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### THE IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) IN STOCK MARKET DEVELOPMENT IN SAUDI ARABIA

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#### **ABSTRACT**

This paper expects to explore the effect of Foreign Direct Investment (FDI) on money markets improvement in Saudi Arabia. The Question to be reply: Is there a relationship amongst FDI and Stock Market capitalization esteem in Saudi Arabia? Would we be able to consider FDI as supplement of Saudi Stock Market? The significance of study being that that the outcome will decide the directional relationship moving from the Stock Market to monetary development and to adjust steps that can be taken by government to enhance FDI strategy in Saudi Arabia. The examination depends on auxiliary information for the period 1990-2012. Relapse model and connection is utilized for inspecting the relationship of Market Capitalization of Saudi Stock Market, FDI and monetary development in Saudi Arabia. The outcomes bolster the positive relationship of FDI in boosting the total securities exchange improvement, it demonstrated a critical measurable connection among FDI and total market capitalization accordingly mirroring the correlative job of FDI in the stock exchange advancement of Saudi Arabia.

#### **INTRODUCTION**

Since the financial crises in Asia and Latin America, developing countries have been strongly advised to depend primarily on Foreign Direct Investment (FDI) in order to rise economic development on a sustainable basis [1]. In case of Saudi Arabia, it possesses as one of the largest economies in the Middle East and North Africa (MENA) region. And it has experienced major changes, moving from a desert economy to state-of-the-art infrastructure and technology [2].

Economic of Saudi Arabia strongly depend on oil and Oil revenue and it is the most important element in the total KSA exporting earning that contribute to 85% share of the total revenue in the county [3]. Furthermore, the annual economic report shows that through last 10 years the Mining and Quarrying sector is the major contributing in the GDP that is come from Crude Petroleum and Natural Gas [4]. Through history, the boom of the petroleum in KSA start around 1964 to rich a high price that led to strong develop of the economy in seventies and eighties. But as the result the energy substitutes start developing in the world. At the end of the 1997 due to the East Asian economic crises and increase of non-oil production; Saudi Arabia faced major challenging of low oil price because of the decrease in demand [5]. In the begging of 2000, Saudi Arabia take the step to reform its economic and start to focus on privatization and investment promotion. The Government was encouraged private investment and they open the chance for FDI to diverse its productivity [6].

Saudi Arabia is becoming an increasingly popular place to invest in due to its abundance in natural resources as well as its prospering economy. According to the World Bank report [7] Saudi Arabia has improved its world ranking on the Doing Business index from 67th to 13th, making it one of the top 10 most attractive destinations for Foreign Direct Investment (FDI) inflows in the world economy. According to AlKhathlan's [8] findings, there are many policies and conducive factors that resulted in FDI inflows to Saudi Arabia. One of these factors includes the richness of Saudi Arabia in natural resource with respect to low energy costs, which gives the country a competitive advantage against other countries. Another important factor that leads to increased FDI inflows is Saudi Arabia's long-term objective to achieve and emphasize a liberal economic system.

According to Claessens et al. [9], there are two different side regarding to the effect of FDI to the development of stock market. First side, they view FDI as substitute for stock market development and according to the view FDI have a negative correlation with development of stock market, because it is not protecting the shareholder right and replace the difficulty to invest in local capital market. The second side which have more strong evidence, they view FDI as a complement for stock market. Baker et al. [10] found that for home country financial market FDI play an important role that affect the performance of stock market and investment by positively related to the stock price. Also, for economic growth and stock market development in long relationship Caporale et al. [11] suggest that we should adapt a long run between economic growth and stock market development in order to emphasize positive impact of FDI on this growth. Other important point that results for prevue's studies showed that the FDI have direct impact in stock market development with positive relationship in economic growth in developing countries, but for developed countries there are absence for this this trend and impact [12]. According to Yartey [13], his study links the impact of FDI with rules and regulations of developing country and its political stability and the efficiency of stock market itself that will lead to incase the capital inflow thus increase economic growth. It concludes with triangular relationship: FDI stimulate economic growth, economic growth

promotes stock market development. Thus, FDI promote stock market development.

For now, there is a critical problem for Saudi Arabia with respect to the relationship between FDI and Stock Market. There is a view that tends to see FDI as substitute for Stock development. Thus, FDI result to decrease the value of trading domestically in local market and this is will lead to limitation for investment opportunities for domestic firms. Thus, this study will investigate the impact of FDI on Saudi Stock Market development. The Question to be answer: Is there a correlation between FDI and Stock Market capitalization and value in Saudi Arabia? Can we consider FDI as complement of Saudi Stock Market?

## METHODOLOGY

The examination pursues a quantitative methodology dependent on optional information of Saudi Stock Market (TASI) in the time of 1991-2012 (22 years) because of the accessibility of the information. The variable of the examination include: Aggregate Stock Market Development (refereed to the market capitalization of TASI in current US \$), FDI (net FDI inflow in current US \$), and GDP development of Economic of Saudi Arabia. The examination inspects FDI as a central point influencing securities exchange advancement and monetary development.

Hypotheses are formulated for the study are: H1: There exist a positive relationship between FDI and Saudi Market capitalization. H2: There exist a negative relationship between FDI and Saudi Market capitalization. For identify the relationship, regression model is used. The regression equation is:  $MC = \alpha + \beta_1(FDI) + \beta_2(GDP) + \varepsilon$ , where MC = market capitalization,  $\alpha$  = constant, FDI = net foreign direct investment, GDP = gross domestic product,  $\varepsilon$  = error term.

The source of the data is from the database of The World Bank Indicator which is a global source of financial and technical assistance and research to developing countries and it have a historical data for different financial and economic figures across the world. In order to ensure the applicability of the data to been significant an ADF test is used. ADF test (Augmented Dickey–Fuller test) is used for complicated set of time series models and negative result mean strong rejection of the hypothesis which mean there is a unit root at some level of confidence. To implement the regression model R software had been used. It is statistical programming language and environment that provides collections of statistical analysis tools such as linear and nonlinear modeling, classical statistical tests, time-series analysis, classification, clustering, and it is useable with training and it handle the data effectively.

## RESULT AND DISCUSSION

The engaging insights give in general view recurrence and conveyance of the factors (FDI, MC, GDP) that utilized in the model. Positive skewness estimation of market capitalization and FDI are demonstrating that the mean qualities are grouped to one side at the lower esteems, And Fore negative skewness esteem for the GDP demonstrate esteem bunched at the top of the

line mean right hand side of a diagram as appeared in Table 1. The results of ADF test for the information with 22 observations are appeared in table 2.

**Table 1.** Descriptive Statistical

	MC (US \$)	FDI (inflow US\$)	GDP (growth %)
Mean	8651733118.18486	8651733118.18486	4.36542732096082
Median	858266666.666667	858266666.666667	4.74656260541029
Maximum	39455863929.3333	39455863929.3333	9.25416559165176
Minimum	- 1881066666.66667	- 1881066666.66667	-0.748510560111299
Skewness	1.04500772729155	1.27622248284824	- 0.0467692161849905
Observations	22	22	22

**Table 2.** ADF-Test

Dickey-Fuller	Lag order	P-value
-2.4211	2	0.412
-2.6736	2	0.3158
-2.8167	2	0.2613

In this study we conduct a regression Model to investigation the relationships between Market Capitalization (MC) as depended variables where Foreign Direct Investment (FDI) and Economic growth (GDP) as independent variables. To answer for the hypotheses, the investigate mainly seeks to find in the causal effect of FDI upon Saudi Market Capitalization. The yield demonstrated that Both FDI and GDP had t measurements esteems over 2 Thus, inferred to endeavor extra logical incentive to an expansion in securities exchange improvement. Overall, the regression model is statistically significant. The result showed that there is a positive relationship between FDI and MC. If FDI inflow increase will affect to increase Market capitalization of TASI. But the critical point is still the impact of FDI is very small in comparing to the impact of GDP or others factors that lead to increase market capitalization. There are many factors the affect MC directly and strongly, this includes any factor cause to change stock price. It could industrial factors such as firm performance or it could be other Economic factors such as inflation and interstate as shown In Table 3 and Table 4.

**Table 3.** Regression Output

	Estimate Std.	T-statistic	Significance
FDI	6.822E+02	2.961	0.000802 **
GDP	1.982E+12	2.202	0.04024*
Intercept	4.724+12	1.021	0.31992

**Table 4.** Regression Output

	R-squared	Adjusted R-squared	P-value
The Model	0.5252	0.4752	0.0008451

Also, Correlation Coefficient are used to investigate the relationship between FDI and MC and Economic growth. The result show significant relationship between the variables. All three variables are positively correlated. For the study we need to focus that FDI is significantly related with positive correlation to Saudi Stock Market capitalization as shown in Table 5.

**Table 5.** Correlation

	MC	FDI	GDP
MC	1	0.6356506	0.5532105
FDI	0.6356506	1	0.3593150
GDP	0.5532105	0.3593150	1

Two issues are stay for the aftereffect of this investigation. First is the absence of notable perceptions for measurable examination accumulated in Saudi Arabia, which will clearly be comprehended with the section of time. Second issue is the standard contention that intermediaries for investigation don't completely clarify their hypothetical partners. This issue keeps on showing up in any type of relapse investigation including financial hypothesis. The intermediaries for this paper were picked rely upon past research directed [14].

## CONCLUSION

As the summary for the result, higher FDI with better essentials will prompt an expansion in residential securities exchange movement. So FDI function as a supplement fortress Stock market advancement in Saudi Arabia. We can presume that FDI had positive effect on securities exchange advancement in Saudi Arabia and this bolstered the positive relationship speculation. The arrangement suggestions are that Saudi government should finish to direct and keep up of shrewd macroeconomic strategies and keep to enhance and underscore lawful and thoughtful condition. Additionally, outside arrangement should proceed checked on with the end goal to extend the exchange and draw in remote financial specialists to invigorate the stream of outside direct interest in Saudi Arabia. Along these lines may prompt empower the re-venture of surpluses to build that securities exchange advancement and upgrade monetary development of the nation. From inverse side, draw in FDI on feasible bases, securities exchange advancement should be improved so when remote firms enter showcase, they may look to raise extra value through the nearby stock exchange. This will viably prompt higher securities exchange improvement of Saudi Arabia.

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