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Foreign institutional investment, business groups and firm performance: Evidence from India



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ABSTRACT

The article tries to examine the relationship between equity ownership held by the foreign institutional investors and firm performance both in a static and a dynamic framework. We also examine how the relationship differs between group-affiliated and stand-alone firms. By employing the 2SLS panel data estimation technique on 137 BSE listed Indian firms, the study finds that foreign institutional investment has a positive influence on the firm performance as measured through Tobin's Q and ROA. Application of linear dynamic panel data estimation in a dynamic framework also yields similar results. The latter method also shows that FII has a positive significant effect on Tobin's Q in group-affiliated firms. The results are analysed from the perspective of a multi-theoretic approach consisting of agency theory, information asymmetry theory, institutional theory and resource dependency theory.

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1. Introduction

The relationship between equity ownership structure and firm performance has been discussed in detail in the literature of corporate finance. However, the majority of the studies pertaining to this issue have been carried out in developed countries like US and UK where the institutions are characterised by very low concentration of ownership with portfolio investors playing significant role as large owners of the corporations. The empirical studies on the relationship between equity ownership and firm performance have produced conflicting results. In emerging countries like India, ownership structure of the firms is dominated by concentrated ownership with insider control. Further, the relationship between the equity ownership held by foreign institutional investors and firm performance has not been explored much in India. Foreign institutional investment has become an important source of capital in India since the economic reforms in 1991.

Foreign Institutional Investment in India is a part of Foreign Portfolio Investment. A major proportion of FPI comes from FIIs. Foreign Institutional Investors (FIIs) as defined by the Securities and Exchange Board of India (SEBI) are institutions that

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