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The Location Decision of Foreign Portfolio Investment into Emerging and Frontier Markets

Case Finnish mutual funds and institutions

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Abstract

With the developed economies being lately characterised by news of slow growth, mass layoffs and even deflation, investors are increasingly turning towards markets with more positive outlooks. The biggest and most attractive of these markets (like China and the rest of the BRICS countries) have become to be known as emerging markets. However, investors who are always looking for new opportunities have turned their sight even further: to the so-called frontier markets. This phenomenon is of course part of the bigger globalisation that has been in the centre of discussion already for years. Since the 1960s global capital flows have increased in significant numbers be it in terms of equity, direct investment, bonds or currency. Naturally also governments have become increasingly interested in attracting more of this capital, to the point where they have started to adapt economic policies to interest foreign investors. This has translated into a situation where the poorest economies in the world are the most dependent on foreign capital flows. (World Bank, 2015b) Thus it has become more and more important to understand the real drivers behind international investments.

Usually foreign investment is classified into two types: foreign direct investment and foreign portfolio investment. Even though both involve the transfer of some kind of assets cross borders the difference lies, among other things, in the level of control attained after the investment. These two types of foreign investment have received different amounts of attention in academic literature: FDI has been in the focus of mainly international business research whereas FPI has been left for finance literature. However, researchers have in fact suggested that these two types of investment should be looked at through the same theoretical lens. Essentially both are a type of cross border investment but why are their determinants perceived to be so different?

I set out to answer two research questions using a case study methodology: *What characteristics developed market mutual fund managers look for when making the location decision for foreign equity portfolio investment into emerging and frontier markets?* and *What is the role of host country institutions in the aforementioned location decision?* The case studies were conducted through empirical interviews with five Finnish mutual fund managers with the support of other publicly available documents and information.

From the empirical interviews I found that characteristics that developed market fund managers look for when making the location decision include a stable currency, a positive political situation (could have varying meanings), large, liquid and undervalued stock markets, demographic drivers of structural growth and economic growth and development. Furthermore, the interviewees showed strong support for the role of political and economic institutions as influencing the location decision. In addition the case studies brought to light a new perspective on the importance of personal visits and partnerships in reducing information asymmetries and thus influencing the location decision.

Keywords FPI, FDI, emerging markets, institutional theory, investment location decision

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Abbreviations

FDI: Foreign Direct Investment

FPI: Foreign Portfolio Investment

IB: International Business

BRICS: Brazil, Russia, India, China and South Africa

GNI: Gross National Income

MSCI: Morgan Stanley Capital International

S&P: Standard & Poor's

M&A: Mergers and Acquisitions

MNE: Multinational Enterprise

SOE: State Owned Enterprise

SME: Small and Medium Sized Enterprise

1. Introduction

1.1. Topic Background

In the autumn of 2014 it was worldwide news that the Chinese economy had in fact surpassed the US economy and become the biggest in the world (Carter, 2014). Naturally this was a heated topic in the media and a powerful illustration of the growing importance of markets like China. That is markets considered still developing or at least not part of the developed group. With the developed economies being lately characterised by news of slow growth, mass layoffs and even deflation, investors are increasingly turning towards markets with more positive outlooks. (Graham and Emid, 2013) The biggest and most attractive of these markets (like China and the rest of the BRICS countries) have become to be known as emerging markets. They have been in the centre of research and foreign investment already for decades. However, investors who are always looking for new opportunities have turned their sight even further: to the so-called frontier markets. These are the less known, less liquid markets with volatile political and financial systems that nevertheless show increasing potential for growth.

This phenomenon is of course part of the bigger globalisation that has been in the centre of discussion already for years. Since the 1960s global capital flows have increased in significant numbers be it in terms of equity, direct investment, bonds or currency. This growth has been even faster than growth in trade. (World Bank, 2015a) Naturally also governments have become increasingly interested in attracting more of this capital, to the point where they have started to adapt economic policies to interest foreign investors. This has translated into a situation where the poorest economies in the world are the most dependent on foreign capital flows. (World Bank, 2015b) Thus it has become more and more important to understand the real drivers behind international investments.

Generally, global capital flows are often divided into two: foreign direct investment (FDI), associated with Multinational Enterprises and foreign portfolio investment, associated with institutional investors such as mutual funds. Although we have seen significant increases in both, the reputation of FPI remains debatable. Judged by some to be volatile and short-term and even associated with financial crises, it is often viewed as the least preferred method of funding. However, FPI can also increase the liquidity of domestic markets, bring know-how and promote development of financial markets. (Evans, 2002) With only foreign portfolio equity flows around the world amounting to over 760 billion US dollars in 2013, it is clear that this is an important phenomenon that should be studied in detail (World Bank, 2015b). Surprisingly little is known about the determinants of FPI today, a question that will be the focus of this paper.

1.2. Research Gap

Over the last two decades a major focus of international business research has been the study of Foreign Direct Investment (FDI) performed by developed market firms and especially the motivations behind an investment decision. How do managers choose the location where they will invest next and which factors influence this decision? Early research focused on FDI into developed economies and the classic theories, which form the basis of the research, have been structured mainly based on experience from the developed world. However, with the increasing importance of emerging markets the discussion has moved to question whether the same theories can still be applied in these new environments? (Hoskisson et al., 2000) Perhaps these markets portray some special characteristics that require adjustments from the traditional frameworks. In addition, as described above, even the emerging markets cannot be viewed as a homogenous category any more. Recently the term frontier markets has appeared to describe the smaller, less accessible and even unstable markets that nevertheless portray attractive investment opportunities. (Gaeta, 2012) Understanding the particularities of emerging and the new frontier markets has never been more important.

Usually foreign investment is classified into two types: foreign direct investment and foreign portfolio investment. Even though both involve the transfer of some kind of assets cross borders the difference lies, among other things, in the level of control attained after the investment. (Dunning and Dilyard, 1999) These two types of foreign investment have received different amounts of attention in academic literature: FDI has been in the focus of mainly international business research whereas FPI has been left for finance literature. A vast majority of FPI research is quantitative, employing methods such as gravity model analysis on big datasets and focusing on risk and returns. FDI research on the other hand has been more characterised by qualitative case studies employing different theoretical lenses. However, researchers such as Dunning (1999) have in fact suggested that these two types of investment should be looked at through the same theoretical lens. Essentially both are a type of cross border investment but why are their determinants perceived to be so different?

Traditionally the FDI location determinants discussion has focused on factor endowments, such as labour costs and productivity, as the driving force. (Narula and Dunning, 2000) In addition, there are numerous theories explaining FDI behaviour including the likes of transaction cost economics, resource-based view and the eclectic paradigm, which have all been used in research. In FPI literature on the other hand the discussion on determinants has been characterised by an absence of theoretical models. Generally portfolio investments have been thought to be driven by returns only but more recently the role of for example information asymmetries as an investment driver has become a compelling explanation. (Portes and Rey, 2005)

Moving the focus of studies to the growing emerging and frontier markets calls for an adaptation of theoretical frameworks that have previously been used for study in the developed country context. Since these markets are so drastically different in many ways (when compared with the developed markets as well as when compared with each other) there are various factors that may need special consideration. A theoretical framework suitable to study these markets, because it takes into consideration the context, is the institutional approach. (Hoskisson et al., 2000) The institutions of emerging and frontier markets can vary significantly in terms of for example economic and political stability, factors that one can assume to be important for both direct and portfolio investors. In the developed markets investors are used to being able to trust for example the rule of law and being able to operate without the threat of corruption, which might not be the case in the rest of the world. (Wright et al., 2005) The institutional framework has received increased attention in international business literature in the recent past (Xu and Meyer, 2013) but again the evidence for FPI determinants and institutions is limited.

1.3. Research Objective and Questions

The main objective of this study is to find novel insights into the determinants behind the foreign investment location decision, more specifically behind foreign portfolio equity investment. Research in this area has been limited and is lacking theoretical support. In addition, a majority of the studies in the field of FPI are quantitative. By choosing a qualitative standpoint I am hoping to gain new insights from looking at the phenomenon through a different lens. The context of the study will be foreign portfolio investment from a developed country, in this case Finland, to emerging and frontier markets.

Since the literature on FDI determinants is abundant, this study will also focus on the possible similarities and differences behind the motivations for the location decision of both investment types. Fundamentally both are forms of foreign investment, thus what grants such a different treatment in their studies? Could FDI theories help to explain also FPI behaviour?

In particular this study will focus on the location decision of portfolio investment in the emerging and frontier market context and try to discover the particular determinants behind the investment location decision into these markets. More specifically the study will look at the role of institutions in the location decision. Lately especially FDI research has paid increased attention on institutions also in the emerging market context but again this phenomenon has not been widely studied in the field of FPI.

As a result, this study will try to answer the following research questions:

1. *What characteristics developed market mutual fund managers look for when making the location decision for foreign equity portfolio investment into emerging and frontier markets?*
2. *What is the role of host country institutions in the aforementioned location decision?*

1.4. Definitions of Key Concepts

FDI or foreign direct investment is defined as long-term investment by a foreign entity in an enterprise residing in another country. In general this investment form involves the acquisition of ownership as well as management rights. Examples often include investments by multinational corporations (MNCs) in for example foreign plants but individuals may also perform FDI. (OECD, 2009)

FPI or foreign portfolio investment is on the contrary thought to be short-term investment by a foreign entity in the debt and equity securities of an enterprise residing in another country. This investment form involves the acquisition of ownership but no management rights. Examples include investments into foreign stock by institutions such as mutual funds or banks but individuals may also perform FPI. (IMF, 2009)

Developed markets are generally considered as countries with high levels of gross domestic product (GDP) and characterised by higher living standards and industrialisation. Even though no universal definition exists, many reference the World Bank (2015c) definition based on gross national income where high-income countries have GNI per capita of $12,736 or more. Examples include the United States, Japan and most of Europe.

Developing markets again are not universally defined but the World Bank (2015c) classifications serves as a guide where low- to middle-income economies (GNI per capita less than $12,736) are described as developing. The general nature of the concept defines these markets as behind the developed markets in terms of for example GDP, living standards and industrial development. Developing markets can be viewed as the umbrella term that contains emerging, frontier and unclassified markets.

Emerging markets as a concept is very similar to the developing markets and sometimes the terms are used as synonyms. Generally emerging markets are characterised by lower income levels but also strong growth potential; hence the name emerging. They are thought to be in stage of transition towards becoming developed markets. Examples include the BRICS: Brazil, Russia, India, China and South Africa. (Hoskisson et al., 2000 ; Graham and Emid, 2013)

Frontier markets on the other hand are perceived to be one step behind emerging markets. The term is mainly used in finance literature and practice where it has been used in for example the creation of market tracking indices. Definitions vary but in general frontier markets are less liquid and less investable than emerging markets and their economic and political environments might be unstable. (Gaeta, 2012; Graham and Emid, 2013)

Unclassified market is a term sometimes reserved for markets that have not been included in any of the market indices. These are markets that have not quite yet attracted the interest of the investment community and are even considered un-investable. This can be because they do not have a stock market or they are characterised by severe economic and political unrest. (Gaeta, 2012; Graham and Emid 2013)

Institution is a concept used in various areas of research. Most definitions conclude that institutions are made of formal (e.g. laws and regulations) and informal (e.g. traditions and norms) variables. A popular analogy defines institutions as the rules of the game (North, 1990). In international business institutions are often seen as a combination of the variables politics, law, society and culture. (Peng et al., 2008)

1.5. Thesis Structure

To this point this paper has introduced the topic under discussion: the location decision of foreign investment into emerging and frontier markets. In the following I will cover the relevant research that has already been conducted in this field and further introduce the concept of emerging and frontier markets. This overview will cover relevant theories of FDI determinants, namely transaction cost economics, eclectic paradigm and resource-based view and introduce studies performed in the emerging and frontier market context. There will also be an overview of FPI research in the field. This will be followed by a section focusing on the institutional approach in international business and its applicability to the emerging and frontier market context with examples of studies on FDI and FPI location determinants and institutions.

After getting familiar with the relevant literature, the focus will move to the empirical section of this paper. Firstly I will introduce the used methodology, describing the research design and data collection and analysis with some special attention on possible limitations. The chosen design is a case study and the actual research was performed through interviews with portfolio investment professionals in Finland. After the methodology I will provide a description of the chosen country contexts of Thailand (emerging market), Vietnam (frontier market) and Myanmar (unclassified) with a focus on their institutional environments. The institutional conditions of Finland will also be discussed. The interviews that form the empirical part of this study were conducted with chosen mutual fund portfolio managers with the condition of having experience from investing in the context countries. Finally, this paper will conclude with the results from the empirical research, the analysis and discussion of these results and final conclusions with implications for managers and literature as well as recommendations for further research.

2. Literature Review

2.1. Emerging Markets

2.1.1. What are emerging markets

Emerging market is a term that is today most certainly familiar to the wide audience. However, it is used in various contexts with no unified single definition to what exactly categorises as an emerging market. To make things even more complicated it is used in conjunction with concepts such as developing markets and markets in transition. One thing in common with all of these concepts is that they are almost always used in contrast with the term developed markets to represent its counterpart.

The term emerging markets was first coined by Antoine van Agtmael, a World Bank economist, in the 1980s and was used to represent low to middle income per capita countries. Initially the term was a response to the previously used terms such as Third World or less economically developed countries, which had a somewhat negative connotation. (Gaeta, 2012) Today the World Bank classifies countries into different categories based on their annual gross national income (GNI) per capita. The classes are low-income economies (GNI of or less than \$1,045), lower-middle-income economies (GNI more than \$1,045 but less than \$4,125), upper-middle-income economies (GNI more than \$4,125 but less than \$12,746) and high-income economies (GNI \$12,746 or more). The three categories with the lowest GNI (low-income and middle-income) are described to represent developing economies and also often interchangeably the emerging economies. (World Bank, 2015c)

However, in international business literature the definition of an emerging market is not always so clear-cut or quantitative based. Khanna and Palepu (2013) say that definitions are generally based around three parameters: poverty (as the definition by World Bank), capital markets or growth potential. As an example, Hoskisson et al. (2000, p. 249), in their influential article about emerging market strategy, define emerging economies as ”low-income, rapid-growth countries using economic liberalization as their primary engine of growth”. Nonetheless, the combining factor in many of the definitions is the transitory state of the markets described as emerging. They are in the stage of developing and change is expected in the future.

With traditional developed markets showing slow growth especially after the recent financial crisis, foreign investors have also turned to these alternative markets. Terms such as the BRICS and the Next Eleven have become increasingly familiar and not surprisingly so because these markets represent some of the biggest in the world. They are also characterised by great growth figures and relatively unexploited natural resources. (Gaeta, 2012) But which countries are actually classified as emerging?

Morgan Stanley Capital Investment (MSCI), a US-based index provider, first published their Emerging Market Index in 1988 and today several sources provide one. However, with each provider using their own categories and methods for country classifications there is no unified consensus on which countries should be included. Different lists have a majority of the markets in common with some exceptions. Reader should see Appendix 1 for a list of emerging markets provided by MSCI.

2.1.2. <u>The need for further classification</u>

The division between emerging and developed markets is well established in International Business (IB) literature but in reality these two categories still cover a vast array of different markets. This simple division suggests that the countries, part of the emerging market category, are homogenous to the extent that they can be analysed as a group under one label. However it is clear that countries traditionally classified as emerging can differ in various aspects. Taking for example two of the countries considered as emerging by Hoskisson et al. (2000): Bangladesh and South Korea. The GDP per capita of Bangladesh, one of the poorest countries in the world, in 2014 was $3,400 whereas for South Korea it was $35,400 (CIA, 2015). In the World Bank classification Bangladesh is also considered a low-income economy whereas South Korea is a high-income economy. Clearly this demonstrates certain differences between at least the economic developments of these countries. How can we thus grant using a unified strategic approach for the two?

As a matter of fact, in a more recent paper Hoskisson et al. (2013) argue that due to the heterogeneity of these nations there is a need to consider a more detailed classification of emerging markets based on their institutional and infrastructure and factor market development characteristics and they suggest a typology of four different categories situated on a matrix along the two dimensions: traditional emerging economies, mid-range emerging economies type 1 and type 2 and newly developed economies. (See Appendix for figure illustration) However, to my knowledge this paper is the only paper in the field of IB calling for a further classification of developing markets in order to understand them better.

On the other hand, in the literature and practice of international finance it has been common practise to further differentiate between developing markets. Gaeta (2012) describes a division often made in the investment world where markets are ranked into different classes: the first class emerging markets, second class frontier markets and third class unclassified markets. This ranking is made based on assessment of accessibility and tradability of public equities, but many investors (Gaeta says falsely) perceive it to be an indication of quality as well. The country classification of MSCI (available in Appendix 1) in fact classifies Bangladesh as a frontier market as opposed to an emerging market like Hoskisson et al.. In order to understand the concept of frontier markets better the following chapter will discuss its definition, use and investment challenges. Perhaps this division could be useful for also international business literature.

2.1.3. What are frontier markets

Farida Khambata of the International Finance Corporation (IFC) first used the term frontier market in 1992 to describe a set of smaller markets for which the IFC started publishing data. Generally frontier markets are considered to be smaller and less liquid than emerging markets and they are often referred to as the next emerging markets. From the investment viewpoint they have a small stock market and are thus less investable than emerging markets. They are also often characterised by weaker and unstable political and legal systems and thus can be considered to be riskier than emerging markets. (Gaeta, 2012; Graham and Emid, 2013)

Next I will present some of the country classification methods used by different providers to illustrate the differences and the difficulty of coming to a consensus. Perhaps the most known providers of frontier market indices are MSCI, S&P and FTSE and they are largely used as a classification reference in international finance. A comparison of the following classifications can be seen in Appendix 2.

MSCI who were the frontrunner in frontier market indexes include 33 countries in their index. The classification is made based on size and liquidity requirements and market accessibility criteria. This method is used to be able to strike "a balance between a country's economic development and accessibility of its market". More specifically the size and liquidity requirement is comprised of limits for company size, security size and security liquidity. The market accessibility criteria on the other hand consider openness to foreign ownership, ease of capital inflows and outflows, efficiency of the operational framework and stability of the institutional framework. (MSCI, 2014)

The **S&P** Frontier BMI Index includes 34 countries. Before a country is considered for an index S&P say they look at various factors such as number of listings, foreign investor interest in the past, market development prospects and infrastructure. In addition for a country to qualify in the frontier classification it needs to meet two of the following three requirements: full domestic market capitalisation of over US$ 2.5 billion, annual turnover value of US$ 1 billion or a market development ratio of over 5%. (S&P Dow Jones Indices, 2014)

FTSE, also an established index provider, publishes a Frontier Index that includes 22 countries. Their country classification is made based on different Quality of Markets criteria. To be included as a frontier market a market must: have a stock market regulatory authority that actively monitors the market, allow free repatriation of capital and income without penalties or restrictions, rarely see failed trades, clear and settle trades within one to five days after the trade date and be sufficiently transparent with regards to the depth of the equity market, conduct trade reporting on a timely basis and disseminate prices internationally. (FTSE, 2015)

Even though there are some differences between the methods described above, the lists of countries they end up with are quite similar. (See Appendix 3) These lists and indices are also frequently used as investment guides by the investor community because they are perceived to communicate a ranking by quality.

As mentioned above, Hoskisson et al. (2013) on the other hand made their emerging market classification based on institutional and infrastructure and factor market development. Their typology divided emerging markets into four different categories with examples of each. If comparing this division with the division used in finance literature there are some similarities. It could be said that the countries with low institutions and infrastructure and factor market development in fact correspond to the unclassified category used in finance. Hoskisson et al.'s mid-range economies 1 and 2 on the other hand seem to describe frontier markets and finally the newly developed economies correspond to countries generally classified as emerging markets in finance. This illustrates that the names given to different classifications are purely artificial but that there are in fact fundamental differences between emerging markets.

Thus far I have established that developing markets are heterogeneous but the current IB literature is treating them as the same. On the other hand, international finance has adopted a categorisation into emerging, frontier and unclassified markets. Even though these categories might rely heavily on the existence of an active stock market (an aspect less important for FDI than FPI) I have suggested that they could be used also in the context of IB. For the purpose of this study the classification by MSCI will be used as the basis of defining the context of emerging and frontier markets. This classification clearly defines the boundaries between emerging and frontier markets and takes into consideration both financial and institutional aspects. We will now move on to discuss the pros and cons of investing in emerging and even frontier markets.

2.1.4. Motivations and challenges in emerging and frontier markets

So why would a foreign investor from a developed country want to invest in emerging and frontier markets? Being characterised by possible political and economic unrest, limited foreign access and weak liquidity one could assume that the risk is significantly bigger than when investing in the familiar and stable developed markets. So why should an organisation be willing to take this risk?

To begin with, for the interest of both direct and portfolio investors, frontier markets exhibit very positive growth potential in many aspects. They are often characterised by a young population and low rates of urbanisation. For the foreign investor this means not only increased domestic demand in the future when cities and the middle classes will start to grow but also a great potential in low cost labour force. The sheer size of some of these markets (e.g. Bangladesh and Pakistan) will also counterbalance some of their deficits. Growth in terms of for example GDP has also been impressive in most frontier markets. (Graham and Emid, 2013; Speidell, 2011)

On one hand, frontier markets can also be good investment targets due to their low correlation with the rest of the world and even with each other. For example during the most recent financial crisis most frontier markets did not suffer to the same extent as the developed economies. (Graham and Emid, 2013) This means investing in frontier markets could in fact act as a buffer against losses from other markets. Especially for portfolio investors this diversification aspect is important.

Other reasons for investment include low in-debtness levels which can translate into investments in for example infrastructure in the future, currently cheap valuations of the stock market and low integration with the rest of the global economy which means industries such as education and tourism will grow as these markets become more integrated. (Gaeta, 2012)

Even though these markets showcase some attractive investment opportunities there are also some risks specific to these markets that should be taken into consideration. As mentioned above many of these countries portray unstable political systems and their financial markets may be underdeveloped, some of them do not even have a stock market. Often these markets may not be used to complying with international benchmarks such as accounting standards and informal traditions may overrule the formal law. Corruption may be commonplace and foreign investors might receive differential treatment or even be forbidden to invest. (Gaeta, 2012; Graham and Emid, 2013; Speidell, 2011) See Figure 1 for an overview of emerging and frontier market characteristics.

Figure 1. Characteristics of Emerging and Frontier Markets

Emerging Markets

- Low-income, rapid growth economies in a transitory state driven by economic liberalisation
- Stronger institutions and infrastructure development
- High-interest countries such as the BRICS
- Question of political stability
- Foreign access issues

Frontier Markets

- Less liquid, smaller capital markets
- Growth driven by young demographics, low rates of urbanisation
- Low correlation with the rest of the world
- Volatile political and financial systems
- Foreign access issues

I have now established that there is a need for a further classification within the developing markets concept due to the heterogeneity of these markets. There are also several reasons why these newly classified markets will attract more and more investments in the future despite their relatively riskier nature. The next section will move on to focus on the determinants behind foreign investment, the traditional theoretical frameworks used in research and also look at the difference between foreign direct and foreign portfolio investment. The question is whether the existing FDI and FPI frameworks can be applied also to the context of emerging and frontier markets?

2.2. Determinants of Foreign Investment

This chapter discusses the similarities and differences between the two common modalities of foreign investment: FDI and FPI. From the selection of FDI determinant theories I will focus on a selected few, named to be applicable also in the emerging market context and evaluate whether they could also be applied to the case of equity FPI. The most common theoretical viewpoints found in FPI determinants literature will also be covered.

2.2.1. FDI versus FPI

Foreign Direct Investment has long been one of the key topics in International Business research due to globalization and increased number of firms expanding abroad. Research has covered topics from location and entry mode choice determinants to the spill over effects of FDI experienced in host countries. Foreign Portfolio Investment on the other hand has been more in the focus of Finance research where studies have mainly targeted the determinants of higher returns. What is the difference between these two modes of investment that grants such a different treatment?

Dunning and Dilyard (1999, p.10) define FDI as "a modality by which a package of created assets is transferred across national boundaries within the jurisdiction of the transferring firm". The created assets include for example capital and knowledge but exclude for example land and unskilled labour. The OECD (2009, p.7) further describes FDI as a "lasting interest that implies the existence of a long-term relationship…and a significant degree of influence on the management of the enterprise". The modalities of FDI are traditionally thought to include exporting, licensing, wholly owned subsidiaries, joined ventures and strategic alliances. FPI on the other hand is defined as "the flow of both equity and long-term debt (bonds and loans) between individuals and/or institutions domiciled in different countries". The discussion in this paper will mainly focus on equity FPI. (Dunning and Dilyard, 1999, p.10)

Traditionally the biggest difference made between FDI and FPI is the level of control attained after investment. Direct investors usually get some level of control over the target investment and are thus able to manage it accordingly, whereas the portfolio investor only acquires ownership without the right to control. A line has been drawn at

10%: investments that acquire more than 10% of a target company are classified as FDI whereas anything less is FPI. (OECD, 2009) This arbitrary line characterises the ambiguity of the situation where it is not always clear in which category an investment belongs to.

In addition, Dunning and Dilyard (1999) describe three other dimensions where FDI and FPI are traditionally perceived to differ. Firstly FDI involves the transfer of non-financial assets, which can be both tangible and intangible such as technology or knowledge. Secondly they say that FDI is more “indivisible” and “lumpy” than FPI meaning that different parts of the investment are not easily separated. This could also translate into another difference described by many researchers where FPI is viewed as more volatile due to the ease of withdrawing investments (e.g. Chuhan et al., 1996; Goldstein and Razin, 2006). This means that FPI is thought to be more short-term, when compared with FDI, where withdrawing the investment can be extremely costly and time consuming (e.g. in the case of a Greenfield investment). This perceived short-term nature of portfolio investment also means that it is often associated with the occurrence of financial crises (Hausmann & Fernandez-Arias, 2000). Thus FDI has reached a reputation as perhaps the preferred form of financing over FPI. Lastly Dunning and Dilyard (1999) say that the motivation behind FDI lies usually in the will to beat the competitor whereas for FPI it is in higher interests available abroad.

Despite the differences listed above, Dunning and Dilyard (1999) also suggest that in fact FDI and FPI are so similar that they should be evaluated through the use of the same framework. They highlight the increased complexity of international transactions and the difficulty of being able to clearly define what actually constitutes FDI and what FPI. For example the 10% threshold merely categorises FPI and mergers and acquisitions (M&A, traditionally recognised as an FDI entry mode) as the same type of investment, the only difference being the size of the acquired share. This statement is supported by for example Hattari and Rajan (2011) who show that distance of cross-border investment has the same negative effect on both FPI and M&A whereas the effect on other forms of FDI is significantly larger. Dunning and Dilyard (1999) also emphasise that instead of viewing FDI and FPI as separate (even competing) forms of investment they should be viewed as complementary. A summary of the characteristics of both types of investment can be seen in figure 2.

Figure 2. Foreign investment forms

FDI	FPI
• Ownership and management • Control > 10% • Long-term • Transfer of both financial and created assets	• Ownership • Control < 10% • Short-term and volatile • Transfer of financial assets

Sources: IMF, 2009; OECD, 2009

Nevertheless, not all researchers are in favour of giving FDI and FPI the same treatment. For example Wilkins (1999) argues that even though FDI and FPI have coexisted for a long time and they share similar modalities, the actors and motives behind these investment types are fundamentally different. Moreover their impact on the host countries varies. Evans (2002) points out that neither investment type should be labelled good or better but instead they need to be treated differently respecting their specific characteristics. Wilkins also (1999) points out profit seeking as the main motive behind FPI albeit she also recognises that for example mutual funds invest in order to diversify. However, the question arises why these motives cannot also be the determinants behind FDI?

The next section will cover some of the most well known theories of FDI determinants with a focus on the emerging market context. Some consideration will be given to whether these theories could also be applicable in the FPI case and in what way. Finally the theoretical background behind FPI determinants is presented.

2.2.2. <u>Overview of FDI theories for emerging markets</u>

Traditional theories of FDI strategy are varied and numerous. However, for the purpose of this study it is essential to identify those theories that are applicable also to the emerging (and frontier) market context. These markets can differ from the developed world in aspects such as market efficiency, government involvement and the level of business networking and uncertainty (Xu and Meyer, 2013). As Wright et al. (2005) point out the “rules of the game” in these markets are not what researchers’ are used to in developed countries, which calls for new literature trying to understand the new game.

An influential article by Hoskisson et al. (2000), titled *Strategy in Emerging Economies,* focuses on discussing the appropriate strategy frameworks to be used in the emerging market context. The authors identify three key approaches they deem appropriate: the institutional theory perspective, the transaction cost economics perspective (combined with agency theory) and the resource-based perspective. In addition, they point out that institutional theory is more suited to markets in the early stages of development whereas transaction cost and resource-based theories are fitting to more mature markets. Linking this with the discussion above we could assume that the institutional approach is more suitable for frontier market analysis since these markets generally have weaker institutions. The following will describe the selected theories in more detail with an additional focus on Dunning's Eclectic Paradigm.

2.2.2.1. Transaction costs economics

It is thought that Ronald Coase (1937) first described the transaction cost economics approach in the theory of the firm. It describes the situation where if the transaction cost of performing operations through the market is high, the firm instead decides to perform them within. The firm is essentially faced with a trade-off between the transaction costs present at the market, the costs of organising operations internally and the level of control attained.

Khanna and Palepu (2010) state that developed economies with well functioning markets have low transaction costs, high liquidity and transparency and the time to complete transactions is shorter. They also make a comparison of some transaction costs between emerging and developed markets (2010, p.18). For example the number of start up procedures required to register a business is more than double in China and India (13) than in the UK or the US (6). Thus the transaction cost environment of emerging markets calls for perhaps a different type of organisational structure and strategy than in developed markets. For example Peng and Heath (1996) suggest that a hybrid structure embracing the importance of networks (which in developing markets are often more important than legal requirements) would be suitable for emerging markets. By combining resources of partners, foreign firms can reduce the uncertainty provoked by for example institutional weaknesses.

Information asymmetry and thus the agency problem are also present in emerging markets. These concepts imply that the information held by the different actors in a transaction (e.g. seller and buyer, manager and shareholder) is not necessarily the same, which leads to imperfectly functioning markets. (Hoskisson et al., 2000) In developed markets there are institutional arrangements to help to solve these issues whereas in emerging markets the problem can be bigger.

As will be seen later on, transaction costs are also relevant for the portfolio investor despite the fact that FPI does not involve the transfer of physical assets. Instead of affecting the choice of organisational structure or entry mode for an MNE, they could be the determinant behind the initial portfolio investment location choice. If assumed that the foreign portfolio investor prefers low transactions costs it would follow that they prefer developed markets over the more complex emerging and frontier markets. However, if considering the similarity between M&A and FPI, the above example by Peng and Heath (1996) would suggest that when choosing between FDI and FPI in an emerging market environment, FPI would still be a more appropriate investment method than for example Greenfield investment. Later in this paper we will see what the reality of FPI geography is.

2.2.2.2. Eclectic paradigm

One influential theory focusing on FDI determinants is the Eclectic Paradigm developed by Dunning (1977). His theory can be said to derive from transaction cost economics and as Dunning describes it "seeks to explain the cross-border value-added activities of firms at an aggregate level" (Dunning and Lundan, 2008, p.120). In essence the paradigm states that the decisions behind cross-border investments are done based around three factors: ownerships advantages, location advantages and internalisation advantages. Hence the alternative name, the OLI-model.

Traditionally the model has been used to describe specifically foreign direct investment. The O-advantages refer to the competitive advantage within a firm. These can be anything from trademarks and patents to internal processes or managerial skills. In order to engage in foreign investment a firm must have some specific O-advantages. The L-advantages on the other hand involve the special characteristics of a certain location that make it attractive for an investment. This could mean the availability of natural resources, low cost or skilled labour force or favourable trade tariffs. Finally the I-advantages deal with the decision whether to perform operations internally or to engage in for example partnerships. Basically this is a decision between the suitable entry modes for FDI. (Dunning, 1993)

We have seen how Dunning and Dilyard (1999) have in fact suggested that the OLI-framework could also be applicable to foreign portfolio investment. In their work they discuss how the different advantages can be translated to explain FPI activity. For example, in the case of FPI, the O-advantages of the investing entity could be the availability of equity (when compared with competitors) and information about investment target firms. The L-advantages they say are related to where the investing entity can find the best rates of return and if these returns are greater than the risk. However, they also argue that unlike FDI, FPI is more concerned with the performance of the target investment firm (as compared to the home company) and thus characteristics of the host location that affect this performance will be more important. Finally, the I-advantages are translated into Externalization advantages in the case of FPI. These include level of correlation of returns with other markets and transaction costs. All in all Dunning and Dilyard (1999) clearly illustrate that the Eclectic Paradigm is equally applicable to FDI as well as FPI.

In addition to the OLI-model, Dunning (1993) has suggested that the motivations behind the FDI choice are important determinants when choosing the location. He identifies four different types of foreign investment motivations: market-seeking, resource-seeking, efficiency-seeking and strategic asset- seeking. Naturally the motivation will guide the choice between markets: market-seeking investors might choose markets with big potential and size whereas resource-seeking investors will look for markets with certain resources available at a competitive price. Dunning also emphasises that almost all investors today will have more than one motivation behind their investment.

Dunning and Dilyard (1999, p.19) also describe the major actors of private portfolio investment as being institutional investors, bank holding companies and non-financial firms. They describe the objectives for institutional investors as being yield, capital gain, diversification, speculation and market knowledge or access. Even though these objectives differ slightly from the motivations described above, the authors draw a parallel between especially the strategic asset-seeking FDI and FPI because both are seeking to "tap into the resources and capabilities of foreign firms".

2.2.2.3. Resource-based view

The resource-based view, on the other hand, focuses around the resources of the firm and how they can be used to produce a competitive advantage. These resources can be both tangible and intangible but what is essential is whether they can be transformed in a unique way to form a competitive advantage. The firm is thus looking for resources that are valuable, rare, inimitable and non-substitutable in order to be able to form that sustainable competitive advantage that will lead to superior returns over their competitors. (Penrose and Pitelis, 2009)

In the emerging market context Hoskisson et al. (2000) point out that firms, that can manage their resources while taking into consideration the context, can reap great benefits from being a first-mover. Although firs-mover advantage can also be reached in traditional markets, the authors state that its effects can be greater in the emerging context. They also note that in emerging markets the importance of networks and partnerships extends to all areas and being part of an influential business group can be an advantage in itself. The weak and changing institutional environment of these markets means that it is important for the MNE to be able to establish resources that compensate for the lack of institutions, like the local competitors have. Understanding also how to develop these resources with the changing institutional environment is key to success.

The resources that could produce the competitive advantage for a portfolio investor are likely to be somewhat different from a direct investor but nevertheless could influence the investment decision. For example the availability of great managerial skills necessary to spot the right investments and right markets might form such an advantage. Other aspects could be the availability of equity or partners in investment locations.

Despite the fact that all the theories described above (transaction cost economics, eclectic paradigm and resource-based view) are suggested to be applicable for study also in the emerging market context, I have pointed out that these markets in themselves are not homogenous. For example Wright et al. (2005) point out that some of the countries identified as emerging by Hoskisson et al. (2000), namely from Central and Eastern Europe, have developed in very different measures even though they share similar backgrounds and geographic location. This calls for a theoretical framework that puts more emphasis on the location context as a determinant behind the investment decision. We will now look at the prevailing theoretical frameworks in the field of FPI before moving on to discuss the final theoretical approach that could provide an answer to the context issue: the institutional approach.

2.2.3. Foreign Portfolio Investment and developing markets

The theoretical underpinnings of research focusing on the determinants of foreign portfolio investment are not as established or particular as seen with foreign direct investment above, possibly because international and domestic financial markets are perceived to be rather unpredictable. As described by Portes and Rey (2005) and Xun (2009, 2014) many studies are lacking theoretical backing and perform purely empirical one-off research with no real patterns discovered. Much of literature in this area has instead focused on determinants of returns and how to choose a portfolio. (Portes and Rey, 2005) As a result the basic fundamentals of investment determinants theory are seen in the need to find an investment where the rate of return is higher than the risks. This applies also for the case of foreign investment. In finance literature these risks have been defined by many to be, default risk, currency risk and inflation risk. (Ahlquist, 2006)

Fundamental investment theory suggests that portfolio diversification is a key element in reducing risk, which in turn seems to drive where investments flow. As pointed out in section 2 above, it has been shown that emerging markets and especially frontier markets are weakly correlated with the rest of the world, thus making them a perfect target for diversification. These markets have also shown superior performance, i.e. returns when compared with the developed world. However, Xun (2009) states that much of empirical research has in fact found that there is a “home bias” within FPI: investors tend to concentrate foreign investment into areas close to home.

Portes and Rey (2005) studied bilateral cross-border equity flows from developed markets in Europe, USA and Asia during 1989-1996 and ended up with a set of variables that explain 70% of the variance in these capital flows. One of these variables was distance: distance has a negative effect on portfolio equity flows, even though trade in assets is “weightless” and does not incur transportation costs like trade in goods. They illustrate that this paradoxical phenomenon can be explained through the fact that distance indicates greater information asymmetries (approximated by telephone call traffic, multinational bank branches and insider trading). Naturally investors are more likely to invest in countries with less information asymmetries, a view similar to the phenomenon of the agency problem described earlier in transaction cost economics. Thus international capital tends to flow between geographically close areas despite the diversification argument.

In a more recent study, Xun (2009) studied international portfolio investment flows both from OECD and non-OECD countries and their relationship with certain variables, including also a measure for political institutions. His results from a gravity model analysis indicated that geographical distance, language, level of bilateral trade and opacity as well as political institutions (democracy, approximated by the Polity score) all have an effect on FPI when including both OECD and non-OECD countries. More FPI tends to flow into countries that are geographically closer to the home country, share a similar language with it and have strong trade connections. In addition FPI tends to favour countries with greater transparency (possibly an indication of less information asymmetries) and stronger democracies. Essentially these results support the general view where investors tend to invest in countries they are more familiar with (e.g. as the result of increased trade, similar culture or geographic area).

A significant part of FPI literature has also focused on the discussion whether transnational capital affects domestic economic policy and vice versa. In general foreign investment has been viewed as a desirable source of capital by governments due to, among other factors, the possible positive spill over effects it has on numerous areas of society. Thus some governments may be inclined to change their domestic economic policy to be more favourable towards foreign investors in order to attract more investments. (Xun, 2009) This is especially true for the developing world where economic policies may not be as established and the need for foreign capital is greater. Foreign portfolio investors may be more prone to invest in countries that have favourable business conditions for foreigners. However, the evidence surrounding this discussion is contradictory. There are no universal findings to support the positive effects of foreign investment nor is there support for governments changing their policies purely to attract investors. For example Mosley (2000, p.766) states that "financial market influences on governments…are somewhat strong but somewhat narrow". She finds that foreign investment flows respond to changes in inflation rates but not to changes in government fiscal balance. Her study was conducted on developed market participants but it is one of few studies employing a qualitative method in this field.

Figure 3. Foreign investment determinants

FDI Determinants	FPI Determinants
• Transaction costs (higher in emerging markets) • Agency problem • Location-advantages: natural resources, labor force, trade tariffs • Existing resources, networks • First mover advantage	• Rates of return • Diversification • Home bias: geographical and cultural distance • Information asymmetries

To conclude, it is clear that FPI determinants have not been studied to the same extent as FDI and as a result there is no clear theoretical background to support any arguments. We have seen that some of the frameworks used to describe FDI could also be applicable to the case of FPI (See figure 3 for an overview). Now the next section will look at one approach deemed to be specifically suitable for the emerging and frontier market context: the institutional approach. This approach can take into consideration the heterogeneity of these markets thus providing an appropriate platform for further study. We will look at the definition of institutions and how they have been studied in various contexts and whether this framework could be applied to both FDI and FPI.

2.3. Institutional Approach

Finally, the third theoretical framework described by Hoskisson et al. (2000) as applicable for study in the emerging market context, is the institutional approach. This theory reaches beyond management and strategy research but has its roots in social sciences where it has been popular since the 1970s. However, up until recently the institutional approach has received limited coverage in strategy and international business research. Nonetheless, as pointed out earlier, the drastically different institutional environments of emerging, frontier and developed markets clearly grant a different treatment also from the strategy perspective.

2.3.1. Defining institutions

Today, there is no single universally accepted definition of institutions but scholars from different lines of research have slightly different variations. Perhaps the most influential figure in institutional economics has been Douglas North. In 1990 he defined institutions as (p.3): "the rules of the game in a society or…the humanly devised constraints that shape human interaction." He points out that, institutions, as the rules of the game, should not be mixed with organisations which are the actors trying to win the game. North also adds that the institutional framework affects the way organisations evolve but at the same time organisations can affect the way institutions evolve. His work has been highly influential and thus much of the research has also agreed with this definition.

Moreover North (1990) divided institutions into formal, the rules and laws, and informal, the traditions and customs. This is similar to other definitions by for example Scott (1995), an American sociologist, who describes the institutional environment as being comprised of three domains: the regulatory, the cognitive and the normative, where the regulatory is the tangible rules and laws and the cognitive and normative are the intangible values and norms. In international business research specifically, institutions have been defined as including the political and economic institutions as well as socio-cultural factors (Mudambi and Navarra, 2002; Peng et al., 2008). What seems to combine all of the different approaches is that institutions are essentially comprised of a tangible, formal element, as well as an intangible, informal element.

As suggested by the lack of a single definition there is also no clear consensus as to what the effects of institutions are on organizations. Some researchers argue that organizational characteristics depend solely on the institutional environment where it operates and thus organizations can be studied through their environments. On the contrary other researchers show that organizations with vastly different characteristics exist in the same institutional environment. (Mudambi and Navarra, 2002) Xu and Meyer (2013 p.17) identify four different ways in which institutions affect rational actors: through the effectiveness of alternative governance structures which in turn affect strategic decisions, through the efficiency of markets which affects the transaction costs faced by economic actors, through the rules of competition including laws and through uncertainty caused by change. Even though this list is not universal it is clear that the effect of institutions is multifaceted.

2.3.2. Institutions in emerging markets

In 2000 Hoskisson et al. suggested that the institutional approach could be used in the emerging market context, especially to test theories and to gain insight into changing institutional environments that are characteristic to these markets. They also suggested that research should focus on the firms' strategic responses to the changing institutions. All in all, they called for more research using the institutional approach in the emerging context both alone and in combination with the other two, transaction and resource-based approaches.

As a result, in a study focusing on publications related to the emerging market context in major IB journals, Xu and Meyer (2013) found that the use of institutional theory has been gradually increasing. They studied articles published during 2001-2010 with a division into two groups: articles after the initial publishing of Hoskisson et al. (2000) and articles after Wright et al.'s (2005) influential article on the same topic. The use of institutional theory as a foundation had doubled when considering all the journals, a change which was significantly larger than with other theoretical frameworks. Thus the academic community seems to have taken the advice of Hoskisson et al. and Wright et al. in deeming the institutional approach fruitful for study in emerging markets.

Studies performed in the emerging market context using an institutional framework have mainly focused around the determinants of entry mode choice (Meyer, 2001; Meyer et al., 2009; Peng, 2003), organisational legitimacy, firms' responses to institutional change and home country institutional influence on emerging market firms expanding abroad. (Xu and Meyer, 2013) For example Meyer et al. (2009) studied four different emerging markets (Vietnam, India, South Africa and Egypt) and found that the institutional framework in these markets affects the relative cost of different entry modes thus affecting the FDI decision. They also suggest that different entry modes (namely Greenfield and M&A or joint ventures) need different levels of institutional development to be viable.

However, for the purpose of this study I have chosen to look deeper into the determinants behind the original location choice of FDI (and FPI). The following will present selected studies focusing on the location choice in emerging markets.

2.3.3. FDI location choice decision and institutions

"However, prior to deciding how to enter, investors have to decide where to invest"
(Bevin et al., 2004, p.44)

Traditionally FDI research has focused on factor endowments, such as labour costs and productivity, as an important determinant behind location choice. However, recently created assets of the host economy (as opposed to natural assets), as described by Narula and Dunning (2000), have gained importance. This is at least partly due to foreign companies conducting more knowledge-based activities in the host countries. Institutions make up one part of created assets and research has increasingly turned its focus towards the effects of institutions on location choice. As pointed out earlier, the institutional differences between emerging and developed markets, makes this an especially important issue for the emerging market context. As indicated by Mudambi and Navarra (2002), institutions are immobile in an otherwise globalised market thus making them an important factor in location and context decisions.

2.3.3.1. Eclectic paradigm: location and institutions

As described above, the eclectic paradigm focuses on explaining FDI determinants through three dimensions, one of which is location. Dunning himself (1998) has stated that out of the three, location factors have actually been understudied when compared with ownership and internalisation. Although the OLI-framework is traditionally viewed as being based on transactions cost theory, Dunning and Lundan (2008) have shown support for incorporating institutions into the framework. Even though institutions could more easily be viewed as important for the I-advantages they suggest that MNE's increasingly look for locations with the best institutional facilities to support their core competencies. Dunning and Lundan (2008, p.139) state that "the combination of formal and informal institutions influences the kinds of Oa and Oi advantages firms are likely to develop" and thus affect the attractiveness of a given country.

As an example Dunning and Lundan (2008) point out that the incentive structures and enforcement mechanisms present in a particular national context can serve as an institutional L advantage. They use the example of East Asia where the incentive structure of the 1970s to early 1990s, worked towards the usage of existing resources, capabilities and markets and supported developmental goals whereas the systems of Latin America and sub-Saharan Africa did not reach the same goals. This example also illustrates the institutional heterogeneity of markets considered as developing. (Dunning and Lundan, 2008)

In the previously discussed article by Dunning and Dilyard (1999, p.20), the authors list factors that can form location-advantages from the point of view of FDI as well as FPI. When looking at the FPI list one can see that the location factors include several institutional aspects such as political stability, degree of market openness, government support and the condition of the banking system. One thing to note is that this list is very similar to for example the market accessibility criteria used by MSCI to classify emerging markets (and to differentiate from frontier markets). If the presence of these factors determines the attractiveness of the location for investment and acts as a base for classifying markets we could say that emerging markets are markets with stronger institutions and hence more inwards foreign investment (be it portfolio or direct).

2.3.3.2. Institutions and sub-national location

Meyer and Nguyen (2005) studied the determinants of FDI location and entry mode choice in Vietnam. Instead of focusing merely on country comparisons, they investigate the motivations behind location choice on the local level, i.e. between different parts of Vietnam. They argue that institutional differences are significant enough even on the local level to have an effect on FDI decision-making. This approach becomes very plausible when considering large countries with great variations in demographics. It is evident that the institutions of for example Shanghai are vastly different from rural China. They also hypothesise that in the case of weaker formal institutions and strong influence of incumbent firms, foreign investors are less likely to engage in Greenfield investment but instead choose a partnership.

Their analysis concludes that in Vietnam the sub-national institutions, in this case approximated by availability of real estate and the presence of State Owned Enterprises, affect the amount and type of FDI inflows. However, they call for further research in other contexts to verify these results. In addition there is a need to focus also on the informal aspects of institutions, which have not really been tackled by past research.

When considering these results from the perspective of FPI two considerations come to mind. First of all considering FPI as an investment that can only attain less than 10% of control over the investment target the same questions of entry mode decision do not apply. For FPI decisions it is more a matter of whether to invest or not (instead of a decision between ownership or partnership). Secondly, especially in the case of FPI into unclassified or frontier markets, the investment is more than likely to take place through the stock market. In these markets the stock exchange usually exists only in one or two locations. The institutions related to the stock exchange are likely to influence the decision-making in a greater extent and thus the sub-national location consideration may not be relevant. In addition the hypothesis that weaker institutions are more likely to encourage a partnership and thus Greenfield investment needs strong institutions, would suggest that FPI could be the right choice in an institutional context somewhere in the middle.

2.3.3.3. Institutional development and location choice

Bevan et al. (2004) studied the effects of institutions on FDI inflows in Eastern European transition economies. They were interested in whether the significant changes that have taken place in the institutional development of these markets has had an effect on the amount of FDI inflows. Institutional development in this study was measured by approximations of privatization, financial sector reform, liberalization and legal development. The results show support for a positive relationship between privatization, banking sector reform, foreign exchange and trade liberalization, extensiveness of the legal framework and FDI. However, other non-banking financial sector reforms and factors such as competition policy and domestic price liberalization were found to not have an effect. Again the authors highlight the difficulty of measuring informal institutions and state this as an important goal for future research. They suggest that for example the corruption index provided by Transparency International could be one way of measuring the informal aspect of institutions.

For the case of FPI especially the privatization development could be of importance. Without a private sector where to freely invest, a country is unlikely to be an attractive target for portfolio investors. The other aspects such as legal development and foreign exchange and trade liberalization could be assumed to be of equal importance to both FDI and FPI (especially originating from developed countries). On the other hand, one could assume that for example non-banking financial sector development is important for portfolio investors even though the evidence for FDI is the opposite. Presence of other funds and for example financial advisory companies could be beneficial when making a foreign investment decision.

2.3.4. FPI location choice decision and institutions

The number of studies focusing on FPI location determinants and institutions in the developing market context seems to be limited. In a somewhat unique study Ahlquist (2006) looked at both portfolio and direct investment flows and their relationship with economic policy and institutions. He states that the two types of investments will react differently to the information changes about possible rates of return and risks, signalled through economic policy and institutions (approximated by the Polity IV scores). The results show that portfolio investors are likely to react to changes in policy signals that indicate a change in default risk whereas direct investors do not react to changing default risk but instead look for more democratic political institutions.

Interestingly these results by Ahlquist (2006) are somewhat contradictory with earlier findings about FPI home bias. The home bias phenomenon would suggest that portfolio investors would indeed increase their interest in countries where political institutions move towards democracy, i.e. closer to the standards at home. This among other things reduces the information asymmetries thus reducing risk. A study by Xun and Ward (2014) focused exclusively on political institutions, namely level of democracy, and their effect on cross border portfolio flows. They hypothesise that democracies do indeed attract more inwards FPI. However, this is not because democracies are perceived to be more stable investment environments but because they translate into better property rights protection.

Xun and Ward (2014) studied bilateral portfolio investment data provided by the IMF during 2001-2005 from 72 countries. They argue that unlike FDI, FPI is not interested in governmental policy changes or support in order to gain market share and incentives, but instead FPI is driven by adequate property rights protection. This is especially true in the case of developing markets where the investment targets may not be able to make use of the foreign investments to their full capacity without any foreign help. In these markets expropriation risk is often high which means that for the foreign investor it is essential that property rights be adequately protected. Democracies, on the other hand, translate into better property rights protection because they generally are established on the same principles: "individual voice and rights, constraints on the executive and rule of law" (Xun and Ward, 2014, p.2). Thus portfolio investors often use democracies as an "information short-cut" to indicate good property rights protection. Interestingly the authors also found that instead of studying the potential markets' property rights protection in detail, the investors trusted their own subjective estimates of property rights protection more than institutional analysis such as the Polity IV score. This study by Xun and Ward (2014) is one of a very limited number of FPI studies that used also qualitative methods to investigate FPI determinants. They also call for more research in this area to "fully uncover the decision-making process of investors".

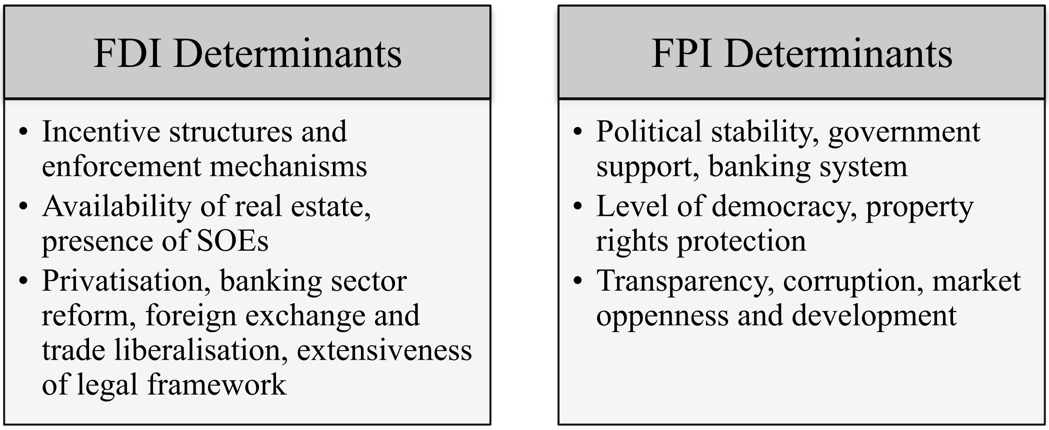
2.3.4.1. The relationship between FDI, FPI and institutions

The studies described above, as well as other research focusing on institutions and entry mode decisions in emerging markets, seem to highlight a relationship between institutional development and choice of investment mode. As pointed out by Meyer and Nguyen (2005), in the case of weak institutions, foreign investors opt for a partnership to make up for, for example the lack of law enforcement. Considering the comparison made earlier by Dunning and Dilyard (1999) that FPI is essentially equivalent to M&A, we could assume that FPI could be suited for weaker institutional environments. Foreign portfolio investors are basically investing in firms that are local to the institutional context thus it would be safe to assume that these firms know how to operate profitably in that context despite the possibly weak institutions.

Nonetheless, after analysing cross-border investment flows of 77 countries, Daude and Fratzscher (2008) found that it is in fact FPI (especially equity FPI) that is more sensitive to changes in the institutional environment (in this case approximated by transparency, investor protection and corruption). Their study shows that majority of foreign investment is in the form of FDI in weaker institutional contexts whereas within developed countries the majority of foreign investment occurs through FPI. Authors say that strong flows of FDI may in fact be a sign of institutional weaknesses whereas the presence of FPI implies that investors trust the market institutions.

Daude and Fratzscher (2008) as well as Fernandez-Arias and Hausmann (2000) point out that FPI essentially needs a strong financial sector. On the other hand, one could assume that other factors, such as availability of real estate to foreigners, are not as important for portfolio investors as for direct investors. Thus in the light of the research presented above we can conclude that different foreign entry modes, as well as FDI and FPI, have different institutional needs and may react in different ways to changing institutional contexts. An overview of the findings of the studies described above can be seen in figure 4.

Figure 4. Foreign investment location decision and institutions



2.3.5. <u>How to measure institutions</u>

The essential difficulty of the institutional approach for research is how to measure institutions, both formal and informal. As illustrated by the examples above, there exists numerous statistics that have been used as approximations of institutions. Perhaps because literature does not even agree on a definition of institutions there has been no unified method of measurement either. Naturally it seems that formal institutions are easier to identify and thus easier to measure than the informal values and norms. Several researchers have called for more research into informal institutions and to methods of measurement (e.g. Bevan et al., 2004; Meyer and Nguyen, 2005).

Numerous studies in both IB and finance research have chosen to measure institutions through different indices. Examples include the Global Competitiveness Report by the World Economic Forum (Hoskisson et al. 2013), the Economic Freedom Index by the Heritage Foundation (Gaeta, 2012), the Polity IV Project (Ahlquist, 2006) and numerous indices offered by the European Bank for Reconstruction and Development (Bevan et al., 2004). However, these indices can only be said to be approximations of a certain institutional aspect. It seems extremely difficult to measure an institutional environment as a whole in one location since there is no consensus as to what to measure. Thus it is essential to recognise that these studies only focus on specific aspects, the choice of which has been justified through the research context.

2.4. Theoretical Framework

Based on the literature discussed above the following theoretical framework will serve as the basis for the empirical section of this study. This framework is comprised of elements from both FDI and FPI literature and adapted to suite the scope of this study.

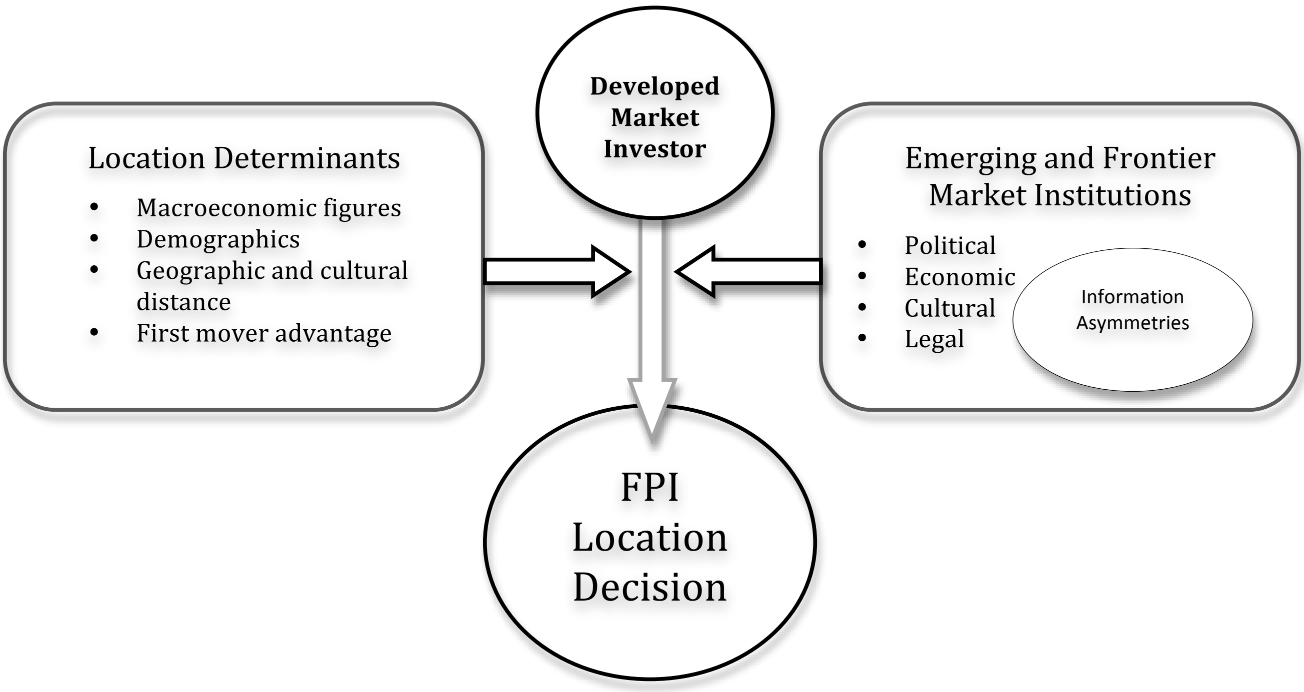
As seen above, a significant part of international business literature and literature on FDI has started to focus on institutions. Many researchers have argued that it is the appropriate approach especially in the emerging and frontier market context where the markets are heterogeneous not only compared with the developed markets but also compared with each other. As will be seen in the next section, the context of this study will include Southeast Asian emerging, frontier and unclassified markets, namely Thailand, Vietnam and Myanmar. All of these markets are at different developmental stages and their institutions differ. Thus the institutional framework will form the basis of this study.

Both FDI researchers Meyer and Nguyen (2005) and Bevan et al. (2004) and the FPI studies by Xun and Ward (2014) and Daude and Fratzscher (2008) showed that there was a relationship between some institutional variables and foreign investment flows. For Meyer and Nguyen the variables were the presence of SOEs and availability of real estate, for Bevan et al. privatization, banking sector reform, foreign exchange and trade liberalization and extensiveness of the legal framework, Xun and Ward used level of democracy as an approximation of political institutions and Daude and Fratzscher focused on transparency and corruption. This list is not by any means exhaustive and there have been numerous other variables used in studies investigating the relationship between institutions and foreign investment. In addition research from both fields showed support that institutions might in fact symbolise other motivations such as reduced transaction costs or information asymmetries. Nonetheless, for this theoretical framework these results form the basis of institutional variables hypothesised as influencing the location decision of foreign investment.

In addition to institutions, previous research has identified some location specific variables that drive foreign investment. Literature focusing especially on frontier markets describes that reasons why many investors are turning towards these markets include attractive growth in many macroeconomic indicators (such as GDP growth) and favourable demographic conditions for future growth in certain sectors. (Gaeta, 2012; Graham and Emid, 2013; Speidell, 2011) FPI research on the other hand has focused on the so-called home bias phenomenon where investment location is driven by geographic and cultural distance. Finally the resource-based view suggests that, especially in the emerging and frontier market context, first mover advantage should be a key interest of investors. The theoretical framework presented in figure 2 was drawn based on these assumptions from existing literature.

The chosen theoretical framework hypothesises that strong institutions have a positive effect on foreign portfolio investment location choice and correspondingly weak institutions have a negative effect. This effect is due to strong institutions indicating that other measures, such as transaction costs described by information asymmetries in the FPI case, are relatively lower when compared with markets with weak institutions. This hypothesis will be tested with empirical research, namely through qualitative interviews with Finnish mutual fund managers investing into emerging and frontier markets.

Figure 5. Theoretical Framework



A key aspect to this framework is defining which institutional variables to investigate since approximating institutions as a whole, can be problematic. I am following the common perception used in international business where institutions are made of political, economic, legal and cultural variables. Since the number of institutional variables that have been studied specifically in the FPI context is very limited, the use of also variables commonly found in international business literature may provide new insights. However, as will be explained in the following chapter, the empirical study will be conducted through qualitative interviews with open-ended questions. Thus the specific institutional variables that will be covered will depend on not only the interview guide but also the interviewees' own understanding and experience of institutions.

Another key issue for this framework is the definition of strong and weak institutions, which might vary depending on the home country of the investor. For the purpose of this study Finland is used as a benchmark but it serves to represent also other developed markets with similar institutional characteristics. The underlying assumption is that the portfolio managers making the foreign portfolio investment location decision will use the home context as a starting point for evaluating institutions.

3. Methodology

This chapter will discuss the methodology of the empirical research conducted for this paper. I will describe and provide reasoning for the chosen multiple case study research design and further present the Finnish mutual fund management case study companies as well as the interviewees from these funds. I will also discuss the data collection method and finally the data analysis approach.

3.1. Research Design: Case Study

For this paper I have chosen to use the case study research design due to the specific context of the study. Yin (2003, p. 1) states: "case studies are the preferred strategy…when the investigator has little control over events, and when the focus is on a contemporary phenomenon with some real-life context." The context of this study is developed market mutual fund managers, represented by Finnish managers, investing in emerging and frontier markets. To get a deeper insight I have chosen four company cases that can contribute to the understanding of the phenomenon. This study will be looking at the determinants behind the historical investment decisions as well as future ones and hence I as the researcher have no control over the events. In addition the term and concept of frontier markets (and even emerging markets) have only recently come in to use and investment into these markets and their institutional development are certainly contemporary phenomena.

In addition, I think the case study is well suited for my purpose because it allows for the use of several data sources, which can be combined to produce a thorough picture of the case. In my case the appropriate sources include company documents and information as well as manager interviews. I feel it is necessary to use multiple data sources to be able to better understand the full picture behind the investment location decision. Several date sources can complement each other and information that may not come up in the interviews may be available in other documents.

I chose to use multiple cases because it can be assumed that each investment decision is somewhat different. The organisational culture as well as personal characteristics of a manager can largely affect the location decision process. In addition no two mutual funds in Finland invest in exactly the same markets or firms, thus making it hard to find a single representative case. By using multiple cases I am hoping to achieve data that is richer and that can provide a picture of the general situation in developed markets through Finland. Furthermore, by using multiple cases I hope the analytic conclusions drawn from each case can possibly be replicated and thus become stronger. In case the implications from each case are in fact similar the generalisability of the results will grow exponentially. (Yin, 2003)

It should be noted that the use of multiple cases means that the research will not be as thorough as when using a single case. Multiple case research design often also seems to lead to "thinner" descriptions when compared with single cases. (Dyer and Wilkins, 1991) This is a sacrifice that I chose to make in order to get a wider understanding even though a less in-depth one. Nonetheless, I feel that for specifically international business a study that compares investments into several national contexts is more appropriate than a single case design. Much of the research in international business on topics such as foreign entry mode decisions has been done using multiple cases (e.g. Meyer et al., 2009), which is why I believe this method to be appropriate.

3.2. Context and Sample

The context of this study can be defined as foreign institutional portfolio investment into developing markets: frontier and emerging. More specifically this study will focus on the viewpoint of Finnish mutual fund investors and to limit the scope of research focus on the Southeast Asian countries. Even though the emphasis is on developing markets in general, the study will pay special emphasis on example countries from different classifications: emerging, frontier and unclassified. In case any patterns emerge, the results could have some applicability to developing markets in other geographical areas. Finland is chosen to represent the developed markets and thus the results are also applicable to investment originating from other developed markets.

This study will be conducted as a multiple case study looking at five different Finnish mutual fund portfolio managers. I will look at the determinants behind the location decision into emerging and frontier markets. What is the role of national macroeconomic characteristics in this decision? How much emphasis is put on institutional factors? Are there differences between the mutual funds? Thus the chosen unit of analysis is the investment decision of a particular mutual fund portfolio manager. According to Piekkari and Welch (2011) this could be defined as a temporal unit and the approach a holistic case study. The study will not focus on single investment decisions but more on the investment pattern of a chosen manager throughout history. However, since investing in emerging and especially frontier markets is a relatively new phenomenon, it can be assumed that the relevant decisions have been made within a close timeframe.

The selection of mutual fund portfolio managers to be included was made based firstly on the fund location in Finland and secondly on the historical geographic scope of the specific fund's investments. Funds were chosen if investments had been made to the context area of Southeast Asia. In addition the chosen funds has to be actively managed and majority of investments had to be in equity. The national context of Finland was chosen to represent the developed markets due to familiarity and ease of access to data. It turned out that the number of Finnish mutual funds actively investing in Southeast Asia is limited thus affecting the size of the sample. In addition studies focusing on the Finnish investment decisions have been limited in number and thus the present study can provide new insights. Choosing fund managers from the same cultural context eliminates any possible confusion and ambiguity when discussing any key concepts where the definition may be culturally tied.

There were also personal factors that affected the choice of the cases: firstly the ease of access to primary data within the Southeast Asian context. I have personal connections to professionals, with extensive experience from these markets, who could thus share their information as interviewees. They were also able to provide contacts to other fund managers relevant to the study, which naturally meant time and cost savings in data collection. Secondly I have personal experience from the Southeast Asian region having travelled around it, and also lived in China, and thus a great interest in studying the area further. I find the Asian markets in general very interesting and hope to increase my expertise in this area to benefit also my future career.

Therefore, the most accurate description of the sampling technique used in this study is perhaps a combination of selective and criterion sampling which, as described by

Piekkari and Welch (2011, p.179), involves the selection of cases "according to a preconceived but reasonable initial set of criteria". The criteria in this case are the Finnish origin and Southeast Asian investment activity of the mutual fund. However, as stated above, there are also some elements of convenience sampling (Piekkari and Welch, 2011) due to personal characteristics and experience. It should be noted that especially the use of convenience sampling means that the credibility of the study and the quality of information might suffer.

I believe that by choosing several cases the results can provide a larger insight about the particular characteristics of developed market mutual fund investors investing into the Southeast Asian frontier and emerging markets (and perhaps even into frontier and emerging markets around the world) and allow for a brief overview. However, it is important to note that the sample cannot be used to perfectly describe all investors and investment contexts and thus any generalisations should be made with caution. I am fully aware that the extent of the study is so limited that no generalisations should be considered universally valid. Nonetheless I had to limit the number of cases due to time management and scope reasons. Actually I believe that in this case increasing the number of cases would have only decreased the quality of data collection and analysis.

3.3. Data Collection

The data collection for this study was based on interviews with selected mutual fund managers. Initial contact was made with one fund management company who were then able to provide suggestions of other appropriate interviewees. All managers who were initially contacted agreed to partake in the study. Tables 1 and 2 provide further information on the funds and the interviews.

Table 1. Case companies

Company	Fund name	Starting date	Fund size million EUR	Focus	Currently investing
eQ	eQ Kehittyvä Aasia	07/05/2010	40.0	Asian emerging markets	China, Thailand, Indonesia, Malaysia, Hong Kong, Singapore, India, Philippines
	eQ Kehittyvät markkinat osinko	15/02/2011	200.2	Emerging markets around the world	China, Thailand, Brazil, South Africa, Hong Kong, Indonesia, Turkey, Nigeria, Malaysia
	eQ Frontier osake	19/12/2011	20.1	Frontier markets around the world	Argentina, Kazakhstan, Nigeria, Qatar, Ukraine, Vietnam
FIM	FIM Frontier	30/08/2013	63.5	Frontier markets around the world	Including Philippines, UAE, Britain, Egypt, Colombia, Pakistan, Kuwait, Romania, Vietnam
	FIM BRIC +	07/12/2005	54.6	BRIC	Brazil, Russia, India, China
JOM	JOM Silkkitie	31/07/2009	48.8	Asia	China, Vietnam, Indonesia, Philippines, Malaysia, India
	JOM Komodo	15/05/2012	11.8	Indonesia	Indonesia
PYN	Pyn Elite Fund	01/02/1999	280.2	Asia	Vietnam, China

Table 2. Interviews

Interview	Company	Portfolio manager	Mode	Date
1	FIM	Hertta Alava	Face to face	06.10.2015
2	JOM	Juuso Mykkänen	Face to face	19.10.2015
3	eQ	Jukka-Pekka Leppä & Lauri Svartling	Face to face	21.10.2015
4	PYN	Petri Deryng	Telephone	16.11.2015

Each manager took part in one interview of 30-45 minutes. The conducted interviews were semi-structured and open-ended and performed either face-to-face or as a phone interview due to geographic reasons. I believe this structure was appropriate because the study is focused both on facts and the interviewees' experiences. The semi-structured design allows for focus on specific issues but leaves room for the interviewees to discuss their opinions and personal experiences more freely. Open-ended questions give the interviewees the freedom to express their opinion to the extent they like and lead to more detailed responses. (Erikkson and Kovalainen, 2008; Gilham, 2010)

Initially a pilot interview was conducted with a staff member of PYN fund management, which acted as a guideline in determining the appropriate questions for the other interviews. Informed consent was asked of all interviewees and all participants were also given the option to remain anonymous in the final thesis paper.

Each individual was interviewed only once since the study does not focus on a period of changes but more on the interviewees' current opinion about the markets and investing. All interviews were taped with the permission of the interviewee and afterwards a word-to-word transcription was made based on the recordings. In addition some notes were taken during the interviews. All interviews were conducted in Finnish because it is the native language of all interviewees and the interviewer.

In addition to interviews, background information on the fund management case companies and the institutional conditions of selected Southeast Asian markets was derived from textual secondary material. The textual secondary material covers material from several sources including, but not limited to, publicly available documents, reports and records, media texts such as articles and interviews and online resources such as country databases (e.g. Global Competitiveness Report and Ease of Doing Business report).

Possible limitations of the chosen data collection method include my inexperience in conducting interviews. This could have limited the scope and quality of data collected. Moreover conducting a telephone interview has its own particular problems for example how to get the conversation flowing naturally. (Gilham, 2010) Another concern is my ability to screen out appropriate secondary material for the context countries. With unlimited information available on the Internet it is sometimes problematic to be able to focus on the essentials and provide a comprehensive picture of the whole situation.

3.4. Data Analysis Approach

All in all the data analysis of this study can be described as a more inductive-oriented approach where the gathered data will gives rise to the essential themes and patterns as opposed to starting from a theoretical point. This also means that the research questions are flexible and likely to change along the process. (Yin, 2003) Despite the fact that a theoretical framework was presented earlier in this study, the previous evidence on influence of institutions on FPI decisions has been so limited that there is hardly a strong theoretical basis. In addition there is wide variance in the theories focusing on FDI. Instead of taking one theoretical view as a starting point I will use concepts from existing theory and the theoretical framework to support any patterns that are found, in the manner of the sensitizing concepts described by Erikkson and Kovalainen (2008).

Eisenhardt (1989) suggests that within-case analysis is the appropriate method to start analyzing multiple-case studies due to, the often vast, amount of data gathered. Thus for the analysis of this study I developed a case description, one of the general analytic strategies suggested by Yin (2003). Essentially this involved producing write-ups for each of the funds studied, which were in a more narrative form just trying to bring together data retrieved from the interviews and also background information. I feel the descriptive technique suits this study since the research questions are not directly derived from theory and are thus not trying to prove a theory right or wrong. Starting with a round up of each case enables me to find the unique characteristics of the single cases and to get to know them first, before moving on to comparisons (Eisenhardt, 1989).

After organizing and getting to know the data for each single case, the analysis moved on to cross-case comparisons. To enable meaningful comparisons the data from each case was organized thematically under selected categories. Categories were based on previous research and the within-case analysis with divisions into traditional location variables and institutional variables. This helped to identify any similarities and differences between the cases (and previous research) as well as possible patterns. (Eisenhardt, 1989)

4. Country Context

The following countries will serve as a defined context for this study, the aim of which is to improve understanding of the determinants behind FPI location decisions. To give more in-depth and perhaps reliable results by controlling for certain variables, the scope of the study was limited to the Southeast Asian context. From this categorisation I chose three countries that each represent one of the above discussed classifications: emerging, frontier and unclassified. By choosing to study country contexts representing the different classifications I am hoping to gain some insights into how the institutional contexts of these countries describe the classifications.

The empirical research for this study was conducted through interviews with Finnish mutual fund managers. Justification for this context choice was shown in the previous section. More specifically the interviews focused on mutual funds investing in the selected context countries of Thailand, Vietnam and Myanmar. This section will provide some background information on these countries with a further focus on the institutional framework.

4.1. Thailand

4.1.1. Background

Thailand is a country with a population of nearly 68 million making it the world's 21st most populated country. It is located in Southeast Asia and surrounded by neighbouring Myanmar, Laos, Cambodia and Malaysia. Officially the country is a constitutional monarchy ruled by the king Rama IX but it has a long history of political turmoil, with 19 military coups since 1932. Most recently in 2014 the military junta took the power in a coup d'état. Nevertheless, Thailand has become known for being a popular tourist destination due to its paradise like beaches, low price levels and friendly people. Tourism is indeed one of the most important industries along with textiles, agriculture and manufacturing. (CIA, 2015)

Thailand has long been ranked part of the emerging market category; in fact it was part of the MSCI emerging market index since the onset in 1988. In the World Bank classification Thailand is rated an upper middle-income country giving some indication of its economy. (World Bank, 2015c) However the economic situation has not always been stable. Like most of the Asian countries, Thailand was also heavily affected by the Asian crisis of the 1990s with GDP growth rate dropping to -10.5% in 1998. Nonetheless Thailand seemed to recover relatively fast. (World Bank, 2015a) As seen from table 1 the amount of FDI inflows in 2013 was estimated at 14,3 billion US$. The Foreign Business Act of 1999 improved rights for foreign investors making Thailand a popular investment target all over the world.

From a portfolio investment perspective Thailand's financial market is well developed. The stock market is healthy with several different exchanges in the capital Bangkok. The size of the listed market is approximately 313 billion US$ and even though it is significantly smaller than other emerging markets like China and India it is in fact bigger than some developed markets. (CIA, 2015) Interestingly the GDP growth rate of Thailand today is estimated only at 1%, which means it has significantly slowed down from the most successful years. The estimate for FDI inflows for the year 2014 also implies a 10% decrease from the 2013 number. (World Bank, 2015a) Perhaps this can interpreted as Thailand gradually ”emerging”. The country has been part of the emerging market category for almost 30 years, is it time we start calling it a developed market?

The answer seems to still be no. Despite significant economic growth and success there are still several factors that grant the classification of Thailand as an emerging market. If looking at the MSCI market accessibility criteria (see Appendix 4), which are frequently used as a benchmark by foreign portfolio investors, we can highlight some of the issues. For example all industries in Thailand are subject to a 49% foreign ownership limit which can be problematic both for direct and portfolio investment. Thailand does provide access to Thai companies through non-voting depository receipts (NVDR) which nevertheless are discriminatory by nature. Not all issuers are able to issue NVDRs, which has resulted in a recent downgrade of Thailand in the foreign room level classification. (MSCI, 2015b)

Table 3. Macroeconomic variables for context countries 2014

Macroeconomic variables	Thailand	Vietnam	Myanmar
GDP per capita PPP (international $)	14,400	5,600	4,700
GDP (current US$ billion)	373.8	186.2	64.33
GDP growth (annual %)	0.7	6.0	8.5
FDI net inflows (US$ billion)	14.3 (2013)	8.9 (2013)	2.3 (2013)
FPI net equity inflows (US$ billion)	-3.5 (2013)	1.4 (2013)	n/a

Sources: CIA, 2015; World Bank, 2015c

4.1.2. Institutions

For the purpose of this study I have chosen a few selected institutional measurements that can provide some indication of the general institutional framework of the context countries. These measures are the Global Competitiveness Report, Corruption Perceptions Index, Ease of Doing Business Report, Rule of Law Index, Global Peace Index and the Polity IV Project. I will not cover the methodology of these indices but it is important to understand that they are not without limitations (to found out more about the methodologies the reader can refer to the respective sources). These indices were chosen due to their accessibility, coverage and established use in previous research. They provide a relatively comprehensive view of the institutional landscape of the selected countries and thus serve the purpose of this study.

In general, Thailand tends to rank somewhere around the middle in the different indices (note that the number of countries included in different measures is not constant) with some variation depending on the institutions being measured. To begin with, the Global Competitiveness Report, published by the World Economic Forum, is a report combining different macro- and microeconomic measurements to give a picture of the economic growth and prosperity of a country. In the most recent report Thailand ranks 31st out of 144 countries overall. However, when looking at the institutional pillar, highly relevant for this study, Thailand's success is not as impressive. In fact at 81st this ranking is the worst out of all the measurements for Thailand. In general Thailand's private institutions score significantly higher than public institutions with especially accountability showing great scores. The biggest issues seem to arise from ethics and corruption as well as security, most of which is explained by the insecure political situation and high crime levels of the country. Corruption is not uncommon and the public doe not trust the deciding elite. These results are backed up by the Corruption

Perceptions index where Thailand's public sector is perceived to be highly corrupted, with a score lower than the Asian average. (World Economic Forum, 2015; Transparency International, 2015)

Thailand's best score is in the Ease of Doing Business report where it outperforms all Asian countries except Malaysia. Basically this report describes how easy it is to set up a new business relative to the rest of the world, measure that is perhaps more relevant for direct investment. However, variables such as protecting minority investors, enforcing contracts and resolving insolvency are also important to portfolio investments. Thailand ranks relatively well in all of these categories implying a favourable investment environment. (World Bank Group, 2015)

The Rule of Law Index by the World Justice Protect measures what is most often described as the formal institutions of a society. It includes variables such as criminal and civil justice, regulatory enforcement and order and security. Considering the perceived high levels of corruption and also low levels of security due to the political environment, it is not surprising to see that Thailand does not score well in this index ranking 11th out of 15 countries in the region. Particular issues are found with rights to privacy, life and security and with discrimination. Constraints on government power are also found to be insufficient when compared with the region. (World Justice Project, 2015)

The Index of Economic Freedom by the Heritage Foundation (2015) gives Thailand a score of 62.4 classifying it as moderately free. However, after the most recent military coup there has been declines in for example property rights protection (found by Xun and Ward (2014) to be a significant determinant behind foreign investment flows), investment and labour freedom and control of government spending. In general the investment environment is described as unsteady and perceptions of corruption are high.

Before 2005 and the military coup Thailand was in fact viewed as a democracy as indicated by the Polity IV project. The political instability and insecurity that followed the coup decreased their ”ranking” to an autocracy. If considering the results found by X as presented earlier, a democracy is more likely to attract more foreign investment. Perhaps this could offer an explanation for the decline of FDI and FPI inflows into

Thailand. Despite its economic development, the unstable political situation is enough to deter foreign investors? This political unrest and security issues have also translated into Thailand ranking extremely low on the Global Peace Index. (Center for Systemic Peace, 2014; Vision of Humanity, 2015)

All in all what can be deduced from the measurements provided by these indices is that the political situation clearly affects also the economic environment. The constant political unrest between the rural and urban population has lead to Thailand being perceived as an environment with low levels of security and high corruption where the rule of law cannot necessarily be trusted. Even though it is relatively easy to invest in Thailand, the foreign investor has to consider whether they are willing to compromise these institutional factors for the possibility of tapping into higher emerging market returns. If Thailand can get past the political situation and on to the same path of development she was on before, perhaps it will emerge and move on to the developed category.

Table 4. Institutional variables for context countries 2015

Institutional variable	Thailand		Vietnam		Myanmar		Total number of countries
	Score	Rank	Score	Rank	Score	Rank	
Global Competitiveness Report	4.7	31	4.2	68	3.2	134	144
Institutions	3.7	84	3.5	92	2.8	136	
Public	3.4	93	3.5	85	2.7	135	
Private	4.4	49	3.5	128	3.1	141	
Corruption Perceptions Index	38.0	85	31.0	119	21.0	156	174
Ease of Doing Business	75.3	26	64.4	78	43.6	177	189
Rule of Law Index	0.5	56	0.5	64	0.4	92	102
Economic Freedom Index	62.4	75	51.7	148	46.9	161	178
Global Peace Index	2.3	126	1.7	42	2.2	119	162
Polity IV Project	4.0	n/a	-7.0	n/a	-6.0	n/a	167

Sources: World Economic Forum, 2015; Transparency International, 2015; World Bank Group, 2015; World Justice Project, 2015; Heritage Foundation, 2015; Vision of Humanity, 2015; Center for Systemic Peace, 2014

4.2. Vietnam

4.2.1. Background

Vietnam is one of the biggest countries in Southeast Asia in population terms with over 93 million people. China, Laos and Cambodia border it to the west but on the eastern side Vietnam has over 3000 km of coastline. The political history of Vietnam has been characterised by turmoil. Up until the 1950s Vietnam was under French conquest and part of the French Indochina. This period was followed by the infamous Vietnam War, which ended with Vietnam finally uniting under communist rule in the 1970s. Today, a single communist party that does not recognise other political forces rules the country. The ruling party has taken some initiative to open up Vietnam to foreign investment, starting with the Doi Moi reforms of 1986. Vietnam also joined the WTO in 2007 but major economic reforms are yet to materialise making the investment environment somewhat challenging for foreigners. (CIA, 2015)

If considering some of the macroeconomic variables in table 1 it is easy to see that Vietnam is on a growth path. Expected GDP growth rate for the year 2015 is 6% and the nominal size of the economy is still far from for example Thailand or other emerging market countries. With one of the biggest populations in the world, future urbanisation movements and a growing middle-class are bound to affect the economy.

In the index providers' classifications Vietnam is frequently featured as a frontier market (see e.g. appendix 1). However in some of the international business research discussed above, Vietnam is also an emerging market. This would imply that the economy of Vietnam is seen as developed enough for it to be considered an FDI target. If comparing the MSCI market classification categories, there are quite a few similarities between Thailand and Vietnam (Appendix 4). For example, in a similar manner to Thailand, foreign investors are generally subject to a 49% ownership limit of Vietnamese listed companies. Vietnam also has two functioning stock exchanges making it a viable portfolio investment target, even though the size of the listed market remains limited.

What separates Vietnam from the emerging markets to grant its classification as a frontier market? In addition to the smaller size of the economy and limitations on activities such as short selling, MSCI evaluates Vietnam (Appendix 4) as having issues with for example investor registration, market regulations and information flow. Surprisingly most of the issues lie in the fact that information is not available in English or registration documents must be filed in Vietnamese. Despite being a hindrance for foreign investors who do not speak the language, this is an issue that should be fairly easy to solve.

Interestingly in the MSCI classification the stability of the Vietnamese institutional framework is evaluated as having no major issues whereas for Thailand the classification implies that improvements are needed (Appendix 4). This perceived difference in institutional frameworks could explain the difference in FPI equity inflows between the two countries. As seen in table 1 in 2013 Vietnam attracted significantly more FPI than Thailand.

4.2.2. <u>Institutions</u>

Lets look at the Vietnamese institutions more closely through the different institutional indices as with Thailand. Firstly, in the Global Competitiveness Report, Vietnam ranks 68th with a score of 4.2. However, like in the case of Thailand, Vietnam's institutions rank significantly lower at 92nd place. For Vietnam the public institutions score better than the private ones with especially high levels of public trust towards politicians (opposite from Thailand where this indicator was relatively low). It remains unclear whether these results are genuine considering the power of the ruling communist party. Nevertheless, many indicators score so low that Vietnam ranks below the 100th mark. There are issues with for example accountability, ethical behaviour of firms and property rights protection, one of the factors that research has found to influence foreign investment flows. The GC reports, as well as the Corruption Perceptions Index, both indicate that there are issues with bribery and irregular payments. (See table 2)

Vietnam's placement in the Rule of Law Index is heavily affected by the fact that the country is ruled by a single party system that has the judiciary and legislative power. Thus the constraints on government powers are well below the Asian average.

Transparency is low and as a result corruption high with common improper influence by the government. In addition there are issues with regulatory enforcement, a factor that is important for foreign investors. Even if the right kinds of laws are in place they are useless without proper enforcement. Nevertheless, on a more positive note Vietnam is perceived to be more secure with little violent crime due to the stable political situation and lack of internal conflict. Vietnam ranks high above Thailand in the Global Peace Index indicating a more stable environment. (World Justice Project, 2015; Vision of humanity, 2015)

The Economic Freedom Index ranks Vietnam in the *mostly unfree* category indicating that there are several issues that concern also foreign investors. The communist party still employs heavy tariff quotas and state owned enterprises tend to dominate the markets. The government also screens foreign investment and there are limitations to which sectors foreigners can invest resulting in poor investment freedom. In addition property rights protection is inadequate. (Heritage Foundation, 2015)

Finally, the Polity IV project graphs Vietnam's polity score as an unchanged autocracy since the 1970s. Even though previous research suggests that foreign investment flows are affected by the level of democracy this does not seem to apply for Vietnam. Both FDI and FPI inflows have been steadily increasing despite no change in the political system. Perhaps in the case of Vietnam the political stability combined with an improving economy are more important than a ruling democracy per se. (Center for Systemic Peace, 2014)

Overall the Vietnamese institutional framework seems to be heavily characterised by the single rule of the communist party. This causes issues with rule of law where regulations are not properly enforced, transparency is low and corruption is high. Despite the government expressing an interest in opening up their markets, there remain several issues that can deter the foreign investor. Improvements are needed in terms of limitations on foreigners, property rights protection and also the availability of information in languages other than Vietnamese. However, it can be observed that in many ways the state of the Vietnamese institutions is similar to that of Thailand, if not in some ways stronger. Thus if institutions act as an indication of foreign investment flows, Vietnam should be able to reach the same inflows as some emerging market countries.

4.3. Myanmar

4.3.1. Background

Finally, Myanmar is a country not very familiar to western investors even though the country possesses several characteristics that imply great growth in the future. With a population of over 56 million, 44% of whom are under 24 years old and a 34% urban population rate, the country is likely to see big growth in industries boosted by the looming increase in urbanisation. However, it is no wonder that investors have not found this country as of yet when looking at its political history. Myanmar (formerly known as Burma) has gone from under the British rule to infamously being ruled by a dictatorship like military junta where no opposition was accepted. In 2011 after the selection of a new president, the country has slowly started to open up to the rest of the world and we can now observe some of the previous sanctions being lifted and an increase in tourist inflows. (CIA, 2015)

After the change to a civilian government, the leaders of the nation have started to focus on economic reforms that will attract more foreign investors. As can be seen from table 1, the FDI inflows into Myanmar in 2013 where relatively limited in amount when compared with Thailand and Vietnam. However these flows have over doubled from 2010 and future growth is to be expected. GDP growth rate is expected at 8%, further supporting the view of an economy on the path to growth. (World Bank, 2015a) At the moment agriculture and natural resource extraction remain the driving industries but a slow move to manufacturing and services has begun. Due to the previously heavy sanctions employed by the US and the EU, Myanmar's trade and foreign investment has mainly taken place with its ASEAN neighbours. (Central Statistical Organization Myanmar, 2015)

As of yet Myanmar has not been included in any of the country classifications making it an ”unclassified market”. It is not even under consideration for the MSCI Frontier Market classification implying that the stock market liquidity requirements are not fulfilled. This issue might be resolved quite soon with the plan to open a new stock exchange in Yangon in December 2015. (Aung and Lwin, 2015) A new Foreign Investment Law was passed in 2012 alleviating some restrictions on foreign investment and providing new incentives in the form of for example tax exemptions. Compared to for example Thailand and Vietnam, in Myanmar foreign investors can own a 100% stake in a company with some limitations on specific sectors thus making it a viable direct investment target. (Tun, 2012) In addition, due to the political history of the country, most of the population can speak at least a little English (unlike in Vietnam) alleviating communication issues for foreigners. (Gaeta, 2012)

4.3.2. Institutions

What is the situation of Myanmar's institutions after a 50-year military rule? Starting with the Global Competitiveness Report, Myanmar ranks 134th out of 144. Again institutions rank even lower at 136th demonstrating that Myanmar's institutions are one of the weakest in the world. These scores give some indication of the macroeconomic and institutional issues facing foreign investors. Public institutions score slightly better than private institutions, which are almost the last in the rankings at 141st place. Thus it is clear that Myanmar has issues that concern foreign investor in all aspects of institutions. (Table 2)

The only two scores where Myanmar ranks under a 100 are public's trust in politicians and wastefulness of government spending. Surprisingly, Myanmar scores better than Thailand on the trust indicator. It is however questionable whether this is the real opinion of people or perhaps the ever-present nature of the military rule still has some effect on the answers? Perhaps one could also assume that the Thai people as a more educated group are better informed to form a critical opinion about the actions of politicians.

Again both the GC report and the Corruption Perceptions Index indicate that Myanmar has serious issues with corruption including bribery and irregular payments. Despite the move towards a more democratic ruling system it is not uncommon that personal relationships or government interference affect business. After years of repression and censorship even fundamental rights are lacking. There are severe issues with freedom of expression and religion and labour rights. The people remain uneducated and with weak civil and criminal justice systems they still remain under the fist of the government. This translates to a very poor ranking in the Global Peace Index, which paints a picture of continuing violence and conflict between minority groups and the government. (World Economic Forum, 2015; Transparency International, 2015; Vision of Humanity, 2015)

In the Economic Freedom Index Myanmar is described as repressed which illustrates perhaps why the different index providers do not consider it a viable investment target. In fact it is one of the least free economies in the world. However, over the past five years Myanmar's economic freedom development has been impressive, second out of the countries included in the EFI. Biggest issues for foreign investment lie in the underdevelopment of the financial markets. There is no functioning stock market and the government still monitors and limits foreign investors' access. (Heritage Foundation, 2015)

To conclude it is clear that the institutional framework of Myanmar remains underdeveloped. Before it can become a serious investment target with a foreigner friendly open economy, the country needs to take care of fundamental rights of the people. The slow stabilisation of the political situation is a step in the right direction but it remains to be seen whether the country can move on to a real democracy. If they can move on from a regime of discrimination and guarantee human rights the next steps would need to involve the development of the financial system. There have been talks about opening a new stock market in Yangon but the government needs to also further alleviate the limitations on foreign investment.

4.4. Finland

The empirical section of this study will focus specifically on the investment decisions of Finnish institutional investors making it thus necessary to take a closer look at the institutional environment of Finland. The Finnish institutional context is purposefully used, as a benchmark because it can be assumed that investors located in Finland will be making comparisons between the system they are used to at home and the systems of the possible investment target countries. Thus for the purpose of this study the Finnish institutional context is defined as strong.

In any ranking Finland is perceived to be part of the developed markets category due to for example high-income levels (GNI per capita of over 48,000 US$) and high GDP per capita (49,541 US$). (World Bank, 2015a) In the MSCI market accessibility criteria Finland gets clear marks for all categories also supporting the developed state of all institutions. Located in Northern Europe, Finland is significantly smaller than any of the context countries with a population of approximately 5,5 million. GDP growth in the recent years has been negative and ageing of the population is a significant problem thus further distinguishing Finland from the context countries. (CIA, 2015)

In general Finland has a reputation of a small Nordic country with excellent social welfare and education systems. The Finnish political system is stabilised as a democracy and for example the Polity IV project indicates that the system has been stable already from the 1940s onwards. (Center for Systemic Peace, 2015) Even though the aftermath of the latest financial crisis has left Finland with a glum economic situation, the economic institutions are still strong. In general corruption is non-existent except some issues with transparency. (World Economic Forum, 2015)

If looking at the Global Competitiveness Report as with the other context countries we can see that Finland ranks 4th. However, its institutions rank the second in the world (public institutions first) thus justifying the use of Finland as a benchmark for strong institutions (see Table 3). Finland ranks the first in property rights, business costs of terrorism, reliability of police services and protection of minority shareholder's interest. Biggest issues lie in the way the government functions with lower scores for wastefulness of government spending and burden of government regulation, which illustrate the increased red tape, found in many government processes. (World Economic Forum, 2015)

Interestingly in the Economic Freedom Index Finland is only ranked *mostly free* in the 19th place, its worst ranking. This is mainly due to the declining economic state where economic growth has stagnated and government spending along with public debt has actually increased. The tax burden is also heavy and non-salary cost of employment is high, illustrating the downside of a comprehensive social security system. Since Finland is a member of the European Union several aspects of markets are guided by EU regulations such as trade tariffs. (Heritage Foundation, 2015)

All in all, the Finnish institutional framework is exemplary in the world. The few issues it has are completely different from the developing countries where fundamental rights, personal security and corruption are still at centre stage. If institutions indeed affect foreign investment flows these differences should be significant enough to demonstrate this effect.

Table 5. Finland institutional variables 2015

Institutional variable	Finland Score	Finland Rank	Total number of countries
Global Competitiveness Report	5.5	4	144
Institutions	6.1	2	
Public	6.1	1	
Private	6.1	3	
Corruption Perceptions Index	89	3	174
Ease of Doing Business	80.83	9	189
Rule of Law Index	0.85	4	102
Economic Freedom Index	73.4	19	178
Global Peace Index	1.27	6	162
Polity IV Project	10	n/a	167

5. Empirical Results

Based on the interviews conducted with five different portfolio managers of Finnish actively managed mutual funds, some patterns of FPI location decision determinants can be detected. In the following I will present the summarised key points of these interviews. These results are discussed under two sections: FPI location choice determinants and the methods to evaluate these determinants.

5.1. <u>Determinants behind FPI location decision</u>

In all interviews what became evident was that the process of deciding in which markets to invest in is multifaceted and involves several steps. As a result there are various facts and figures that all portfolio managers described as having an effect on the final decision. However from all interviews there were some determinants that stood out as the most important and thus having the greatest impact on the location decision.

Interview 1 quite clearly identified foreign exchange risk and the size of the stock market as the most important factors the portfolio managers looks at before the country allocation decision. The former is because they are looking to invest in stable strong currencies. To determine the foreign exchange risk this interviewee follows several macroeconomic figures that in her opinion give a strong indication of the state of the currency. These figures include the likes of current account deficit, economic growth, budget deficit and the amounts of foreign and short-term debt. Stock market size on the other hand is important because even though a national market might look like an interesting investment target, there may simply not be enough stocks to invest in. Liquidity is also an important factor for this fund, leaving too small illiquid markets out of their investment scope.

In addition, as a part of the location decision this portfolio manager also looks at the political situation through a risk model and personally. Interestingly she stated that “we Scandinavians seem to always think that democracy is the correct way even though the issue is not so simple”. Thus when evaluating political risk this portfolio managers looks at the situation from different angles. Determining whether a political confrontation is reason enough to withdraw investment always requires analysis of its consequences on the economy. When asked, this portfolio manager had not faced any major issues due to cultural differences and issues due to language where limited to the Chinese context thus making these factors unimportant for the location decision.

From interview 2 two factors emerged as the most important for the location decision: the signs of structural growth and the political situation. This portfolio manager is looking for countries with the right demographics: a large young population that will in the near future form a growing middle class that will have more money to spend and demand better services and infrastructure. For this reason they have limited their investments to emerging and frontier markets of Southeast Asia instead of the more developed Japan, Korea and Taiwan where the structural growth is small. This structural growth is deemed even more important than stock market size.

Furthermore interviewee 2 says the political situation of a target country can be highly influential when making the location decision. They have experience from withdrawing investments from countries where the political situation takes a turn for the worst. However interviewee 2 also notes that the influence of politics on investments is not always clear-cut. Small political turmoil can for example induce changes in the economy such as stock market price drops, which can form favourable conditions for investment. In addition politics can have a positive effect in the case where current economic facts and figures seem negative but the political environment allows for swift decisions that can promote investment. For interviewee 2 the most important macroeconomic figures were current account deficit due to its influence on currency and the foreign exchange risk, trade balance, inflation and interest rates.

The third interview also highlighted two variables that the portfolio managers deemed as most important for the location decision. Firstly they highlighted the importance of economic growth and development, which was evaluated through a country risk model using several macroeconomic measurements. These measurements included GDP growth, inflation and balance of payments, which were deemed important in determining the foreign exchange risk, public debt ratio and market pricing. In addition they were interested in the drivers behind this growth with one portfolio manager mentioning manufacturing as the more interesting driver at the moment.

The second variable highlighted by interview 3 was again political stability. This company used a country risk model where politically too risky countries were automatically excluded. However there had been examples of politically unstable situations where the effect on investments was not so clear-cut. In the case of Thailand for example, the latest coup actually induced economic change that these investors deemed more positive than negative despite it taking the country further away from democracy. Furthermore, these portfolio managers used a corporate governance score provided by Bloomberg that measures among other things corruption, property rights and patent protection. Interestingly this company is the only one out of all interviewed who was evaluating corporate governance measures on the national market scale. All other interviewees explained that corporate governance issues were tackled through careful stock selection.

Finally interview 4 emphasised the big picture and the importance of being able to make investment decisions that are sustainable in the long run. This portfolio manager is interested in countries with attractive macroeconomic outlook for the future, which is evaluated through for example GDP growth rate predictions, balance of payments and trade balance. Another important factor was the stock market valuation level: they are looking for stock markets where the values are currently low but an increase is foreseen in the near future. Again the political environment is an important influence for the location decision. Interviewee 4 states that instead of looking at the current situation they try to predict what the outcome will be in the near future. Thus investing in a country with current but temporary political turmoil may be a key to accessing undervalued stocks and tapping on the future growth. This portfolio manager emphasised also, that once they have invested in a market, changes in any single variables would not be enough to withdraw investment.

To summarise, the interviewees highlighted a set of different variables influencing the location decision with some overlaps. The most important determinants that emerged during the interviews were foreign exchange risk, stock market size and valuation, structural and economic growth and the political situation.

5.2. Methods for evaluating location determinants

In addition to emphasising certain determinants, the interviews described the methods used by different portfolio managers in evaluating these determinants. Portfolio managers of interviews 1 and 3 both described that they have a special model for evaluating potential investment markets and that the evaluation process is relatively systematic in all cases. The portfolio manager of interview 4 also described the location decision process to be similar with each case. On the other hand the portfolio manager of interview 2 described the method as changing from case to case depending on the particular country characteristics.

Interviewee 1 described the location decision process as a combination of a country risk model analysis and personal opinion. The country risk model they use is based on selected economic variables and a political risk measure. Another part of the analysis is formed by personal visits to target markets and firms, a method highlighted by all interviewees as important. This portfolio manager visits not only investment target firms but also local ministries and central banks on a regular basis. She emphasised the role of personal visits especially in the emerging market context because it allows for finding information that is not readily available on the market. She also described the location decision process as containing a great amount of subjectivity. According to her for example political risk is hard to measure numerically but is better evaluated through personal contacts. In the end the country risk model analysis needs to back up the subjective analysis to make the final decision.

The portfolio manager of interview 2 on the other hand did not follow a systematic process but more observed a number of variables from each country including for example current account deficit (due to its impact on currency), trade balance, inflation and interests. The numeric observations were combined with personal visits, which he described as amounting to up to 50 days a year of travelling. These visits had an important impact on the location decision as well as on the stock choice.

Portfolio managers of interview 3 again described the use of a systematic country risk model that is used to classify countries based on their risk rating. In addition to macroeconomic measures described above this model includes also ratings for corporate governance and political risk. The same risk model was in use throughout the company and thus applied for both developed and emerging and frontier markets. In addition portfolio managers of interview 3 emphasised the importance of an extensive and tight partnership network in target countries. By working closely with selected partners they described the need for personal visits being smaller but local information was instead gathered through frequent conference calls with local analysts. Thus finding the right partner that they can trust was a top priority especially for the emerging market context where they described the quality of information as weaker when compared with the western markets.

Finally the portfolio manager of interview 4 did not use a specific model to analyse markets but he did describe the process as being consistent no matter which market he was looking at. The key to evaluation was following the market situation for a long period of time before the actual investment. In the case of Vietnam this manager had followed the market for 10 years before making an investment. This enables him to have a profound knowledge of the market and also be able to predict future movements to a certain extent. In addition this portfolio manager was the only one physically located outside Finland (in Thailand) and the fund management company the only one employing local analysts in the target markets. Personal visits and local presence is a key part of their strategy. However, the manager emphasised that it is not so much good relationships that matter but more the local presence and information gathered through these visits that make the difference. Instead of differentiating between strategies for developed market and developing market evaluation, this portfolio manager pointed out that the more significant difference for them is in the way small and medium sized enterprises (SMEs) publish information as compared to large multinationals. He saw local presence as a necessity when investing in SMEs (also in the developed markets) because they do not actively publish all the information that may be relevant for a potential investor.

All in all these results discover several variables that are important for the location decision. In addition, the methods of evaluating these variables differ throughout the case funds from systematic risk models to case-by-case analysis. Personal visits and frequent contact with the investment target market and companies are in the essence of the evaluation process. The next section will move on to discuss how these results relate to previous research and the theoretical framework presented earlier.

6. Discussion

From the results presented in the previous chapter we can observe some similarities but also differences with existing literature covered earlier in this paper. The following will discuss these results in the light of prior research and focus on finding any patterns as well as inconsistencies within the data. As with the literature review section I will first look at other location specific characteristics that affect the foreign investment location decision and then move on to discuss institutions and their significance.

6.1. Location characteristics

The theoretical framework presented in the end of chapter 2 (see figure 5) identified four variables based on previous literature having an influence on the location decision: macroeconomic figures, demographics, geographic and cultural distance and first mover advantage. Firstly from the empirical interviews there was clear indication by all interviewees that they strongly follow different macroeconomic measurements and that these measurements indeed affect the location decision. In fact many stated that the reason why they invest in emerging or frontier markets in the first place is indeed the more attractive macroeconomic picture which supports the views of for example Gaeta (2012), Graham and Emid (2013) and Speidell (2011). If the downward spiral of western markets does not show signs of change it is likely that the macroeconomic situation of emerging and frontier markets will look more and more attractive in the future.

All interviewees described several numbers (e.g. balance of payments, trade balance, inflation, GDP growth, public debt ratio) that they follow either independently or as a part of a risk analysis model. However, none of the portfolio managers relied their analysis solely on numerical measurements but instead these figures were studied in combination with other variables. Previous literature has also studied the influence of macroeconomic variables often focusing on a few selected variables in one study (e.g inflation in Mosley (2000) and exchange rate in Froot and Stein (1992)). It seems that often the methodology of these studies is such that they do not allow for looking at the "big picture". Instead of treating these variables as independent, the focus should perhaps move on discovering the relationships between them. The results of this paper do not intend to rank or value the different macroeconomic variables but instead show which types of figures portfolio managers use as an approximation for the state of the economy or financial system. They are part of the overall analysis but in no case the one single reason for investing in a location.

Foreign exchange risk and the stability of the currency was a factor that all interviewees named as important for the location decision. Many of the macroeconomic figures, for example balance of payments and inflation rates, were followed due to their effect on currency. Previous research has also found strong support for the influence of foreign exchange rates on the inflows of both FPI and FDI (Aggarwal et al., 2005; Bevan et al., 2004; Froot and Stein, 1992). It is no surprise that foreign exchange considerations are important in the emerging and frontier market context due to numerous different currency regimes either floating or fixed. Additionally the importance for FPI could be explained through the perceived short-term nature and volatility of investments: fluctuations in exchange rates can significantly affect the value and liquidity of investments in the short-term. Thus foreign exchange rate considerations are likely to be more important for a portfolio investor than direct investor.

It should be noted that much of this previous research on foreign exchange rates, and also on other variables affecting foreign investments, tends to focus on the amount of foreign investment inflows over a given period of time. From that evidence it is impossible to tell whether certain variables influenced the initial location choice or whether they only affected the amount of inflows after this decision was made. This makes results comparison relatively difficult but the evidence from this study can link foreign exchange rates (and other variables) with the initial location decision.

Secondly after macroeconomic variables, demographics rose as an important driver behind the location decision, one of the interviewees naming it as the single most important factor. As described by Gaeta (2012), Graham and Emid (2013) and Speidell (2011) many emerging and especially frontier markets portray demographic characteristics favourable for structural growth, which makes them attractive investment targets. The interviewees confirmed that they were looking to invest in countries with young large populations indeed because of the future growth these characteristics implied. Indications of structural growth were even deemed more important than stable economic figures. The fact that positive demographics are driving investment could be explained through the market-seeking investment motive presented by Dunning (1993). Since demographics are used as an indication of a growing infrastructure and consumer goods market, these investors are basically looking to invest in countries with large and growing markets in certain areas. For the future this result could imply that more and more investment is going to flow from developed markets to emerging and especially frontier markets because in the developed world populations are only getting older. Demographics can seem like a way to predict future growth and returns thus making the investment seem less risky.

Thirdly, the empirical interviews did not provide any evidence for geographic or cultural distance affecting the location choice. It should be noted that by default the funds chosen for this study had to invest in emerging and/or frontier markets. Thus the geographic and cultural distance with Finland was necessarily going to be large. However, some of the funds (like PYN Elite) had an unlimited scope and thus in theory could have for example concentrated investments to the emerging markets of Eastern Europe, which are geographically and perhaps even culturally closer to Finland. Nonetheless, all of the funds showed a strong emphasis for investments in Asia. Thus there was no evidence for the home bias phenomenon as described by for example Portes and Rey (2005) where investors are more likely to invest closer to home. Some funds showed support for the diversification argument since they invest in emerging and frontier markets around the world that are likely to be weakly correlated. However, many of the funds chose to concentrate investment in one particular geographic location, for example emerging markets of Asia. Perhaps a personal attachment and familiarity with these particular locations could explain this concentration demonstrating another form of the "home bias". Previous studies have used geographical distance as an indication of increased information asymmetries but with the cases presented in this paper the frequent visits and strong partnerships may be the reason why this distance has lost its influence.

Surprisingly, despite the strong emphasis on personal visits and partnerships, none of the interviewees identified cultural differences as an issue. One of the interviewees commented that "since the world is already so global the best ways to communicate and to do business have already spread around the world". Even though all interviewees admitted that they had had to use a translator on some occasions, in countries such as China and Vietnam, they did not perceive it as a hindrance on investing. It should be noted that the definition of culture or cultural factors was not made explicit and thus the results rely on the interviewees' personal definitions of culture. Perhaps the familiarity with the culture and people of the investment target nation could have again acted to reduce any perceived cultural differences. It could also be assumed that foreign direct investors, especially in the case of Greenfield investment, will have to emerge themselves in the local culture more fully than portfolio investors, who can quite easily handle everything from an off-shore location. Thus cultural differences might be more important for the FDI than FPI location decision.

Finally, the interviewees had two fold opinions about achieving first mover advantage and thus letting it determine the location choice. All interviewees agreed that they would not want to be the first foreign investor to a market but instead required some kind of established foreign investment infrastructure. The presence of a foreign standard custodian and the size of the stock market were among the limiting factors. On the other hand being the first foreign investor in a particular firm was viewed as favourable and common practise. The resource-based view suggests that being the first mover may allow an investor to benefit from certain resources to a greater extent than possible following competitors even if they have access to the same resources. It seems that in the foreign portfolio investment case the cost of setting up the necessary infrastructure is higher than the perceived benefits from getting to be the first foreign investor. The fact that the case study portfolio managers had been able to be the first foreign investor in some firms shows that issues with for example foreign ownership limits have not been significant enough to make them seek completely new markets. It could be that the first-movers are more likely to be big global funds (unlike the case study funds) with the necessary resources to bring along partners to set up the market conditions necessary for foreign investment.

6.2. Emerging and frontier market institutions

Moving on to the institutional focus of this study, the results indicate that the political situation is the most influential institutional variable in the location decision process. Observing the political situation was a critical part of all the interviewees' analysis, both as a part of a model using a numerical measurement and personally based on individual views. These results are in line with the suggestions of Dunning and Dilyard (1999) and Xun and Ward (2014), both of whom imply a strong influence of political institutions on FPI inflows.

Interestingly, defining what kind of political situation would deter investment was not so straightforward. Xun and Ward (2014) state that FPI is more likely to flow to countries with higher levels of democracy because democracies approximate certain institutional conditions such as better property rights protection. However, all of the interviewees in my study agreed that even though in the west we always tend to view democracy as the ideal option, the situation might not be so simple in emerging and frontier markets. One interviewee stated that despite the political instability created by the coup of May 2014 in Thailand, that turmoil actually brought about positive change for the economy and financial markets. At the same time the same coup together with changes in some economic indicators were enough for another fund to withdraw their investments from the country. One explanation for the differences between these and Xun and Ward's results regarding democracy could be that the participants of my study did not deem property rights protection (the underlying driver by Xun and Ward) as significantly important for the location decision and thus did not actively seek to invest in democracies.

The results from the empirical section of this study also oppose those of Ahlquist's (2006) when it comes to the importance of democracy. Basically what Ahlquist found is that investor perceptions of return and risk improve with democracies and investors fail to appreciate that political turmoil and upheaval may lead to democracy. He also studied the relationship between political stability (variance and persistence) and foreign investment flows. The amount of FDI did not respond to changes in variance, which is described as the short-term political fluctuations, but it varied with persistence. Interestingly, the participants of my study showed that they can indeed appreciate the political upheaval necessary for an improvement in political (and other) institutions and also that variance in political stability can influence both the initial location decision as well as later withdrawal decisions. Perhaps the qualitative methodology of this study allows for the participants, to better express themselves and show a more thorough understanding of institutions and their interconnectedness. Most importantly the quantitative methodologies employed by many studies fail to see the need for a case-by-case analysis when evaluating the role of the political situation.

Thus the influence of political institutions on the location decision is evidently not as clear-cut as indicated by previous research. This paper found no evidence to support the statement that FPI is more likely to flow into countries with higher levels of democracy but instead the results highlight the importance of the effects any political instability has on other variables. Many of the previous research such as Xun and Ward (2014) and Ahlquist (2006) use the Polity IV score to measure political institutions. However, as stated by one of the case study portfolio managers, it is very difficult to put a number on the political situation, which calls for more qualitative studies focusing on this issue. It could be that the interviewees' personal perceptions of political institutions and the level of democracy is in fact completely different from the Polity IV score thus resulting on different interpretations of the relationships between democracy and foreign investment.

In addition to political institutions, the empirical interviews showed strong support for the influence of economic institutions. Interviewees named variables such as foreign ownership limits, stock market size, and presence of custodians as important for the location decision. Interviewees pointed out Vietnam as a problematic investment target especially due to the stringent foreign ownership limit of 49% (before September 2015) and certain sectors being completely reserved for the state owned enterprises (SOE). Despite Vietnam otherwise being an attractive investment location (due to for example strong demographics), these factors complicate stock selection and can even deter investment completely. These statements support the results of both Meyer and Nguyen (2005) and Bevan et al. (2004) who found that the presence of SOEs and level of privatization have an influence on the amount of FDI inflows. Daude and Fratszcher (2008) also showed that FPI is strongly driven by market openness and development factors. Naturally, for a foreign fund looking to invest in equities, the availability of stock to foreigners is a key question: without available stock no investment can be made. This study seems to verify that certain economic institutions influence both the FDI and FPI location decisions in a similar manner. For emerging and frontier market governments interested in attracting more foreign capital, these results could provide a guideline for policy decisions.

When moving on to legal institutions the evidence from the interviews is two fold. Only two of the fund management companies named legal considerations as one of the variables being evaluated for the location decision. One company used a specific country score that accounted for, among other things, corruption, property rights protection and accounting standards. Countries classified as risky based on this score were excluded from the investment scope. The two remaining funds described that corporate governance issues such as corruption were tackled through company selection and not on the national level. Nonetheless, issues such as following western accounting standards and zero corruption were stressed as being important. This implies a certain belief that companies are independent of government level practises and despite the national location the managers would always be able to find compliant companies. These results are in contradiction with the previous FPI location decision research by Xun and Ward (2014) and Daude and Fratszcher (2008) who all found that FPI is highly driven by considerations such as property rights protection, transparency and corruption. However, the general opinion of the interviewees of this study seemed to be that these are issues present in all emerging and frontier markets. It seems that the investors might trust their personal valuation to the extent that they think they will find the wheat from the chaff instead of avoiding a national market completely. Again local presence and partnerships are the key to finding the right information to complete stock selection.

Finally, there was no evidence for cultural institutions influencing the location decision. Despite the fact that the cultures of all emerging and frontier markets are quite different to the Finnish culture, none of the interviewees reported having had any difficulties caused by these differences. They seemed to view the investment world as a very professional environment were all players were able to act according to a “global standard”. All interviewees had experience of using a translator to deal with language differences but none of them viewed it as a hindrance. Again these results show no support for the home bias phenomenon where investors are more likely to invest in cultures similar to home.

All in all these results clearly show the relevance of the institutional approach also for the FPI location decision. However, the results of this study imply that the influence of institutions may not be the same as suggested by previous research. Researchers such as

Daude and Fratzscher (2008) and Fernandez-Arias and Hausmann (2000) suggested that essentially FPI would flow into countries with strong institutions partly because the strong institutions imply less information asymmetries. The results of this study however do not show support for this argument. Investors were willing to invest in countries with for example political instability and instead of using institutions as an approximation they used local presence and partnerships to tackle the information asymmetry problems. These results are more in line with statements of Meyer and Nguyen (2005) who suggested that FDI is more likely to opt for a form of partnership in locations with weaker institutions. This is exactly what the case participants seemed to suggest in the emerging and frontier market context, which by definition have a weaker institutional environment. Thus there is some support for similar behaviour between FDI and FPI, which supports the need for a similar theoretical treatment of both forms of investment. The presented importance of institutional variables also emphasises the importance of context both between develop and developing markets but also among emerging and frontier market countries. These last points will be discussed further in the following section.

6.3. Local presence

In addition to any variables influencing the location decision of FPI, one theme that kept reoccurring during the interviews was the importance of local presence. All of the interviewees reported being actively involved in the investment process by either personally visiting the investment location countries and key personnel there or by engaging in conference calls and other contact. However, only one company had physically located analysts and the portfolio manager into the target markets. As suggested by previous research transaction costs can be viewed as a driver behind FDI in emerging and frontier markets (e.g. Khanna and Palepu, 2010; Peng and Heath, 1996). For FPI, which does not involve transfer of physical assets, the transaction costs could be translated into information asymmetries between the foreign investor and locals (Portes and Rey, 2005). Importantly all of the interviewees reported personal contacts and visits as a method of gaining information that is not readily available in the market, in another words a method for decreasing information asymmetries. This was more applicable to the emerging and frontier market context because, as described by the interviewees, in the western world all information is public and of high quality.

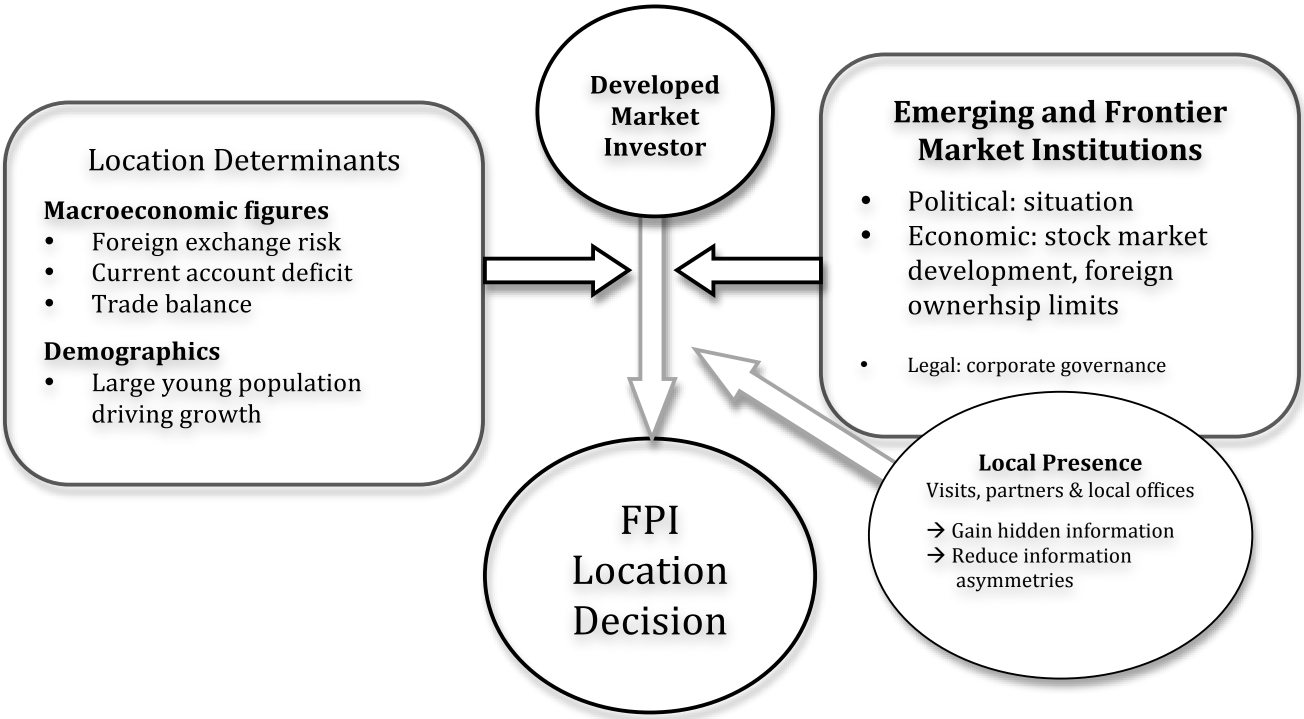
Thus in a way we could say that the local presence and networks actually affect the location decision through reduced information asymmetries. If an investor can establish trustworthy connections with local partners already before the investment decision, it is likely that the information gathered from these partners will influence the final investment decision. Existing FDI research has already suggested that the suitable form of operation for the emerging and frontier market context is through partnerships and networks (Meyer and Nguyen, 2005; Peng and Heath, 1996) thus making this a branch of research where further investigation might be fruitful. This study did not discover whether the local contacts and partnerships had been established before the investment decision, was the personal relationship important or was it more about the ability to personally supervise operations, that made local presence important?

Nevertheless, it is clear that the managers used the information gathered through local visits and partners in evaluating for example quality of institutions. As described by one interviewee “it is difficult to put a number on political risk but instead you have to evaluate it through different contacts”. In most cases these portfolio managers combined their subjective opinion with the analysis from numerical risk models. It seems that this is a factor largely ignored by traditional finance research focusing on FPI. Solely due to the fact that a vast majority of FPI research has been done using quantitative techniques it is no surprise that the importance of the subjective opinion and networks has not been widely discussed. There are studies focusing on managerial skill as a predictor of returns but often these studies do not focus on how that managerial skill is formed. All in all it seems that much of the FPI research is very black and white focusing on single, often numeric, variables as the most important determinant. However, what the results from my study indicate is that the location decision process is in fact more complicated and characterised by a combination of several methods of evaluation focusing on several variables.

6.4. Revised theoretical framework

This discussion brings us to the revised theoretical framework since the empirical results showed varying support as well as evidence against some of the assumptions of the original framework.

Figure 6. Revised theoretical framework



This framework emphasises the importance of macroeconomic figures together with demographics and political and economic institutions for the FPI location decision, as highlighted by the empirical interviews. There was some variance in the type of macroeconomic figures being followed but the importance of political and economic institutions seemed to be widespread. Unlike in previous research, it was not the level of democracy that was important for the investors but the possible effects any changes in the political situation would have on other areas of the market, including economy. Economic institutions on the other hand were deemed important especially in the case where they were limiting investment opportunities, be it through the number of firms in the stock market overall or the number of shares available for foreigners.

Notably geographic and cultural distance considerations have been removed from the original framework and the role of local presence has been stressed further. The case study funds did not show any evidence for the home bias phenomenon but instead seemed to tackle information asymmetries through increased visits and partnerships. This could be interpreted as a method for reducing the geographic distance between the countries thus influencing the investment location decision. Especially the importance of political and economic institutions seems to be characteristic of both FDI and FPI inflows, aligning this study with previous research from the field of international business.

7. Conclusion

This paper has discussed the location decision of foreign portfolio investment into emerging and frontier markets and the most important determinants behind this decision. I set out to answer two research questions using a case study methodology: *What characteristics developed market mutual fund managers look for when making the location decision for foreign equity portfolio investment into emerging and frontier markets?* and *What is the role of host country institutions in the aforementioned location decision?* The case studies were conducted through empirical interviews with five Finnish mutual fund managers with the support of other publicly available documents and information.

From the empirical interviews I found that characteristics that developed market fund managers look for when making the location decision include a stable currency, a positive political situation (could have varying meanings), large, liquid and undervalued stock markets, demographic drivers of structural growth and economic growth and development. Furthermore, the interviewees showed strong support for the role of political and economic institutions as influencing the location decision. In addition the case studies brought to light a new perspective on the importance of personal visits and partnerships in reducing information asymmetries and thus influencing the location decision. This final chapter will review the theoretical contributions of my study as well as its implications for managers and policy makers. I will also discuss possible limitations of this study and finally conclude with suggestions for further research.

7.1. Theoretical contributions

One of the key motivations for this research was the current gap in the way FDI and FPI have been treated in literature. With a glaring absence of FPI research in the field of international business, this paper contributes to the discussion whether the same theoretical frameworks could in fact be used to study both FDI and FPI and whether the determinants behind both types of investments are in fact similar? The empirical results of this study (presented in chapter 5) actually seem to highlight similar type of determinants as with previous research performed with FDI by researchers such as Meyer and Nguyen (2005), Bevan et al. (2004) and Dunning and Dilyard (1999). This similarity supports the notion of using a unified framework to study both types of investment. In this paper I opted for a qualitative approach unlike most finance research on FPI, which could offer one explanation for the results aligning more with previous international business rather than finance research.

The second research question of this study set out to investigate the role of institutions in the FPI location decision. Researchers such as Hoskisson et al. (2000) have suggested that institutions are especially important in the emerging and frontier market context but again there was a lack of studies focusing on institutions as determinants of FPI. The empirical interviews of this study clearly highlighted the significance of especially political and economic institutions for the portfolio managers. Instead of highlighting the significance of democracies, the results instead suggested that the influence of political stability is more complex. On behalf of economic institutions these results could be used to verify previous research on both FDI and FPI. Furthermore, the interviews indicated an interconnectedness of political and economic institutions suggesting that studies should move from focusing on singe variables to a more comprehensive view. For further study of FPI location determinants it is evident that the institutional approach should be incorporated into the studies especially when focusing on emerging and frontier markets.

One aspect that came out in the interviews was the need to adapt approaches when moving from developed to developing markets and also between emerging and frontier markets. In the case of political institutions it was clear that democracy might not always be the ideal state investors are looking for, even though previous research by for example Xun and Ward (2014) seemed to suggest so. The interviewed portfolio managers were using different approaches when analysing the investment potential of developed versus emerging and frontier markets thus suggesting that the theoretical frameworks used to study these different contexts should also be different.

7.2. Managerial and policy contributions

From the managerial perspective the results of this study have several implications. Firstly, not paying attention to the performance of the case study funds, it is evident that engaging in the evaluation process personally can have some benefits. Personal networks and communication skills may be as important as analytical understanding. Especially in the emerging and frontier market environments personal connections may be able to reveal information that is not publicly available. This seems to reduce perceived distance between the investor and the target and thus reduces any associated transaction costs.

It is also important that managers understand when to adapt their evaluation approaches depending on the investment location. As shown by the example of the political situation, a situation that may be viewed as negative by some may actually lead to positive results for others. Being able to take some distance from the values and traditions of home and instead looking at the situation from different angles could reveal opportunities otherwise lost. This also calls for courage to not follow the home bias phenomenon but instead be willing to engage with different cultures. None of the case study managers reported having encountered any issues with cultural differences possibly because they adapted the way they work in the emerging and frontier market context.

For policy makers the implications of this study could be related to the importance of the state of the economic institutions. Often policy makers, who are interested in attracting more foreign investment, provide different incentives in the form of tax or trade tariff alleviations. In the case of developed market investment flowing to emerging or frontier markets it seems that instead of the incentives, policy makers should focus more on enabling privatization and foreign investor access. A country with the right economic characteristics may not be able to attract investments if there are not enough private firms to invest in, in the stock market. For some of the emerging and frontier countries this question may be critical because they have a long history of strong single party rule with heavy control of state owned enterprises. Policy markers should also pay attention to understanding the links between different policies and actions. A decision that might seem purely political could have drastic influence on the economy and send unwanted signals for the foreign investor community.

In addition, the results seem to indicate that the drivers behind FDI and FPI location decision are relatively similar. Traditionally FDI has been seen as the preferred method of funding due to the supposed volatility and short-term nature of FPI. However instead of focusing purely on attracting FDI, governments can in fact take measures that would encourage both types of foreign investors. Some of the empirical interview answers also indicate that these portfolio managers ale looking to invest in a country for the long-term. If they spend almost ten years following a market prior investment they are not looking to make hasty withdrawals after the investment. Attracting these types of investors should be as important as the attention of direct investors.

7.3. Limitations

The limitations of this study, which affect both the quality, and applicability of the results arise from the limited scope of a master's thesis and my inexperience as a researcher. Firstly the sample size was limited to only four funds, all originating from Finland. Naturally this limits the generalisability of the results to other cases of developed market investments flowing into emerging and frontier markets. However, due to time constraints and the intended scope of a master's thesis covering more cases would have been costly. Using a sampling technique with elements of convenience sampling helped with the time constraints but at the same time it casts a shadow on the validity and quality of the results. In order to improve the design of the study the sample should have covered a greater number of funds originating from several developed countries and it should have been derived using a more random sampling technique.

In addition my inexperience as a researcher could have affected the depth and quality of the empirical results drawn from the interviews. Constructing the interview guide and being able to make the interviewee comfortable to share information on record are skills that arise from experience. Despite the semi-structured nature of the interviews in some cases the discussion was relatively shallow, which did not encourage the interviewees to reveal their real opinion. The empirical section included also one telephone interview where building rapport and a natural conversation is even more difficult.

This study has only focused on location characteristics of the target markets in influencing the investment decision. In doing so it has not taken into consideration possible “push” factors arising from for example organisational variables or home location. Since the home context of all studied funds was the same, this leaves open whether differences between the funds could have affected the interviewees’ answers. Factors that could have influenced the location decision could be the organisational culture, fund size, target markets, fund age or even managers’ personal and career background. With the limited number of actively managed emerging and frontier market funds originating from Finland, controlling for these variables would have been impossible. However, for future research this is a consideration that should be taken into account when looking at differences and similarities between fund decision-making.

Finally, for the purpose of this paper, institutions were treated as a separate set of variables in the theoretical framework. However, during the course of the study it became apparent that the definition of institutions is ambiguous at best. Identifying studies investigating institutions and foreign investment was based on the researchers explicitly naming the variables studied as institutional. Nonetheless many variables that were not explicitly labelled as institutional could still be included in that category under different definitions. Thus the scope of research that would have been relevant was probably significantly larger. In addition the interviewees of the case study were not given a definition of institutions and thus in the analysis process it was essential to identify which of the variables described as influencing the location decision could be classified as institutional. This classification was again subject to my own inexperience.

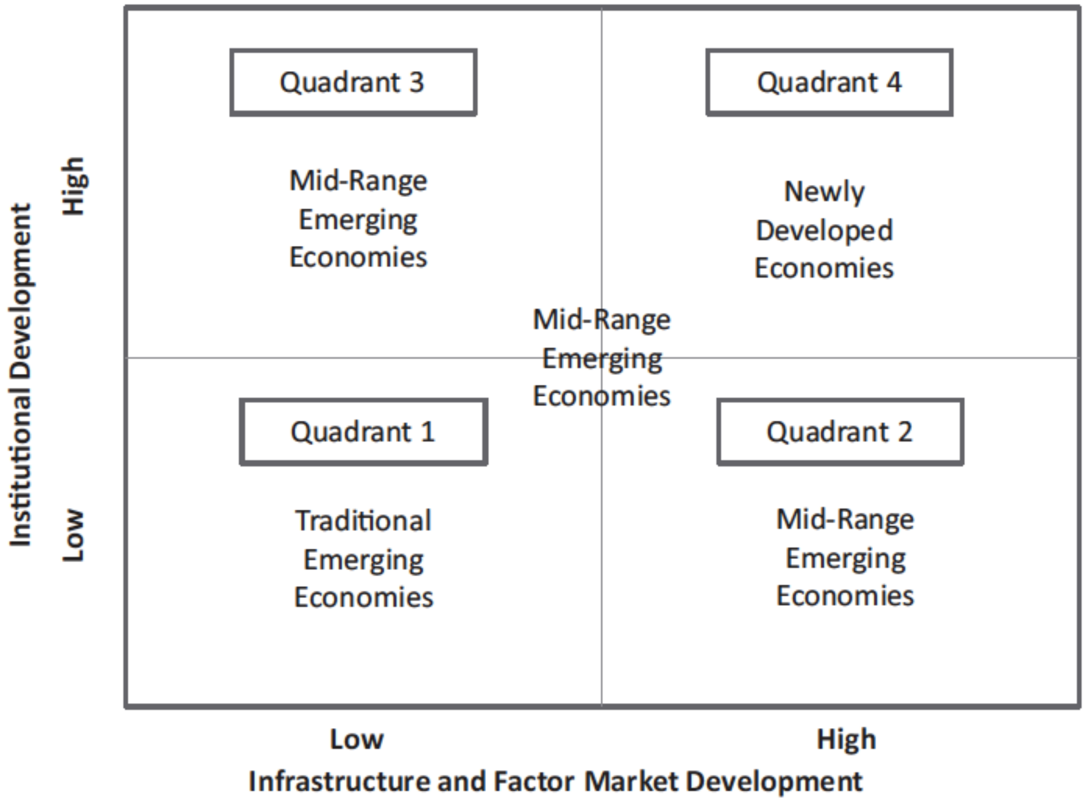
7.4. Future research

The initial motivation for this study was the lack of FPI research outside the field of finance and namely in international business. Thus this motivation alone provides suggestions for further research. In order to be able to better understand the drivers behind FPI it is essential that the phenomenon be approached from different perspectives. More particularly there is a need for research focusing on institutions and FPI. As illustrated by this study, institutions clearly influence also the decision making behind FPI. This study focused on discovering any institutional determinants as suggested by the portfolio managers. The same approach could be executed on a larger scale but there is also a need for analysis focusing on particular institutional variables and their relationship with FPI. As identified by numerous researchers, covering especially the informal aspect of institutions is a key issue for further research. Even though, this study did not find support for a relationship between cultural institutions and the FPI location decision more research is required before any conclusions can be drawn.

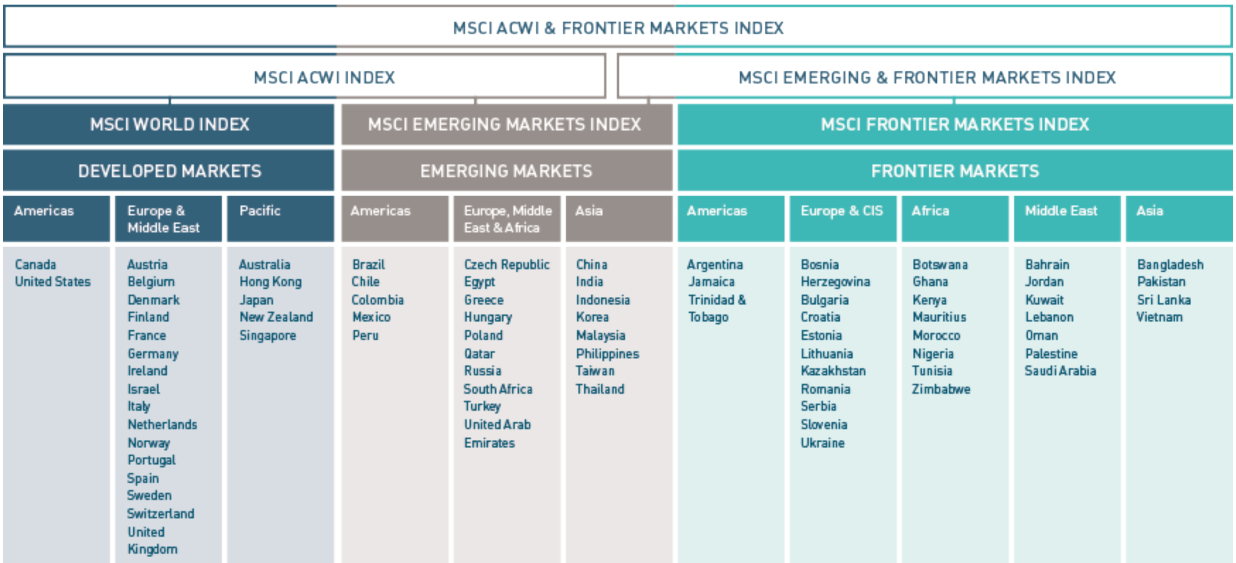
Another perspective highlighted by this study is the focus on the subjective role of the manager in the FPI process. Networking theories are an influential part of international business that could be applied also to the FPI case. In addition the qualitative approach is a method frequently employed in international business research as opposed to finance, which tends to favour quantitative analysis. By further investigating FPI determinants and institutions using a qualitative method in for example different contexts could provide new insights and help to better understand the similarities and differences between FDI and FPI.

8. Appendix

Appendix 1. A typology of emerging economies by Hoskisson et al., 2013



Appendix 2. MSCI country classifications



Source: https://www.msci.com/market-classification

Appendix 3. Frontier market classifications

MSCI	S&P	FTSE
30 countries Size and liquidity Company size Security size and liquidity Market accessibility Openness to foreign ownership Ease of capital flows Efficiency of operational framework Stability of institutional framework	35 countries Number of listings Foreign investor past interest Development prospects Infrastructure market cap >US$ 2.5 billion annual turnover US$ 1 billion market development ratio > 5%.	22 countries Quality of markets criteria Active monitoring Free repatriation of capital Rare failed trades Clearing within 5 days Transparency Trade reporting

Appendix 4. Frontier Market Countries by Index Provider (differences in bold)

MSCI	S&P	FTSE
Americas Argentina Jamaica Trinidad and Tobago	Americas Argentina **Ecuador** Jamaica **Panama** Trinidad and Tobago	Americas
Europe & CIS **Bosnia Herzegovina** Bulgaria Croatia Estonia Lithuania Kazakhstan Romania **Serbia** Slovenia **Ukraine**	Europe & CIS Bulgaria Croatia **Cyprus** Estonia **Latvia** Lithuania Kazakhstan Romania **Slovakia** Slovenia **Ukraine**	Europe & CIS Bulgaria Croatia **Cyprus** Estonia Lithuania Romania **Serbia** Slovenia
Africa Botswana Ghana Kenya Mauritius Morocco Nigeria Tunisia **Zimbabwe**	Africa Botswana **Côte D'Ivoire** Ghana Kenya Mauritius Morocco **Namibia** Nigeria Tunisia **Zambia**	Africa Botswana Ghana Kenya Mauritius Morocco Nigeria Tunisia
Middle East Bahrain Jordan Kuwait Lebanon Oman **Palestine**	Middle East Bahrain Jordan Kuwait Lebanon Oman	Middle East Jordan Oman **Qatar**
Asia Bangladesh **Pakistan** Sri Lanka Vietnam	Asia Bangladesh **Pakistan** Sri Lanka Vietnam	Asia Bangladesh Sri Lanka Vietnam

Appendix 4. MSCI Market Accessibility Criteria Assessment 2015

Market Accessibility Measures	**Thailand**	**Vietnam**
Openness to foreign ownership		
Investor qualification requirement	++	++
Foreign ownership limit (FOL) level	-/?	-/?
Foreign room level	-/?	-/?
Equal right s to foreign investors	-/?	-/?
Ease of capital inflows / outflows		
Capital flow restriction level	++	++
Foreign exchange market liberalization level	+	-/?
Efficiency of the operational framework		
Market entry		
Investor registration & account set up	++	-/?
Market organization		
Market regulations	++	+
Competitive landscape	++	
Information flow	++	-/?
Market infrastructure		
Clearing and Settlement	+	-/?
Custody	++	++
Registry / Depository	++	++
Trading	++	++
Transferability	++	-/?
Stock lending	+	-/?
Short selling	+	-/?
Stability of institutional framework	-/?	+

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