ABSTRACT

Foreign investment, both in the form of direct, long-term and portfolio flows, is necessary for the development of countries. Fund managers are regulated to allocate funds from their portfolios to countries that are in Emerging Market Indices, following the guide laid out by MSCI and Standard & Poor Dow Jones Indices. Accordingly, countries that graduate into these indexes are defined as ‘investable’.

This study examined the underlying factors that both foreign direct and portfolio investors consider when making investments. The factors were then regressed against the countries that had graduated into the emerging market indices to determine which characteristics are necessary for qualification into the index. The sample size included 22 countries common to MSCI and S&P Dow Jones Emerging Market Indices and 28 countries that were economically similar but did not qualify for entry into the index.

The study revealed that inflation has negatively correlated with the odds of a country’s graduation into the index. Additionally, of the different types of infrastructure considered, human capital had the largest marginal impact on a country’s investability, while taxation laws and foreign exchange were found to be statistically insignificant. Political stability was found to be negatively correlated with the country’s odds of graduation. Lastly, foreign investors preferred investing in countries with higher sovereign credit rankings and placed high emphasis on the size of financial markets.

Policy makers of countries that intend to graduate into the emerging market indices should therefore place emphasis on macroeconomic stability of their economies. They should aim to develop resources, through development of human capital. Finally, they should aim to improve and maintain their credit ratings over time.