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IMPACT OF FOREIGN INSITUTIONAL INVESTORS IN GLOBALISED INDIAN CAPITAL MARKET

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Abstract

India, which is the second fastest growing economy after China, has lately been a major recipient of Foreign Institutional Investor (FII) funds, drawn by strong fundamentals and growth opportunities. The late revival of monsoon, upward revision of economic growth from 5.8 per cent to 6.1 per cent, better-than-expected performance of companies in the quarter ended-June 30, the new Direct Taxes Code, leading to savings in the tax payer's money, and the trade policy with an ambitious target of US$ 200 billion exports for 2010-11, have all revived the confidence of FIIs investing in India. Both consumption and investment-led industries linked to domestic demand, such as auto, banking, capital goods, infrastructure and retail, are likely to continue attracting FII funds. This paper analyses the role ahead for the Foreign Institutional Investors in the present Indian Economic Scenario with the focus on the impact of FIIs on the Indian Capital Market and the Adequacy of Measures taken by the Government in the present Global Financial Crisis for the Investor Protection and to control volatile fluctuations in the Capital Market.

Key Words: *Foreign Institutional Investor, Nifty, SENSEX.*

I. Introduction

"Investors want it; Institutions want it, & Companies are starting to react"

- Howard Silverblatt.

Until the 1980s, there was a general disinclination towards foreign investment or private commercial flows as India's development strategy was focused on self-reliance and import substitution and current account deficits were financed largely through debt flows and official development assistance. After the launch of the reforms, Foreign Institutional Investors (FIIs) have been allowed to invest in all securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or to be listed on the Stock Exchanges in India and in schemes floated by domestic mutual funds. From September 14, 1992, with suitable restrictions, FIIs were permitted to invest in financial instruments. Since then foreign portfolio inflows through FIIs, in India, have been important from the policy perspective, especially when the country has emerged as one of the most attractive investment destinations in Asia. Although the FIIs have been blamed for large and concerted withdrawals of capital from the country at the time of recent financial crisis, they have emerged as important players in the Indian Capital Market. As on June 4, 2009, the net equity investment by FIIs in India was Rs. 2, 52,233.10 Crores with the registration of 1662 Foreign Institutional Investors. Thus, in this paper an effort has been made to examine the Impact of Foreign Institutional Investors on Indian Capital Market.

II. Literature Review

Considerable amount of research have been conducted to study the Impact of Investments of Foreign Institutional Investors on the Capital Markets. A brief review of related studies is furnished.

Rajesh Chakrabarthi (2001) found that FII flows are highly correlated with equity returns and FIIs do not seem to be at informational disadvantages in India compared to the local investors. Paramita Mukherjee, Suchismita Bose and Dipankor Coodoo (2002) established that FII flows significantly affected the returns in domestic equity market. Returns from exchange rate variation influenced the FII decision. Amita Batra (2003) confirmed that the trading behavior and biases of the FIIs do not appear to have a destabilizing impact on the equity market. Kulwant Rai and N.R.Bhanmurthy (2003) suggested that stabilizing the stock market volatility and minimizing the ex-ante risk would help in attracting more FII inflows which would have positive impact on the real economy. S.S.S Kumar (2006) examined the role of FII in Indian Stock Markets and found that the market movement can be explained using the direction of the funds flow from these investors. Sunil Pashakwale and Chandra Thapa (2007) identified the influence of Foreign Institutional Investment in the short and long run relationship on the Indian Equity Market. They concluded that the mobility of foreign portfolio contains significant information in explaining the short and long term co-movements of Indian Equity Market with that of US and the UK Equity Market. P. Krishna Prasanna (2008) discusses the relationship between Foreign Institutional Investment and firm specific charactertics in terms of ownership structure, financial performance and stock performance. He observed that foreign investors invested more in companies where a high volume of shares were owned by the general public. M.Suresh Babu and K.P. Prabheesh (2008) established the existence of bidirectional causality between FII flows and stock returns and also indicated that FII flows are driven by the stock returns. Anand Bansal and J.S. Paricha (2005) estimated that there is no significant change in the Indian Stock Market average returns and also volatility is significantly reduced after India unlocked its stock market to foreign investors. Kumar Sundaram (2009) emphasizes that there was no causal relationship between the nominal exchange rate and the stock returns and FII does not have a unit root at conventional level and it also gives positive directional Granger Causality Results.

The review of literature reveals that only few studies have been carried out by incorporating all the variables influencing FIIs in the midst of financial sector reforms in the Indian Scenario. Hence an attempt has been made to study the FIIs investment in capital market reforms in terms of primary market, secondary market, instruments and their changes, return on investment.

III. Statement of the Problem

India has been allowing Foreign Institutional Investment from 1991 onwards and it increased from 1991 to 2009. It shows that Indian Equity Market attracted the FII. In 2007-2008, Foreign Institutional Investors invested huge amount in the Indian Market. Foreign Institutional Investors park their money in the Indian Stock Market and domestic investors get benefit from them in the process. In the year 2008-2009, FIIs withdrew their investment from the Indian Capital Market because of profit booking and they were not ready to invest in the Indian Stock Market due to Global Financial Crisis. Foreign Institutional Investors thus also destabilized and damaged the market by withdrawing their investment from the Equity Market abruptly. Hence domestic investors were also affected by the Foreign Institutional Investors' withdrawal. Foreign Institutional Investment depends upon the economic wealth of the country and the macro economic variables such as interest rate, exchange rate, and inflation rate.

IV. Objectives of the Study

The objectives of this paper are:

1. To analyse the nature and extent of Net Foreign Institutional Investment in India.
2. To examine the trend of Indian Capital Market.
3. To study the Impact of FIIs Investment on the Globalised India Capital Market.

V. Hypotheses of the Study

1. **Null Hypothesis (Ho):** The BSE and Nifty indices did not rise with the increase in FIIs investment.
2. **Alternate Hypothesis (H):** The BSE and Nifty indices increased with the increase in FIIs investment.

VI. Methodology of the Study

This Paper mainly leans upon secondary data. The secondary data were systematically collected from SEBI sources from internet and tabulated for analysis purpose. The monthly closing index of BSE SENSEX and NSE Nifty and monthly average of net investments made by FIIs during the period 1992-2008 have been taken for Study. The data were taken from various financial websites like www.banknetindia.com, www.rbi.org.com, www.bseindia.com and www.nseindia.com.

VII. Statistical Tools used in this Study

The Multiple Regression Analysis and Karl Pearson's Coefficient of Correlation were used to find the influence of Net Investments of FIIs on the Indian Capital Market. Percentage Analysis and Average Growth Rate with maximum and minimum index were exploited to establish the FIIs in the Capital Market.

VIII Analysis of the Study

FIIs were allowed to invest in the Indian Capital Market Securities from September 1992. From the **Table-1,** it is found that in the year 1992- 93, FIIs did not contribute to the Capital Market because of the Global Crisis. But during 93-94, an extraordinary percentage of increase was noticed and in subsequent years till 97-98, there was a gradual increase in the FIIs in the Capital Market which was due to various reasons like different portfolio opportunities for the investors, development of software industry, growth in the manufacturing sector, emergence of pharmaceuticals industries and liberalisation policies regarding investment. In the year1998-99, there was a down flow of FIIs which was due to SEBI Regulations. The period 2003 -2004 witnessed a sudden spurt of FIIs (1548.56%) which was due to boom in the economy. The next year FII investment decreased by -5.87%.

The Descriptive Statistics of daily average return of BSE SENSEX and NSE Nifty are presented in **Table – 2.** The Table indicates that during the period, 2000-2001 and 2002-2003 the indices recorded negative returns. It is also surprising to note that during 1998-1999 and 2001-2002, SENSEX alone recorded negative return compared to meager positive return for Nifty. The lowest Nifty return (-0.09435 %) was obtained in the year 2000-2001 and the highest Nifty return (0.24440%) was obtained in the year 2003-2004. But the results vary for SENSEX. The year 2002-2003 recorded the lowest negative value of -0.05568% and the year 2003-2004 recorded the highest positive value of 0.23833% for SENSEX.

Table – 3 exhibits the Correlation Value and Regression Values of the independent variable, FII net investments, on the increase in the dependent variables i.e., NSE Nifty and BSE

SENSEX. Correlation helps to measure the degree of relationship between the variables. Correlation of Foreign Institutional Investment and NSE Nifty is 0.307 and that of BSE SENSEX is - 0.017. This implies that in the span of 13 years, FIIs from different nations increased their investments in Indian Capital Market. But in the case of SENSEX, the negative correlation coefficient indicates the scare experienced by FIIs investors in investing in different portfolios of Sensex Companies.

Larger the value of R, stronger the relationship. R^2 is the coefficient of simple determination. It expresses the extent of variation in the dependent variable as explained uniquely or jointly by the independent variables. The values of R^2 range from 0 to 1. Small values indicate that the model does not fit the data well. It is seen from the Table -3 that R is 0.302, R^2 is 0.0915 for NSE Nifty, implying that 9% of the change in the dependent variable was explained by the independent variable. R is - 0.017 and R^2 is 0.0003 for BSE SENSEX and it reveals that 0.03% of change in the dependent variable was explained by the independent variable.

Hence the Null Hypothesis(H0), i.e. The BSE and Nifty indices did not rise with the increase in FIIs investment, is rejected and the Alternate Hypothesis (H) i.e., The BSE and Nifty indices increased with the increase in FIIs investment, is accepted.

Correlation Value and Regression Values of the independent variable of FII purchases and sales, and the increase in the dependent variables i.e., NSE Nifty and BSE SENSEX, are presented in the **Table- 4.** The Table indicates that in the case of purchase and sales, Nifty and SENSEX expressed 37.2% and 43% of variance with positive correlation coefficient of 0.609 and 0.656 respectively. It is also concluded from the analysis that FIIs were magnetically attracted towards various portfolios of Indian Economy.

IX. Findings of the Study

In India, the major portion of FII went into equities over the years since its inception in 1990's. The impact of huge volume of these flows, especially after 2003, on domestic financial market is worthy of a rigorous empirical analysis. The short-term nature of FII also suggests a possibility of bidirectional causality running between it and stock returns.

1. FIIs tend to buy and sell stocks in bulk and tend to create major withdrawal effects when they leave. This has been coined, albeit inappropriately, as ‘hot money’, given the tendency of such flows to suddenly reverse direction in response to adverse market sentiments and precipitating large capital outflows.
2. The stock market behavior is dependent on many fundamental factors and FIIs are not the only factor. The entry of FIIs gives a positive impact on the stock market. Foreign investments will come if the returns and risks are well managed. India’s risks and returns on investment are indeed well managed **(Table-3 & 4)**.
3. It was also found that the FIIs flourished in the Indian Capital Market over a period of 13 years, 1992 -2008 **(Table-1)**.
4. Both Nifty and SENSEX clearly indicated the interest of FIIs in the top 50 and 30 companies of Indian Capital Market **(Table- 3 & 4)**.

X. Suggestions of the Study

The outlook for India is remarkably good. Corporate and personal balance sheets are strong. Corporations are experiencing high profits. The stock market is at a record high.

1. It is suggested that FIIs can choose their portfolio of investments in banking sectors and other financial institutions.
2. SEBI clarifications on FIIs through Participatory Notes can strengthen the market.

3. FIIs meticulously observe the crash of the market attributed to the recession in the global economies. The Indian Government and SEBI must invite all FIIs to invest in the globalised economic situations.

XI. Conclusion of the Study

India, which is the second fastest growing economy after China, has lately been a major recipient of Foreign Institutional Investor (FII) funds, attracted by the strong fundamentals and growth opportunities. According to analysts, the late revival of monsoon, upward revision of economic growth from 5.8 per cent to 6.1 per cent, better-than-expected performance of companies in the quarter ended-June 30, the new Direct Taxes Code, leading to savings in the tax payer's money, and the trade policy with an ambitious target of US$ 200 billion exports for 2010-11, have revived the confidence of FIIs investing in India. Both consumption and investment-led industries linked to domestic demand, such as auto, banking, capital goods, infrastructure and retail, are likely to continue attracting FII funds. This would have positive effect on the overall performance of the Indian Stock Market.

XII. Scope for Further Research

1. This study ascertained net investments, gross investments, gross purchases and gross sales of FIIs in Indian Capital Market. Hence a separate intensified research can be undertaken to study the Portfolio Management of FIIs.
2. A separate research can be carried out to identify segment wise analysis of FIIs and their interested top Nifty Companies and SENSEX Companies. There is large scope for further research in analyzing the sickness of FIIs during the Global Recession of 2008.

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Table -1- Table Showing Net Investments by FIIs in the Indian Capital Market

(Rs. Crores)

Year / Month	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Total	%
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1992-93	–	–	–	–	–	–	–	–	–	1	0	3	**4**	
1993-94	5	41	96	149	299	167	195	1087	565	1234	787	820	**5445**	1360.25
1994-95	525	882	816	328	425	443	544	62	26	232	293	199	**4777**	-12.27
1995-96	187	203	361	648	548	410	321	191	412	738	1613	1089	**6721**	40.69
1996-97	1473	1036	1042	874	148	365	366	403	422	340	424	494	**7386**	9.89
1997-98	625	889	1404	1003	494	599	642	-290	-182	-375	629	472	**5908**	-20..01
1998-99	169	-557	-896	105	-91	111	-552	47	307	370	354	204	**-729**	-1254
1999-00	815	1524	504	1508	-12	-878	-735	1197	1571	184	2727	1360	**9765**	9765
2000-01	2438	172	-986	-1569	1626	-454	76	1090	-462	3972	1574	2205	**9683**	-.084
2001-02	1695	1031	809	773	270	-229	605	162	279	370	2024	484	**8273**	-14.56
2002-03	-82	-154	-183	305	192	422	-444	342	457	1088	433	293	**2669**	-67.74
2003-04	572	1233	2593	2496	2058	4048	6940	3282	6291	2493	3183	8812	**44000**	1548.56
2004-05	4208	-3151	511	1293	2850	2816	3952	6345	5890	1324	7494	7886	**41416**	-5.87
2005-06	-946	-587	5699	7391	4085	3258	-3808	4559	9615	5177	.	.	.	.

Source:-rbidocs.rbi.org.in/rbi/publications/PDFS/69120 (TABLE 60)

Table – 2
Year-wise Descriptive Statistics for Nifty and SENSEX (1998-2008)

Year	*Name of the Indices*	*Minimum Index level*	*Maximum Index level*	*Daily Average Return*
1998-1999	Nifty	808.70	1212.75	0.00294 %
	SENSEX	2764.16	4280.96	-0.02482%
1999-2000	Nifty	931.00	1756	0.15606 %
	SENSEX	3245.27	5933.56	0.14112%
2000-2001	Nifty	1124.70	1624.65	-0.09435 %
	SENSEX	3540.65	5541.54	-013788%
2001-2002	Nifty	854.20	1198.45	0.00317 %
	SENSEX	2600.12	3742.07	-0.01129%
2002-2003	Nifty	922.70	1146.5	-0.05239 %
	SENSEX	2834.41	3512.55	-0.05568%
2003-2004	Nifty	924.30	1982.15	0.24440 %
	SENSEX	2924.03	6194.11	0.23833%
2004-2005	Nifty	1388.75	2168.95	0.06813 %
	SENSEX	4505.16	6915.09	0.04923%
2005-06	Nifty	1902.5	3418.95	0.20754%
	SENSEX	6134.86	11307.04	0.21580%
2006-07	Nifty	2632.80	4224.25	0.04663%
	SENSEX	8929.44	14652.09	0.05002%
2007-08	Nifty	3633.6	6287.85	0.08534%
	SENSEX	12455.37	20873.33	0.09192%

Source:-Indiastats.com May-June 2009 Socio economic voices

Table No -3

Regression Model for Net Investments

	Correlation with FII	**Multiple R**	**R2**	**Standard Error**
NSE Nifty	0.307	0.302	0.0915	221.1
BSE SENSEX	-0.017	0.017	0.0003	319578.2

Source : www.bseindia.com, www.nseindia.com, www.sebi.com

Table No- 4

Table Showing Regression Model for Purchase and Sales

	Correlation with FII	**Multiple R**	**R2**	**Standard Error**
NSE Nifty	0.609	0.609	0.372	91.8
BSE SENSEX	0.656	0.656	0.430	327.8

Source : www.bseindia.com, www.nseindia.com, www.sebi.com