market functions and its level of attractiveness for portfolio equity investors. The empirical model includes *Inflation* as a control variable, as the stability and healthiness of the macroeconomic environment also could affect the level of portfolio equity investments. The variable *Investment* controls for the level of investment as a percentage of gross domestic product. This variable (*Investment*) is measured the sum of outlays on additions to the fixed assets of the economy and net changes in the level of

inventories. Finally, *Developing* is an indicator variable that takes the value of 1 if a country in our dataset is a developing country, and 0 otherwise.

3.6. Estimation Technique

I use regression method to analyze the relationship I propose in my framework. Note that the dependent variable in my model ranges from 0 to 5, with higher numbers indicating higher values of the variable. As such, the independent variable is an ordered categorical variable. Thus, I use ordered probit regression method to estimate my empirical model and test the hypotheses. Also, because the variance of the error term is not constant, I use heteroskedasticity-robust Huber/White/sandwich estimator of the variance-covariance estimate. Also note that, the correlations among the measures of the institutional environment are very high, causing the problem of multicollinearity when two or more of these variables are in the estimated model at the same time. To avoid this problem, I obtain a separate estimate of the empirical model for each of the institutional variables that I defined above.

Table 1. List of Variables and Data Sources

Variable	Source	Years
Developing	World Bank	2000-2012
Portfolio Equity Investment	World Bank	1990-2013
ln GDP	World Bank	1990-2013
ln Listed	World Bank	1990-2012
S&PIndex	World Bank	1990-2014
Inflation	World Bank	1990-2014
Property Rights	WEF CI	2006-2012
Inverse Corruption	WEF CI	2010-2012
Inverse Undue Influence	WEF CI	2006-2012
Government Efficiency	WEF CI	2009-2012
Security	WEF CI	2006-2012
Corp. Ethic	WEF CI	2006-2012
Corp. Accountability	WEF CI	2006-2012
Investment (% GDP)	World Bank	1990-2013

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics and Correlations

Table 2 presents Summary of Statistics such as number of observations of each variable mean, standard deviation minimum and maximum. Portfolio Equity Investment I got Observations of =3,065.00). Every country received average of three billion two hundred and sixty million dollars of portfolio equity investment with standard deviation of 19,400,000,000.00. The maximum of portfolio equity investment a country received is two hundred seventy nine billions. The average inflation per year is 30.70.our data 65 percent from developing countries while 35 percent from developed countries.

Table 2. Summary Statistics (Full Sample)

Variable	Obs	Mean	Std. Dev.	Min	Max
Developing	2,977	0.65	0.48	0.00	1.00
Portfolio Equity Investment	3,064	1.48	1.81	0.00	5.00
ln GDP	4,632	23.29	2.54	4.06	30.45
ln Listed	2,289	4.71	1.67	0.00	9.09
S&PIndex	1,544	11.51	44.45	-84.23	912.28
Inflation	4,053	30.74	429.24	-18.11	23,773.13
Property Rights	924	4.13	1.11	1.75	6.57
Inverse Corruption	419	2.79	0.97	1.41	5.36
Inverse Undue Influence	924	3.62	1.08	1.42	6.29
Government Efficiency	549	3.68	0.73	1.88	5.96
Security	924	4.85	0.93	2.56	6.71
Corp. Ethic	924	4.26	0.99	2.55	6.78
Corp. Accountability	890	11.62	1.75	7.70	16.08
Investment (% GDP)	4,123	23.58	11.07	-2.42	219.07

The average Property Rights Protection is 4.13 on the scale from 1 to 7. Just more than the average point of 3.5. Ethic and Lack of Corruption in Government= 2.79,

Lack of Undue Influence in Government shows higher than average (=3.62), Government Efficiency is =3.68, Security =4.85, Corporate Ethic =4.26, Accountability=4.740435.

Table 3 and Table 4 presents the summary statistics for developing and developed countries separately. Note that there are significant differences between developed and developing countries with respect to my measures of the institutional environment and portfolio equity investment.

Table 5 presents the correlations for all variables. Regarding my institutional environment and corporate governance variables, we see that all these variables are highlyand positively correlated to portfolio equity investment. On the other hand, Property rights protection variable has the highest correlation with portfolio equity investment while security has lowest correlation with portfolio equity investment.

Table 3. Summary Statistics (Developing Countries)

Variable	Obs	Mean	Std. Dev.	Min	Max
Developing	1,937	1.000	0.000	1.000	1.000
Portfolio Equity Investment	1,163	1.204	1.501	0.000	5.000
ln GDP	1,798	22.950	2.258	4.060	29.739
ln Listed	829	4.437	1.595	0.000	8.689
S&PIndex	510	18.924	59.376	-83.787	912.281
Inflation	1,589	8.585	20.368	-18.109	513.907
Property Rights	599	3.511	0.708	1.745	5.678
Inverse Corruption	277	2.364	0.625	1.410	4.643
Inverse Undue Influence	599	3.079	0.708	1.418	5.224
Government Efficiency	360	3.442	0.541	1.884	5.298
Security	599	4.410	0.755	2.564	6.444
Corp. Ethic	599	3.750	0.559	2.553	5.559
Corp. Accountability	591	10.867	1.354	7.695	15.849
Investment (% GDP)	1,629	23.887	10.484	1.097	147.879

Table 4. Summary Statistics (Developed Countries)

Variable	Obs	Mean	Std. Dev.	Min	Max
Developing	1,040	0.000	0.000	0.000	0.000
Portfolio Equity Investment	543	2.645	2.090	0.000	5.000
ln GDP	696	25.144	2.777	6.567	30.414
ln Listed	587	5.135	1.706	0.000	8.926
S&PIndex	487	8.431	32.513	-71.907	128.500
Inflation	644	2.742	2.452	-4.863	17.647
Property Rights	325	5.263	0.759	3.618	6.574
Inverse Corruption	142	3.616	1.000	1.672	5.363
Inverse Undue Influence	325	4.609	0.933	2.369	6.285
Government Efficiency	189	4.146	0.809	2.513	5.961
Security	325	5.658	0.613	2.952	6.708
Corp. Ethic	325	5.211	0.914	3.099	6.778
Corp. Accountability	299	13.108	1.469	9.788	16.078
Investment (% GDP)	642	23.332	6.152	9.160	58.788

Table 5. Correlations (Panel A)							
Variable	**1**	**2**	**3**	**4**	**5**	**6**	**7**
1. Developing	1.00						
2. Portfolio Equity Investment	-0.37	1.00					
3. ln GDP	-0.38	0.61	1.00				
4. ln Listed	-0.21	0.45	0.75	1.00			
5. S&P Global Equity Index	0.11	0.16	-0.04	-0.02	1.00		
6. Inflation	0.15	-0.03	-0.01	-0.01	-0.05	1.00	
7. Property Rights	-0.76	0.34	0.34	0.24	-0.09	-0.38	1.00
8. Inverse Corruption	-0.61	0.27	0.17	0.15	0.00	-0.33	0.84
9. Inverse Undue Influence	-0.68	0.32	0.30	0.20	-0.08	-0.33	0.91
10. Government Efficiency	-0.46	0.24	0.10	0.08	0.05	-0.33	0.81
11. Security	-0.64	0.21	0.16	0.08	-0.11	-0.33	0.76
12. Ethic in Corp.	-0.70	0.32	0.33	0.23	-0.04	-0.36	0.92
13. Accountability in Corp.	-0.61	0.35	0.38	0.29	-0.02	-0.34	0.88
14. Investment (% GDP)	0.03	0.07	-0.07	0.12	-0.11	-0.03	-0.07

Table 5. Correlations (Panel B)							
Variable	**8**	**9**	**10**	**11**	**12**	**13**	**14**
8. Inverse Corruption	1.00						
9. Inverse Undue Influence	0.94	1.00					
10. Government Efficiency	0.90	0.87	1.00				
11. Security	0.78	0.76	0.69	1.00			
12. Ethic in Corp.	0.92	0.93	0.85	0.74	1.00		
13. Accountability in Corp.	0.74	0.82	0.77	0.61	0.85	1.00	
14. Investment (% GDP)	-0.04	-0.03	0.01	0.06	-0.10	-0.13	1.00

4.2. Ordered Probit Regression Analyses

In this section, I present and discuss the ordered probit regression analyses of the determinant of portfolio equity investment. Table 7 through Table 13 present separate regression estimates for each of the measure of the institutional environment. Note that the Wald statistics is highly significant for all these estimates. Before I discuss these results, I, first present and discuss the regression on control variables.

Table 6presents the results of the regression of portfolio equity investment on my control variables. The coefficient on all control variables in this model are significant,

except for the coefficient on investment. S&P Global Equity Index has coefficient of 0.006. This result is statistically significant at p< 0.001. The sign suggests that if S&P Global Equity Index of a country increases at the same time portfolio equity investment of that country also increases.In (Number of Listed Companies) has coefficient of 0.088 and p-value of 0.021 with portfolio equity investment.

Table 6. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments I: Effect of Control Variables
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Developing	-0.214	0.080	-2.66	0.008	-0.372	-0.056
ln GDP	0.263	0.036	7.26	0.000	0.192	0.334
ln Listed	0.083	0.038	2.22	0.027	0.010	0.157
S&PIndex	0.006	0.001	6.70	0.000	0.004	0.008
Inflation	-0.009	0.005	-1.66	0.098	-0.019	0.002
Investment (% GDP)	0.008	0.006	1.33	0.184	-0.004	0.021
/cut1	6.694	0.829			5.069	8.319
/cut2	6.809	0.829			5.183	8.434
/cut3	7.122	0.832			5.492	8.752
/cut4	7.618	0.840			5.971	9.264
/cut5	8.320	0.854			6.645	9.994

Number of obs	877
Wald chi2(6)	196.20
Prob > chi2	0.00
Pseudo R2	0.08
Log pseudolikelihood	-1338.6
Number of Countries in the sample	78

Normally developed countries have more listed of companies than developing countries because of their strong and reliable institutions. Developing countries have negatively relationship to portfolio equity investment. As shows my evidence model one

table 3, developing country has coefficient of (-0.251) and (p-value=0.003). GDP has positive relationship to portfolio equity investment, with coefficient of 0.259 and (p-value=0.00). Since GDP represents the total dollar value of all goods and services produced over a specific time period of a country and generally health of a country's economy, it is primary indicator for decision making of equity investors to a country.

Now I discuss the results of my hypothesis testing. Hypothesis 1 posits that the higher the property right protection in a country, the higher is the portfolio equity investment in that country. Table 7 present the regression results that assesses the extent to which the property rights protection affects the portfolio equity investment of a country. The coefficient on the property rights protection is 0.182 at p-value of 0.001. The sign suggests that the two variables are correlated and statistically significant. This is consistent with my hypothesis 1 as well as with the argument of Cao & Ward (2014) that is, portfolio investors are more likely to invest in countries with better property rights protection, which is often found in democratic countries. Also, Knack & Keefer (1995) argued that the institutions that protect the property rights are crucial to economic growth and to investment. Absence of secure property and contractual rights discourages investment.

Hypothesis 2 posits that the higher level of corruption in a country, the low is the portfolio equity investment inflows in that country. Table 8 presents the regression relationship between the ethic and lack of corruption in government and portfolio equity investment of a country. The coefficient on the ethic and lack of corruption in government is positive at p-value=0.033. The sign suggests us that countries with higher level of corruption receive foreign portfolio equity investment less than the countries with low level or zero corruption. The evidence supports that the international portfolio equity

investors prefer to invest the countries where the people trusted their politicians, with no

Irregular payments and bribes and this is consistent with my hypothesis three and argument

of Javorcik& Wei (2009) that is corruption generally harms the economic growth.

Corruption reduces the availability of protection available for individuals' assets and the

chances of a fair outcome in courts in case of a dispute between a domestic and foreign

partner. How about a countries where citizens believe that their politicians are immoral,

receiving of government services preceded irregular payment and bribes plus regular

payments. Therefore, this discourages the investors.

Table 7. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments II: Effect of Property Rights Protection
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Property Rights	0.198	0.054	3.67	0.000	0.092	0.303
ln GDP	0.186	0.052	3.59	0.000	0.085	0.288
ln Listed	0.108	0.053	2.02	0.043	0.003	0.212
S&PIndex	0.009	0.001	7.30	0.000	0.007	0.012
Inflation	0.003	0.013	0.24	0.812	-0.022	0.029
Investment (% GDP)	-0.002	0.009	-0.29	0.772	-0.019	0.014
/cut1	5.727	1.218			3.339	8.115
/cut2	5.819	1.217			3.433	8.205
/cut3	6.068	1.219			3.680	8.456
/cut4	6.564	1.226			4.160	8.967
/cut5	7.226	1.245			4.787	9.666

Number of obs	477
Wald chi2(6)	116.11
Prob > chi2	0.00
Pseudo R2	0.09
Log pseudolikelihood	-709.12
Number of Countries in the sample	76

Hypothesis 3 posits that country with strong rule of law, the higher is the portfolio equity investment in that country. Table 9 the regression relationship between Rules of law and foreign portfolio equity investment. The coefficient on the Rule of law is positive and significant at of p-value =0.001. This is consistent with argument of Poshakwale & Thapa (2011) the quality and enforcement efficiency of legal institutions are important policy of attracting higher level of foreign equity portfolio investments and Mishra & Daly (2007) those argued that the rule of law guarantee a credible property rights protection from the government and it is an indicator that measures the perceptions on the effectiveness and predictability of the judiciary, as well as enforceability of contracts.

The evidence at the same time supported my argument of that the countries with strong rule of law receive foreign portfolio equity investment more than the countries with a weak rule of law. Therefore, international portfolio equity investors prefer to invest Countries where the decisions of government officials to firms and individuals are free from favoritism, when deciding upon policies and contracts based on the rules of the country. Judicial independence system and without Favoritism in decisions of government official of a country attract portfolio equity investment. As I have already defined the institutions as rules of games of a country, if the rule does not enforceable the existence is nothing.

Hypothesis 4 posits that the more effectiveness of government institutions and bureaucracy in a country increases, the higher is the portfolio equity investment in that country. Table 10 presents the results of the regression relationship between government efficiency and foreign portfolio equity investment. The coefficient on the Government efficiency is positive and significant at p-value= 0.002. This is consistent with Kaditi (2013) argued importance of government agencies reforms in order to attract private

investments generally. The international portfolio equity investors prefer to invest Countries where it is easy for businesses to comply with governmental administrative requirements such as permits, regulations, reporting and to challenge government actions and/or regulations through the legal system and With Transparency of government policymaking.

Table 8. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments III: Effect of the Lack of Undue Influence
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Inverse Undue Influence	0.189	0.050	3.81	0.000	0.092	0.286
ln GDP	0.187	0.052	3.59	0.000	0.085	0.289
ln Listed	0.105	0.053	1.98	0.047	0.001	0.210
S&PIndex	0.009	0.001	7.21	0.000	0.007	0.012
Inflation	-0.002	0.013	-0.14	0.889	-0.027	0.023
Investment (% GDP)	-0.003	0.009	-0.29	0.769	-0.019	0.014
/cut1	5.552	1.212			3.177	7.927
/cut2	5.644	1.211			3.271	8.017
/cut3	5.895	1.212			3.520	8.270
/cut4	6.394	1.219			4.005	8.784
/cut5	7.056	1.236			4.633	9.480

Number of obs	477
Wald chi2(6)	122.87
Prob > chi2	0.00
Pseudo R2	0.09
Log pseudolikelihood	-708.75
Number of Countries in the sample	76

Hypothesis 5 posits that higher the security in a country, the higher is the portfolio equity investment in that country. Table 11 presents the results of the regression relationship between security and foreign portfolio equity investment. The coefficient on

the security is positive and significant at p-value 0.003. This is consistent with hypothesis 5. The international portfolio equity investors prefer to invest Countries with low Business costs of crime and violence records, low Organized crime records and other conflicts, better reliability of police services.

Table 9. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments IV: Effect of the Lack of Corruption
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Inverse Corruption	0.175	0.080	2.19	0.028	0.018	0.332
ln GDP	0.142	0.083	1.70	0.088	-0.021	0.305
ln Listed	0.141	0.082	1.71	0.088	-0.021	0.303
S&PIndex	0.010	0.003	3.46	0.001	0.004	0.016
Inflation	-0.005	0.022	-0.21	0.835	-0.047	0.038
Investment (% GDP)	0.000	0.014	0.03	0.976	-0.027	0.027
/cut1	4.383	1.883			0.692	8.074
/cut2	4.450	1.883			0.760	8.140
/cut3	4.717	1.885			1.023	8.412
/cut4	5.140	1.892			1.432	8.848
/cut5	5.863	1.919			2.101	9.625

Number of obs	213
Wald chi2(6)	43.52
Prob > chi2	0
Pseudo R2	0.0651
Log pseudolikelihood	-321.64
Number of Countries in the sample	75

Hypothesis 6 posits that the more ethical behavior of a companies of a country increases, the more foreign portfolio equity investment of that country increases. Table 12 presents the results of the regression relationship between Corporate Ethic and foreign portfolio equity investment. The coefficient on the corporate ethic is positive and

significant at p=0.001. The evidence supports hypothesis 6. The result suggests that environment where companies do their businesses ethically and interactions among them is more trustful, and these conditions attract foreign portfolio equity investment. The international portfolio equity investors prefer to invest Countries where culture of the companies is to increase employee commitment, satisfaction, trust and commitment of the stakeholders, shareholder's value and general performance of the company.

Table 10. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments V: Effect of Government Efficiency
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Government Efficiency	0.304	0.095	3.20	0.001	0.118	0.491
ln GDP	0.243	0.072	3.38	0.001	0.102	0.384
ln Listed	0.111	0.070	1.58	0.114	-0.027	0.250
S&PIndex	0.008	0.002	3.99	0.000	0.004	0.011
Inflation	-0.002	0.018	-0.12	0.906	-0.037	0.033
Investment (% GDP)	-0.007	0.011	-0.57	0.567	-0.029	0.016
/cut1	7.281	1.668			4.012	10.550
/cut2	7.364	1.667			4.097	10.632
/cut3	7.661	1.672			4.384	10.938
/cut4	8.140	1.684			4.840	11.440
/cut5	8.894	1.714			5.534	12.254

Number of obs	284
Wald chi2(6)	83.07
Prob > chi2	0.00
Pseudo R2	0.09
Log pseudolikelihood	-421.43
Number of Countries in the sample	76

Hypothesis 7 posits that the more prevalence of corporate governance principles in a country, the more foreign portfolio equity investment of that country

increases. Table 13 presents the results of the regression relationship between accountability of a company level and foreign portfolio equity investment. The coefficient on the accountability is positive and significant at p-value=0.007. The effective good corporate governance practicing attacks foreign portfolio equity investors. The evidence supports the argument of Das (2014) that the audit qualities and disclosure practices play important roles in attracting foreign capital and the firms with better accounting practices attract more foreign capital. The evidence is also consistent with Francis, Khurana, & Pereira (2003), who argue that protection of especially minority investors' right is an important factor that generates good economic incentives and attract outside investors. Investor protection laws and their legal enforcement create safeguards for outside investors**.** Therefore, the portfolio equity investors prefer to invest in countries where the companies are bound by strong auditing and reporting standards. Also it is likely that efficiency of corporate boards and strength of investor protection attract foreign portfolio equity investors.

Portfolio equity inflows of a country dependents on quality of its institutions. As show my findings portfolio equity investors give considerations stability and reliability of all institutions in a country. institutions of country is complementary to each other, for example, constitution of a country writes better Property rights protection but rule of law is weak or courts are not independent for their judgments. The empirical findings suggested that better institutions are associated with higher levels of inward portfolio investments.

Table 11. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments VI: Effect of Security
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Security	0.197	0.059	3.32	0.001	0.081	0.313
ln GDP	0.208	0.052	4.01	0.000	0.107	0.310
ln Listed	0.108	0.054	2.02	0.044	0.003	0.214
S&PIndex	0.010	0.001	7.47	0.000	0.007	0.012
Inflation	0.000	0.013	-0.04	0.969	-0.026	0.025
Investment (% GDP)	-0.005	0.009	-0.60	0.546	-0.022	0.012
/cut1	6.313	1.248			3.868	8.759
/cut2	6.406	1.246			3.963	8.849
/cut3	6.657	1.248			4.211	9.103
/cut4	7.152	1.256			4.691	9.613
/cut5	7.805	1.272			5.312	10.298

Number of obs	284
Wald chi2(6)	126.32
Prob > chi2	0.00
Pseudo R2	0.08
Log pseudolikelihood	-710.81
Number of Countries in the sample	76

Table 12. Ordered Probit Regression Analysis of the Determinants of Portfolio Equity Investments VII: Effect of Ethic in Corporations
Dependent Variable: Portfolio Equity Investment

Ind. Variables	Coef.	Robust Std. Err.	z	P>z	[95% Conf. Int.]	
Corp. Ethic	0.202	0.055	3.67	0.000	0.094	0.310
ln GDP	0.188	0.052	3.60	0.000	0.086	0.290
ln Listed	0.102	0.053	1.91	0.056	-0.002	0.206
S&PIndex	0.009	0.001	7.23	0.000	0.007	0.012
Inflation	0.001	0.013	0.06	0.954	-0.024	0.026
Investment (% GDP)	-0.001	0.008	-0.09	0.928	-0.017	0.016
/cut1	5.787	1.214			3.408	8.165
/cut2	5.879	1.213			3.501	8.256
/cut3	6.129	1.214			3.749	8.508
/cut4	6.626	1.221			4.232	9.020
/cut5	7.288	1.239			4.859	9.716

Number of obs	477
Wald chi2(6)	119.92
Prob > chi2	0.00
Pseudo R2	0.09
Log pseudolikelihood	-708.78
Number of Countries in the sample	76

5. CONCLUSION

I studied relation between environmental institutions and portfolio equity investment of a country. All institutional variables I assessed, are positively related to portfolio equity investment and statistically are significant. My results indicate that countries with better property rights protection receive more foreign portfolio equity than with weak ones. This is consistent with my argument of countries with better property rights protection attract more portfolio equity inflows.

The findings support the hypothesis that the corruption has negative relationship with the portfolio equity investment of country. Countries with high corruption Irregular payments and bribes are high, so it is too costly and risk to do business in like this environment. I further explore the preferences of portfolio equity investors for rule of law of a country. In Countries where rule of law is strong. The decisions of government officials to firms and individuals are free from favoritism, when deciding upon policies and contracts based on the rules of the country. Judicial independence system and without Favoritism in decisions of government official of a country attract portfolio equity investment. This is consistent with my argument of that the portfolio equity investment of a country has positive relation with the rule of the law of that country.

My findings also underlined the preferences of investors to Transparency of government policymaking, efficiency of legal framework in challenging regulations and efficiency of legal framework in settling disputes. Portfolio equity investors prefer countries where it is easy for businesses to comply with governmental administrative requirements such as permits, regulations, reporting and to challenge government actions

and regulations through the legal system. Consistent with my argument of effectiveness of government institutions and bureaucracy of a country affects the portfolio equity inflows of that country.

My evidence shows that portfolio equity investors prefer to invest Countries with low Business costs of crime and violence records, low Organized crime records and other conflicts, better reliability of police services. The result supported my argument of that insecurity reduces foreign portfolio equity investment inflow or security positive relate to portfolio equity investment.

I argued that doing business ethically among companies of a country creates trustful environment that attracts portfolio equity inflows. The evidence supports my argument environment where companies do their businesses ethically and interactions among them is more trustful, and these conditions attract foreign portfolio equity investment.

As I argued that equity investors prefer a country where corporate governance principles are practicing. My evidence supported this argument equity investors prefer to invest Countries where the companies have strength of auditing and reporting standards, efficacy of corporate boards, protection of minority shareholders' interests, Strength of investor protection. The empirical findings suggested that better institutions are associated with higher levels of inward portfolio equity investments. Therefore developed countries receive more equity investment than developing countries.

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