
Home bias and return chasing by foreign portfolio investors: evidence from selected Sub-Saharan African markets

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Abstract: This paper examines home bias and return chasing by foreign investors in selected Sub-Saharan African markets. Using pooled mean group estimation on data drawn from five countries, the study did not find conclusive evidence to suggest that foreign investors exhibit home bias in the long run when they adjust their investment in line with past flows. Return chasing is not seen as the first order of business and is prioritised only in the long run, after foreign investors have gained knowledge of the market. Results show that foreign investors value countries with stable economies and invest more in the sampled markets with higher returns from industrialised markets. Policy makers should intensify efforts to make these markets more attractive for foreign investors, maintain good economic conditions and monitor developments in industrialised markets. This will assist them in reacting to variations or reversals in portfolio flows resulting from occurrences in such markets.

Keywords: home bias; return chasing; foreign portfolio investment; pooled mean group; stock market.

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1 Introduction

International capital flows began to increase considerably in the early 1970s due to rising financial globalisation. Although equity portfolio flows are a substantial component of such international capital flows, equity portfolios flows have received less attention in the literature than foreign direct investment, probably due to the erratic nature of portfolio

investment across capital markets. Nevertheless, there has been an unprecedented rise in portfolio flows worldwide; World Bank data (2016) show that global portfolio equity stood at approximately USD 1.435 trillion in 2016. Similarly, Vo (2016) noted that the flow of funds to emerging markets has increased over the years. This increase is attributable to the shift in investors' interest from developed markets to emerging markets in order to benefit from the latter's growing economies, financial deregulation and international diversification.

Regardless of the rising trend in portfolio flows across the world, the literature notes that some challenges exist with respect to such flows. First, what international investors invest abroad (outside their domestic markets) is still considered insignificant. Prior studies (Abdulkadir et al., 2018; De Santis and Ehling, 2007; Kang and Stulz, 1997) document that despite the significant reduction in barriers, foreign equity capital remains much lower than what one would expect in the absence of barriers. A prominent explanation for this finding in developed market studies is the puzzle of 'home bias', which is investors' tendency to prefer their domestic markets as opposed to foreign markets. Second, it is widely held that the basic motive of foreign portfolio investors is profit making and that these investors therefore 'chase returns' in the host markets. Thus, despite the benefits of foreign portfolio investment (FPI), concerns are usually raised regarding the fact that portfolio investors invest only on a short-term basis, as such flows do not involve a long-lasting interest in the economy (Ahmad et al., 2015; Garg and Dua, 2014; Singhania and Saini, 2018). As such, these investors engage in speculative activities to the detriment of the host market. Unlike FDI, which has recorded constant growth, FPI has been volatile in emerging markets, which comes with high macroeconomic costs for the recipient economy (Amaya and Rowland, 2004; Aziz et al., 2015).

In line with the preceding analysis, this study is premised upon certain motivating factors. Generally speaking, there is dearth of empirical evidence on the behaviour of international portfolio flows (Froot et al., 2001; Humanicki et al., 2013), particularly as compared to foreign direct investment. Specifically, the explanation for 'investor home bias', which is documented as a major reason for low FPI, has largely been confirmed in studies on developed markets and very few studies conducted outside Africa. Prior evidence (Montiel, 2006) shows that a paucity of capital does exist in African markets, in line with the Lucas Paradox; however, FPI flows into African nations have been increasing (though volatile) in recent times, casting doubt on the existence of 'home bias' or otherwise. Thus, it becomes imperative to investigate this phenomenon in the African market, where, to the best of the author's knowledge, little or no evidence exists in this regard. Similarly, the issue of foreign portfolio investors engaging in 'return chasing' has not received attention in studies relating to African markets. Results obtained from studies on developed countries may not be applicable to the target region of this study due to the volatile nature of policies made in Sub-Saharan countries that may affect economic fundamentals and consequently adversely impact the stability of FPI. Additionally, markets fundamentally differ, so what drives portfolio investment into these countries may differ.

Therefore, the dearth of literature on the determinants of foreign portfolio flows, coupled with a lack of empirical evidence on 'home bias' and 'return chasing' tendencies by foreign investors in emerging markets – particularly African markets – stimulated interest in the following research questions: do foreign investors in selected Sub-Saharan African markets exhibit home bias?; is there evidence of return chasing among foreign

investors in the selected Sub-Saharan African markets? Proffering answers to these questions is important because opening the doors of the economy to foreign flows without adequate knowledge of the determinants of such flows may pose a huge risk to the host economy. Additionally, there is a need to know the factors responsible for FPI so that the negative impact of its fluctuation can be kept at a minimal level. This finding also implies that a good knowledge of the determinants of FPI can help in reaping the benefits of such investment, which will guide policy makers in implementing policies tailored towards capital market development and economic stability.

Khasawneh and Staytiah (2017) opined that foreign investment plays a vital role in developing countries. Thus, in proffering answers to the research questions raised, Sub-Saharan Africa is considered an ideal laboratory, as investment by foreigners is believed to be geared towards growing economies in developing countries, including Sub-Saharan Africa, which is based on the notion that there are opportunities for profitable investment in these areas (Raji et al., 2017). In addition, UNCTAD (2016) noted that the need for external financing is more pressing in Africa, particularly Sub-Saharan Africa, as compared to other developing regions in the world, due to the low income levels in this region, which are insufficient for the attainment of modest investment and growth rates. Additionally, a large proportion of FPI inflows are from this region.

Consequently, this study contributes to literature on FPI in different ways. An explanation of the determinants of such investment not only extends to the Sub-Saharan region, which has barely received attention, but also offers explanations for the possibility of 'home bias' and 'return chasing' tendency among foreign portfolio investors in this region. To the best of the researcher's knowledge, there is no research on these tendencies for the African market setting. This study also differs from the scant evidence available for the African region by conducting a multi-country study as opposed to single-country study. Unlike previous studies, this paper puts the data to work in a different way, using the pooled mean group regression (PMG) analysis. With the use of this method, the study examines the determinants jointly for all sampled countries and then draws out areas of difference, as revealed by the PMG estimates for each individual country observed.

The study finds that foreign investors in the Sub-Saharan African countries observed collectively do not exhibit a home bias tendency in the long run. However, evidence for such tendency was found for Kenya and South Africa in the short run. This study also finds that return chasing by foreign investors in the sampled countries becomes prioritised only in the long run.

The remainder of the paper is structured as follows: Section 2 presents a brief review of the related literature; Section 3 describes the data and methodology employed; the findings of the study are discussed in Section 4, while Section 5 concludes.

2 Literature review

Traditional neoclassical economic theory states that difference in the marginal product of capital between countries explains international capital flows. The theory asserts that capital flows from developed to developing markets, premised on the argument that capital should seek countries with a relatively lower stock of capital and higher marginal

productivity in the quest for higher returns. Therefore, FPI is expected to be higher where returns are higher. A common theoretical explanation is the return and creditworthiness model by Fernandez-Arias and Montiel (1996), which states that the creditworthiness of a country is essential for capital flows. In their model, the authors decomposed the factors influencing capital flows into domestic economic conditions and creditor country's financial conditions, which are now prominently referred to in the literature as 'pull factors' and 'push factors'. The push/pull factor theory offers an explanation of what drives FPI into host nations. While the pull theory attributes foreign capital flow to domestic fundamentals, the push theory attributes such flows to external factors. Such external factors include the slow economic growth rate and low interest rate in industrialised countries (Calvo and Reinhart, 1998).

Extant literature indicates that both pull (internal factors of recipient countries) and push factors (external factors) are important for explaining foreign equity flows into host nations. The World Bank (1997) found that countries with largest fundamentals have received the largest proportion of capital flows. Similarly, other studies (Makoni and Marozva, 2018; Waqas et al., 2015) have shown that foreign portfolio investors seek countries with stable financial and macroeconomic environments. From another perspective, Froot et al. (2001) opined that foreign portfolio outflows reflect the underlying state of the fundamentals of the host community. Thus, a stable macroeconomic environment is required in order to maintain a good investment climate and investors' confidence. However, Albuquerque (2003) reported that domestic factors have become less important in accounting for variations in foreign portfolio flows. Thus, there arises a need to understand how both pull and push factors affect FPI flows.

One of the pull factors established in the literature to explain FPI is the concept of 'home bias'. According to Kacperczyk et al. (2018), home bias is historically one of the reasons why foreign investors play a lesser role in financial markets than domestic investors. However, mixed findings exist in the literature in terms of whether past FPI flows affect current flows, which is the prominent method to test home bias tendency. Amaya and Rowland (2004) observed that it is highly unlikely that current flows are influenced by past flows due to the highly volatile nature of FPI flows. However, some studies (De Santis and Ehling, 2007; Froot et al., 2001) have found that past FPI flows positively influence current flows. The positive result reported negates the argument of 'home bias' that has been documented by other studies (De Santis and Luhrmann, 2009; Kang and Stulz, 1997), where it is expected that lag of FPI should negatively influence current FPI because foreign investors will adjust their portfolio downwards since they prefer home markets. In support of the argument of 'home bias', these authors claim that foreign investors are more vulnerable to information asymmetry than domestic investors and therefore prefer to invest in their home markets in which they are more informed.

Another pull factor prominently considered in the literature is the host market performance, as reflected in stock returns. While it may be argued that foreign investment may be used to seek resources and may not necessarily occur after returns, prior studies (Froot et al., 2001; Gordon and Gupta, 2003; Haider et al., 2017; Seabra et al., 2007; Mercado and Park, 2011) have shown that foreign portfolio investors are attracted by high returns. Agarwal (1997) reported that when there are low returns in their home country, foreign portfolio investors seek to invest in other countries where returns are higher. Specifically, studies (De Santis and Ehling, 2007; Froot et al., 2001; Garg and Dua, 2014; Singhania and Saini, 2018) have found that foreign portfolio flows are strongly influenced by stock returns in the host market. While other studies have

employed current returns, Froot et al. (2001) employed past returns. These studies argued that international investors engage in positive feedback trading, also referred to as ‘trend chasing’ or ‘return chasing’. In contrast, other studies (Aron et al., 2010; Kang and Stulz, 1997; Portes and Rey, 2005) found no evidence supporting that foreign investors tilt their portfolios towards stocks with higher expected returns and their finding therefore negates the ‘return chasing’ motive. Portes and Rey (2005) opined that this phenomenon could be as a result of the low-frequency data used, as most other studies that employed high-frequency data found support for this motive.

Studies have shown that the economic condition of the host nation is another factor that attracts foreign investors. The literature (Ahmad et al., 2015; Amaya and Rowland, 2004; Azam et al., 2016; Garg and Dua, 2014; Haider et al., 2016; Meurer, 2016; Wesso, 2001) has found that GDP is positively related to FPI, which implies that countries with larger economic (market) size receive more foreign equity flows than their counterparts. Additionally, higher economic growth signals better investment and profit opportunities to foreign investors. Contrarily, De Santis and Luhrmann (2009) did not find any empirical support to show that market size influences portfolio flows.

With respect to push factors, prior evidence (Amaya and Rowland, 2004) has shown that US GDP growth negatively affects FPI flows to the host nation. These studies contend that foreign investors tend to invest more at home during a boom in their home market while seeking foreign investment when there is a downturn at home. Amaya and Rowland (2004) termed this effect the substitution effect.

Most of the existing evidence with respect to the determinants of foreign portfolio flows focuses on developed markets. Scant evidence exists in this regard in emerging markets, especially in the African markets. The existence of ‘home bias’ and ‘return chasing’ also remain uncertain for the African markets, as little or no evidence exists in this regard. Thus, the present study seeks to contribute to the literature by filling this gap.

3 Data and method

The study draws data from five Sub-Saharan African countries: Cote d’Ivoire, Kenya, Mauritius, Namibia and South Africa. These countries were purposively selected due to the availability of required data. The study employed annual data over the period from 1997 to 2016. Data for all variables were extracted from World Bank Development Indicators. The base model between FPI and the explanatory variables is as specified below:

$$FPI = f(FPI_1; RET; GDP; USRET) \quad (1)$$

The dependent variable is FPI, which is measured by portfolio equity net inflows expressed in US dollars. The main explanatory variables include lag of FPI (FPI_1) and stock market returns (RET). FPI_1 represents FPI in the previous year, which is used to test the existence of home bias among foreign investors. Due to the non-availability of data on stock indexes, market capitalisation is employed for each country (expressed in US dollars) to measure stock market returns. This variable is included in the model to test for the possibility of return chasing by foreign investors. Another pull factor in the model is GDP, as the existing literature (particularly outside the African markets) has shown that this variable influences FPI, but with mixed findings. Gross domestic product (GDP)

is measured as the annual percentage of GDP growth, and for the push factor, the paper employs the annual market capitalisation for the US market to proxy for stock returns in industrialised markets (USRET).

The dynamic panel data regression method is considered due to the inclusion of the lag of the dependent variable in the model. However, since the time period is relatively larger than the cross-section ($T > N$) in the data, the study considers this panel as a dynamic heterogeneous panel. Therefore, the conventional dynamic panel estimators such as difference or system GMM may not be applicable. Consequently, the study employed recommended alternative estimation methods to address heterogeneity bias. The ‘pooled mean group’ (PMG) and the ‘mean group’ (MG) (Pesaran and Smith, 1995; Pesaran et al., 1999) estimators were employed as the estimation methods. The Hausman test (Pesaran et al., 1999) is then employed to select the more appropriate of the two models. The relationships between FPI and the explanatory variables are shown following the panel ARDL model equation specified below:

$$\Delta y_{it} = \phi_i y_{i,t-1} + \beta'_i X_{it} + \sum_{j=1}^{p-1} \lambda_{ij}^* \Delta y_{i,t-j} + \sum_{j=0}^{q-1} \gamma'_{ij} \Delta X_{i,t-j} + \mu_i + \varepsilon_{it} \quad (2)$$

where $i = 1, 2, 3, \dots, N$ and represents the cross-section, while $t = 1, 2, 3, \dots, T$ represents the time series component. The observed time period of 20 years requires us to address issues of non-stationarity. The study employed the panel unit root test of Im et al. (2003) and the basic model is as given below:

$$Y_{it} = \alpha_i + \rho_i Y_{i,t-1} + \sum_k \varphi_k Y_{i,t-k} + \delta_{it} + u_{it}; \quad i = 1, 2, 3, \dots, N; t = 1, 2, 3, \dots, T \quad (3)$$

The Fisher-type test of Maddala and Wu (1999), which takes the following form, was also employed:

$$\lambda = -2 \sum \ln \pi_i$$

These two methods are preferable for this study because they both allow for heterogeneous alternative hypotheses, where ρ_i can vary across countries.

4 Empirical results

4.1 Trend of portfolio investment flows

Table 1 presents the net foreign portfolio inflows for the selected markets on a four-year basis in US dollars. Over the sample period, the sampled markets recorded the lowest value of flows within the 2001–2004 period, with approximately USD 6 billion. The highest value of USD 37.3 billion was recorded within 2009–2012. It is worth noting that the level of foreign portfolio flows in later years (2013–2016) is not too far from what was recorded in the initial years (1997–2000).

The figures shown in the table indicate that South Africa accounts for the bulk of portfolio flows into the selected markets. Although increases were recorded within these years, evidence shows that portfolio flows into South Africa remained relatively stable over the period except for 2001–2004, where an approximately 78% decline was recorded. Cote d’Ivoire received higher inflows in later years than in the initial years. Net portfolio inflows into Kenya were very low in the initial years relative to the other

sampled markets. However, net inflows into Kenya increased from USD 4 million to approximately USD 1 billion during the latter period. This upsurge in inflows into Kenya in later years placed the market above other markets observed (except South Africa) within 2013 and 2016. The highest portfolio flows into Mauritius were recorded during 2009–2012, with the market ranking next to South Africa during this period. However, a significant decline of approximately 93% was recorded in the last period (2013–2016) from what was received in the immediate past period (2009–2012). With respect to Namibia, net inflows were higher in the initial period than in the last period.

Table 1 Net foreign portfolio inflows of sampled countries (every four years, in US dollars)

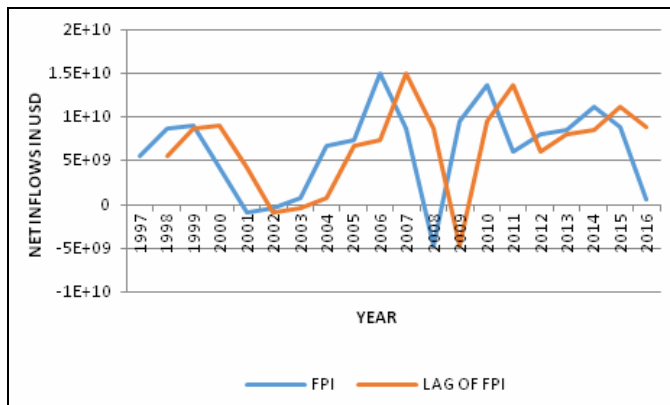
	1997–2000	2001–2004	2005–2008	2009–2012	2013–2016
All sampled countries	27,441,843,169	6,082,744,661	26,353,884,386	37,263,484,477	29,058,261,787
Cote d' Ivoire	24,013,723.39	16,824,134.85	19,011,936.86	34,911,349.45	33,912,443.95
Kenya	4,141,306.06	9,193,031.65	10,426,964.02	301,982,488.20	1,284,582,334
Mauritius	16,722,116.14	17,991,073.07	154,304,002.4	14,464,045,413	963,008,155.7
Namibia	122,322,824.40	42,488,859.85	18,209,605.02	50,615,563.35	17,252,458.28
South Africa	27,274,643,199	5,996,247,561	26,151,931,878	22,411,929,663	26,759,506,395

Source: World Bank Development Indicators

4.2 Pattern of portfolio investment flows and stock returns

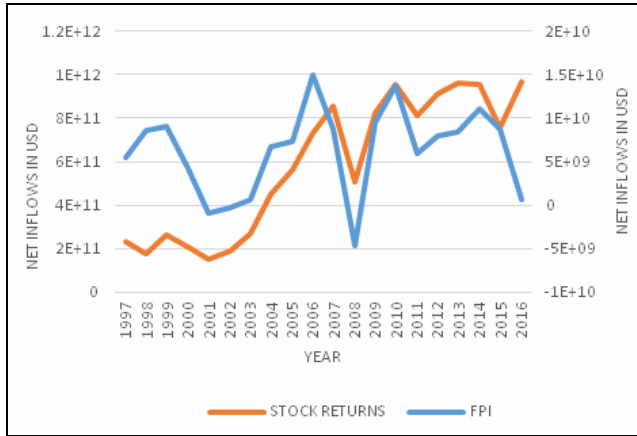
Figure 1 shows the pattern of portfolio investment flows and past flows, while Figure 2 depicts the pattern of portfolio investment flows and stock returns.

Figure 1 Pattern of FPI and lag of FPI (see online version for colours)



FPI in the current period moves in the same direction as past flows, as shown in Figure 1. This trend is reflected throughout the period, as expected, and indicates inconsistency with the 'home bias' tendency. Similarly, Figure 2 shows portfolio flows moving in the same direction as stock returns for most of the period observed. This pattern suggests that foreign investors may be chasing returns, as postulated. Regardless, these tendencies are further tested using inferential statistics.

Figure 2 Pattern of FPI and stock returns (see online version for colours)



4.3 Regression estimates

Table 2 shows unit root tests for variables in the regression model using the IPS and Fisher-type (Phillips-Perron) estimation methods. Similar results were obtained for the two methods, as all variables were stationary at level except home stock market returns and US market returns, which attained stationarity at first difference. Therefore, the null hypotheses of the presence of a unit root for three variables (FPI, FPI_1 and GDP) were rejected at level, while that of stock market returns (home and US) were rejected at first difference.

Table 2 Panel unit root test

Variables	IPS test	Fisher-PP test	Level
FPI	-2.6004*** (0.0047)	31.7716*** (0.0004)	I(0)
FPI_1	-2.5800*** (0.0049)	31.1462*** (0.0006)	I(0)
GDP	-4.8101*** (0.0000)	56.9793*** (0.0000)	I(0)
RET	-6.6752*** (0.0000)	83.5172*** (0.0000)	I(1)
USRET	-12.8185*** (0.0000)	211.1507*** (0.0000)	I(1)

Notes: Automatic lag selection is based on the Bayesian Information Criterion.
 p-values are reported in brackets.
 *** indicates significance at 1%.

Since results shows combination of I(0) and I(1), the study proceeds to use the PMG and MG approach suggested by Pesaran and Smith (1995) and Pesaran et al. (1999) to test the long- and short-run relationships. The Hausman test was then employed to determine the effect of heterogeneity on the means of the coefficient. PMG estimates are regarded as more efficient than MG estimates if the parameters are homogenous. However, MG estimates will be preferred if the null hypothesis is rejected. Thus, the result that shows a

Hausman test statistic of 0.28 (p-value: 0.9908) does not reject equality between both estimators. Hence, PMG estimates are preferred and reported in Table 3.

Table 3 Pooled mean group estimates (all sampled countries)

<i>Variables</i> <i>DV = fpi</i>	<i>Long-run coefficient</i> <i>(all sampled countries)</i>	<i>Short-run coefficient</i> <i>(all sampled countries)</i>
Lag of foreign portfolio investment (fpi_1)	0.730*** (0.014)	-0.076 (0.209)
Home Stock Market Returns (ret)	0.473*** (0.080)	1.432 (2.077)
Gross Domestic Product (gdp)	0.089*** (0.032)	0.123 (0.153)
US Stock Market Returns (USret)	3.697*** (0.116)	1.376 (4.385)
Observations	78	78

Notes: The values in parentheses denote the standard error.

*** indicates significance at 1%.

* indicates significance at 10%.

Results show that none of the explanatory variables were significant in explaining FPI in the short run. This finding is consistent with Seabra et al.'s (2007) finding that portfolio investment is less prone to short-run macroeconomic changes and more driven by long-run fundamentals. In contrast, all variables were found to be significant in the long run. The findings revealed that the current level of FPI is influenced by past FPI. The positive coefficient obtained indicates that these portfolio investors herd towards past portfolio trends. A plausible explanation for this finding is that the foreign portfolio investors would have gained more knowledge of the market and have acquired better experience in their investment activities; thus, they align their current investment with past trends based on the information and experience gained. Additionally, past flows might have contributed to economic growth, which will further attract more flows in the current period. This study's findings on past portfolio flows match those of De Santis and Ehling (2007) and Froot et al. (2001). However, the results are inconsistent with De Santis and Luhrmann (2009) and Kang and Stulz (1997), where a negative relationship was found in line with 'home bias'. The study did not find evidence to support the postulations of 'home bias', which suggests that current portfolio flow is negatively related to past flow. This finding implies that foreign investors in the selected markets do not adjust their portfolio downwards in preferring home markets, and therefore, they engage in the international diversification of their equity portfolios.

As shown in Table 3, the positive coefficient obtained for home market returns shows that FPI increases as returns in the selected markets increase. This finding implies that as domestic stock market performance rises, foreigners invest more to obtain higher returns. This finding suggests that foreign investors actually chase returns, in line with our postulations. Our results are consistent with De Santis and Ehling (2007), Froot et al. (2001) and Garg and Dua (2014). However, this finding contradicts others such as Kang and Stulz (1997), Portes and Rey (2005) and De Santis and Luhrmann (2009). Unlike the findings of Froot et al. (2001), which show that returns help to predict current foreign flows over and above the predictability of past flows, the findings show that past flows have higher predictive power than returns in explaining current foreign portfolio flows.

This finding suggests that the return chasing motive of these foreign investors will be pursued only when these investors have become familiar with the market from past trends. Results also indicate that as GDP increases, FPI will also increase. This finding suggests that there are more investment opportunities for the foreign investors as the economy expands, thus leading to an increase in FPI. This result matches prior studies (Ahmad et al., 2015; Amaya and Rowland, 2004; Garg and Dua, 2014) but contradicts the findings of De Santis and Luhrmann (2009).

As for the push factors observed (stock returns for the US market), a positive coefficient indicates that the FPI into the selected countries increases with an increase in US market returns. From this finding, it can be inferred that foreign portfolio investors earn more returns from the boom in the advanced markets and then channel these returns to other markets for the purpose of international diversification. This result is inconsistent with the substitution effect argued by Amaya and Rowland (2004), which portrays that foreign investors seek foreign investment only when there is a downturn in the home markets. From the above, the findings show that factors exogenous to the recipient country, as well as internal factors, strongly influence foreign flows. However, the coefficients depict that the exogenous factor has more predictive power than the internal factors. Thus, returns generated by the foreign investors from their investments in industrialised nations are the most important factor that determines their ability to bring funds into the sampled markets.

According to Pesaran et al. (1999), PMG constrains long-run coefficients from being identical but allows short-run coefficients to vary across groups. Thus, short-run estimates for individual countries are presented in Table 4.

Table 4 Pooled mean group (short-run estimates for each country)

<i>Variables</i> <i>DV = fpi</i>	<i>Cote D'</i> <i>Ivoire</i>	<i>Kenya</i>	<i>Mauritius</i>	<i>Namibia</i>	<i>South</i> <i>Africa</i>
Lag of FPI (fpi_1)	-0.079 (0.349)	-0.476* (0.271)	0.537*** (0.029)	0.216 (0.211)	-0.578*** (0.204)
Home stock market returns (ret)	0.266 (0.758)	-1.020 (0.656)	9.666*** (0.554)	-0.400*** (0.142)	-1.354 (2.050)
Gross domestic product (gdp)	0.132 (0.238)	0.616*** (0.192)	-0.324*** (0.049)	-0.018 (0.028)	0.207 (0.478)
US market returns (USret)	0.449 (1.234)	-9.117*** (2.956)	-2.943*** (0.515)	1.149* (0.616)	17.340*** (4.598)
Observations	78	78	78	78	78

Notes: The values in parentheses denote the standard error.

*** indicates significance at 1%.

* indicates significance at 10%.

From the short-run estimates obtained for individual countries, the study found evidence of home bias among foreign portfolio investors in Kenya and South Africa. However, this occurs only in the short run, as indicated by the long-run estimates that do not differ across groups. The findings also show that in Mauritius, FPI is positively influenced by past results. This finding aligns with the long-run results obtained for all sampled countries. Unlike those for other countries, the results for Mauritius show further that foreign portfolio investors chase returns, even in the short run. Contrary to expectations, the findings reveal that foreign investors invest fewer funds in the Namibia market as

returns rise. This finding may be due to other factors that the investors consider for that market in the short run.

The findings further indicate that foreign portfolio investors in Kenya adjust their investment upwards as the economy expands in the short run, matches the long-run estimates for all sampled countries. However, the results show a negative relationship between FPI and GDP for Mauritius in the short run. This finding can be attributable to other factors, which may influence their investment decisions during this period.

Each of the four countries is affected by US stock market returns in the short run but in different directions. In line with the long-run estimates for all countries, the results show that as returns in the US rise, foreign investors invest more in Namibia and South Africa. However, FPI reduces in Kenya and Mauritius as US stock market returns rise.

5 Conclusions and implications

This study found evidence of home bias for two countries (Kenya and South Africa) in the short run; however, it concludes that foreign investors in all sampled countries do not exhibit a home bias tendency in the long run, as they tilt their investment in line with past flows. The study also concludes that foreign investors in all the sampled markets (except Mauritius) do not prioritise chasing returns in the short run, but as they gain more knowledge of the market in the long run, return chasing become important to these investors. Despite their return chasing motive, it is inferred from the findings that a healthy macroeconomic environment (as reflected in GDP) is very important in enhancing inflows of foreign equity. Additionally, these foreign investors can bring more funds into the sampled markets when they earn more from their investment in industrialised markets.

The findings of this study offer some important implications. Policy deliberations on enhancing market stability and performance could be guided by knowledge of the specific attributes of foreign portfolio flows. For policy makers, the findings indicate that foreign investors attach importance to the economic environment when making investment decisions. Thus, there is a need for policy makers to create a healthier macroeconomic environment that will attract a higher proportion of foreign investment. Additionally, the results suggest that the present state of foreign portfolio flows in the sampled markets is reflective of its past trend. Thus, policy makers need to direct efforts to increase investor protection and make the market an attractive investment hub. To achieve this, concerted efforts should be made to ameliorate information gaps and build confidence among international financial community in the sampled markets. This approach is necessary because outflows in the current period may lead to further divestment in subsequent periods. Additionally, policy reactions can be formulated in advance, where huge reversals are recorded to forestall such reversals in subsequent periods. With the significance of industrialised nations' market conditions to explain flows, the results also imply that regulators need to keep track of developments in such markets in order to react to variations or reversals in flows.

The decomposition of results into long-term and short-term estimates also have policy implications, which suggests that different policy measures may be required for these different time periods, depending on whether a particular determinant is more prominent in the short run or in the long run. However, the disaggregate-level analysis suggests that

policy makers should pay more attention to sustaining measures in the long run, where the influence of the explanatory variables seems to be more pronounced.

For future research, the findings of the study suggest that past flows and stock returns are core variables that must be considered when seeking alternate/further explanations of the behaviour of foreign flows for the selected markets. However, the results hold more significance in the long run. Thus, future studies can extend the scope of the work to cover additional years, given the availability of required data.

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