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Influence of Foreign Institutional Investors (FIIs) On Indian Capital Market: *An Analytical Study*

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Abstract

Foreign institutional investors (FIIs) have achieved a greater role in Indian capital market during last one and a half decade. They have shown a good relation with various benchmarks especially BSE Sensex in terms of price fluctuations. In this context, the present paper examines the trend and pattern of FIIs from 2000-2016 towards Indian capital market. The period 2000-2016 has been purposely chosen as FIIs investment started soaring in from the millennium year and 17 year study captures the recession phase of 2009-2013. It was found that FIIs have always shown a positive trend towards India except few years like 2008, 2015, and 2016. The scholar also attempted to examine the correlation between FII investment and Sensex volatility during this period by Karl Pearson's correlation test. The test has shown positive correlation.

Keywords: FIIs, Indian capital Market, BSE Sensex, Trend and pattern of FIIs, Correlation between FII and BSE Sensex.

Introduction

Capital market is the backbone of a country's economy. It is considered as an engine for economic growth providing an efficient means of resource mobilization and allocation. Well regulated capital markets are able to provide different kinds of financial services that provide an impetus to the production improvements and overall economic development of the country (Levine and Zervos, 1998). A capital market is a place where buyers and sellers engage in trade of financial securities like shares, debentures, bonds, mutual funds etc. It is a place where both governments as well as public and private companies can raise funds for longer periods. It basically consists of two types of markets viz., primary market where fresh securities are bought and sold and the secondary market dealing with already issued securities. Such buying and selling of securities in both the markets is undertaken by participants including individuals and institutions. The capital market facilitates and provides the platform by working as a conduit for surplus and deficit segments of the economy.

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The financial sector reforms on general and capital market reforms in particular were initiated in India in a big way during 1991-1992. The objectives behind these reforms were to improve market efficiency and transparency, checking unfair trade practices, bringing the Indian capital market upto to the international standards and openness in the Indian capital market and attracting foreign investors. Following the reforms, the Indian capital market experienced a gradual surge of FII investments over the next two decades.

Foreign Investment refers to an investment made by the residents of one country in the financial assets or production processes of another country. Foreign Institutional Investors (FIIs) means an institution established or incorporated outside India and proposes to invest in securities in India. They are registered as FII's in India in accordance with the section 2(f) of the SEBI (FII) Regulations 1995. They were allowed to invest in India in 1992 under the Portfolio Investment Scheme for the subscription of securities in the both primary as well as secondary markets. They were also allowed to participate in both public issues of equities and debt instruments within the sectorial limits for equities and the overall limit for debt instruments set by Govt. of India.

In India FIIs are allowed to invest either following Equity Investment Route or Debt Investment Route. By following Equity route FIIs can invest either 100% in equity related instruments or 70% in Equity instruments and 30% in Debt instruments (SEBI Regulations, 1995). They can invest in securities of both primary and secondary markets including those shares which are either listed, unlisted or to be listed on a recognized stock exchange in India, or units of schemes either floated by UTI or other domestic Mutual funds whether listed or unlisted, or units of schemes floated by a collective investment scheme, security receipts, warrants etc. By following 100% Debt Investment Route, FIIs have to make their investments 100% in Debt related instruments only like Bonds, Debentures, Dated Government securities, Treasury Bills, Commercial papers, Indian Depository Receipts and other debt market instruments. It must be noted here that individuals and foreign companies are not eligible to invest through the 100% debt route. (SEBI guidelines, 1995). FIIs were allowed to invest in Debt in 1997.

Statement of the Problem

FIIs investing in Indian capital market make it highly volatile as there is no entry and exit policy for FIIs leading to the huge loss of funds to small investors in short run. FIIs having indirect control over the Indian capital market create a swaying effect on the market. Moreover, FII investments through Participatory Notes (PN) also creates dilemma in the minds of other investors of market as PNs are usually not identifiable with FIIs. The short holding period horizon of FIIs exerts a significant impact on domestic financial markets in the short run and real impact in the long run.

Keeping in view the uncertain nature of FIIs investment, the present study has been aimed to analyze the overall trend of FII investment in Indian capital Market represented by BSE Sensex. This study will help the researchers, corporations, investors, portfolio managers, research institutions and other entities which are involved either directly or indirectly with the operations of the capital market to understand the investment pattern of FIIs towards India which are controlling and dominating its capital market. The volatility created by investment pattern of FIIs will help the domestic institutional and retail investors to properly understand the impact of FIIs on Indian capital market and formulate their strategies accordingly for earning safer returns. The study will also help the authorities related to Indian capital market like SEBI, NSE, BSE, RBI etc to bring further changes in rules and regulations to attract more and more FIIs while protecting the large interest of small and domestic investors.

FIIs have always shown an increasing pattern towards Indian capital market except the year 2008, because on 21st Jan, 2008 Indian capital market showed a see-saw movement and was shaken due to the Global Economic Meltdown (US Sub-prime Lending Crisis) by which BSE Sensex fell down by 2000 points intra-day. Therefore, the present study aims to analyse the overall investment trend of FIIs on Indian capital market from 2000-2016 and also to find the correlation between FIIs and BSE Sensex. The study shall focus on the relationship aspects of FII Investment on the volatility.

RESEARCH GAP

Based on the extensive research review conducted, it has come to the fore that through different regimes fostered by government from time to time to attract FII investment, the country has not observed the real surge in FII investment. A proper and well-structured policy framework is still in doll drums. Though there are various studies in this area but after going through the existing studies on the subject under reference, we noted that the period of these researches is relatively shorter and very few studies have captured the latest trends and impact of FIIs investment in India capital market. Moreover, 90 percent of the studies concentrate on what attracts capital flow rather than how these flows affect the capital market and the economy. This gives rise to a research gap especially in the Indian context. With the reasons as ascribed above, the scholar proposes to conduct research so that a visible gap is plugged and further literature is added to the body of knowledge on subject matter.

Literature Review

In order to gauge the results of the other studies conducted worldwide in this area which shall lead us to some hypothesis formulation for this study, a review of literature related to the study of Foreign Institutional Investors is made here. The scholar has surveyed the several books, research papers, journals, newspapers, magazines, annual reports and handbooks of SEBI, NSE, BSE, RBI and Literature of Ministry of Finance. During the review it was observed that Foreign Capital inflows have been acknowledged as one of the important sources of funds for developing economies like India for supporting the domestic economy. Inspite of political uncertainties and lack of infrastructural facilities, India is considered as one of the best investment destinations by FIIs because of its emerging nature and therefore, the growth potential of financial investments is also promising . The higher and safer returns in the Indian stock market (perhaps the single most factor) influence the decisions of FIIs towards the India. A large number of studies have been made about the FIIs and their impact on Indian capital market some of them of which are scripted below.

Abid and Jhawar (2017) examined in their study "Impact of Foreign Institutional Investors (FIIs) on Indian capital Market" whether there exists any significant relation between the Indian Stock Market and FIIs. The paper concludes that FIIs affect the Indian Stock Market and thus the Indian economy. The only factor that determines the behavior of the FIIs is the opportunity for profit. If they feel that a market has the potential for profit, they will invest. It is company specific success stories that have engaged FIIs in the Indian market.

Goel and Kaur (2015) in their study basically find out the relationship between Foreign Institutional Investors and Indian Stock Market. According to their study, a positive correlation exists between flow of funds by Foreign Institutional Investors and performance of Indian Stock Market. There exists a positive correlation between variables in consideration and nearly one tenth variations in Stock performance were justified by Foreign Institutional Investors flows. They concluded that with the economic liberalization and entry of FIIs Indian Stock market get strengthened. Foreign Institutional Investors helps to introduce liquidity in local markets and reduces volatility. In the longer run it will be beneficial for Indian Stock Market to have sufficient amount of FIIs available in the Market. But, it is also important that one should understand the basic motive of any Foreign Institutional investor who is investing in the stock market and that motive is to earn profits.

George (2007) has examined the impact of FPI on Indian Capital Markets and observed that net capital flows towards developing countries have shown a positive and fluctuating trend. The findings also report that compound annual growth rate of FPI in India from 1990-91 to 2005-06 was 41.04% and FDI compound annual growth rate was 29.66%. The pattern of FPI inflows had shown that FII had the highest Compound Growth Rate (64.36%) followed by ADR/GDR (31.84%) and off-shore funds (5.04%). It has also observed that FPI has positive but insignificant impact on Gross fixed capital formation (GFCF); Export based Real effective exchange rate (REER) and Nominal effective exchange rate (NEER), GDP and Forex reserves. It also reports that FPI has negative but insignificant impact on employment. FPI does not have much impact on real economic variables. FPI has not benefited the way the mainstream model was predicted. FPI impacts on secondary markets only and not the primary market in terms of volatility and market capitalisation. **Devi** (2014) studied the impact of FIIs in Indian Sock Market and observed that FIIs are of vital component which helps in the development of financial markets and overall financial development of the country. It was observed that there has been a growing presence of FII inflows towards Indian Stock market as registered with SEBI. The study observed that FIIs investments and movement of SENSEX are closely related. FIIs have positive impact on both BSE Sensex and NSE Nifty. FIIs are not only factors in deciding the movement or direction of Sensex, but there are other factors also. However, influence of FIIs cannot be completely ignored. The market rises with the investments of FIIs and collapses with the withdrawal of FIIs, the study inferred. The negative effects of FII investment can be gauged during the time of US sub-prime crisis. FIIs have emerged as the most dominant investor groups in Indian stock market. There exists a bi-directional movement between FII investments and SENSEX which explains that favorable Sensex movements would attract more FIIs and vice versa. **Jain et al.** (2012) studied the impact of FIIs on Stock market with special reference to BSE from 2001 to 2010 and they observed that FIIs are influencing the Sensex movements to a greater extent. It was also evidenced that Sensex has increased with the positive inflows of FIIs and vice versa. The Pearson's correlation has been used which indicate positive correlation between FII investments and movement of Sensex. The Correlation value was 0.7464. **Kulshrestha** (2014) studied the Impact of FIIs on Indian Capital Market from 2000-2011 and observed that investments by FIIs and movements of BSE Sensex and CNX NIFTY are closely correlated. FIIs have positive impact on both Sensex and Nifty. Daily Sensex and Nifty have very low degree of positive correlation with daily FII investments. He also observed that largest number of FIIs in India are from USA and so the maximum investments. He also observed that Economic growth i.e., GDP, IIP, inflation, and Interest rate are basic parameters used by

FIIs to invest in any country. Moreover, FIIs help in economic growth and market efficiency because of increasing FII investments, SEBI and other relevant authorities have to improve trading efficiency and mechanism in order to retain, sustain and attract FIIs. **Shrivastav** (2013) studied the Influence of FIIs flows on Indian Stock Market and observed that Sensex and Nifty have moderate degree of positive correlation with FII investments and move in accordance with the direction of FII investments. Therefore, their influence on stock prices cannot be completely ignored. The consumer goods and consumer durable goods sector are less dependent on FIIs. BSE IT does not rise with rise in FIIs, as they have low degree of negative correlation. FIIs have positive impact on improvement of market efficiency, because due to increasing investments by FIIs, SEBI and other regulatory bodies have to improve their trading mechanism and efficiency for retaining and attracting more FIIs. The key parameters which FIIs use for investing in any country are GDP, IIP, inflation and interest rate. FIIs lead to economic growth by bringing sufficient capital. FIIs are now investing more in Construction and Banking and moving towards PSU sector. He also observed that FII investment is now no more concentrated on only top few companies but are now increasingly investing in medium and low share priced companies. **Singh and Dutt (2011)** analyzed the investment pattern of FII in India and the reasons for indifferent responses of BSE Sensex due to FII inflows. They have observed a significant correlation between FII investment and turnover of different individual groups at BSE Sensex and came with the conclusion that there exists a positive correlation between FII investment and stock market but in years like 2005 and 2008, it was also observed that positive or negative movement of FII's investment have led to a major shift in the sentiments of domestic investors in market. **Kaur and Dhillon (2010)** focused on the determinants of Foreign Institutional investment in India and observed that market capitalization and stock market turnover of India have significant positive influence only in short-run. Stock market risk has negative influence on FIIs inflows to India. Among macroeconomic determinants, the economic growth of India has positive impact on FIIs in both long run as well as in short run but all other macro-economic factors like inflation have significant influence in long run only. They concluded that host country stock market returns (returns on Sensex) have positive and significant impact whereas home country returns (returns on S&P 500 Index) have negative but insignificant influence on FIIs investment inflows in long-run as well as in short-run. **Shukla et al. (2011)** investigated FII equity investment and Indian capital market from 2005 to 2010 for analyzing the impact of FIIs on Indian stock indices and revealed that India after United States hosts the largest number of listed companies and global investors now enthusiastically seek India as their preferred destination for investment. Stock market now appeals to middle class Indians also. The stock- brokers of India have opened offices in different countries to cater the needs of NRIs and many Indians working in foreign countries now divert their savings to stocks because of online trading system and diminishing interest rates from banks. They concluded that FIIs have significant impact on the share prices of the Midcap & Small-cap companies. Small and periodic shift in their behavior leads to market volatility. FIIs have high level of influence on market sentiments and price trends. **Srikanth and Kishore (2012)** investigated a cause and effect relationship between FII and Indian capital market from April 2003 to March 2011. They observed that the main objective of FIIs is maximizing returns and minimizing risk while keeping liquidity of the investments intact. In this paper they came with the conclusion that net FII inflows had a positive impact on the Indian capital market and Forex reserves. FIIs inject global liquidity into capital markets and raise the price-to-earnings ratios thereby reducing cost of capital. FIIs offer dual advantage i.e., they offer a non-debt source of capital and bore the exchange rate risk. Higher IIP and interest rates act as catalysts for FII flows in India. **Morgan (2002)** has examined the FIIs influence on Indian stock market and observed that FIIs have played a very important role in building up India's forex reserves and economic reforms. Secondly, FIIs are now important investors in the country's economic growth despite sluggish domestic sentiment. FIIs strongly influence short-term market movements during bear markets. However, the correlation between returns and flows reduces during bull markets as other market participants raise their involvement reducing the influence of FIIs. It also shows that the correlation between foreign inflows and market returns is high during bear and weakens with strengthening equity prices due to increased participation by other players. **Agarwal and Chakrabarti (2003)**, have found in their research that the equity return has a significant and positive impact on the FII. But given the huge volume of investments, foreign investors could play a role of market makers and book their profits, i.e., they can buy financial assets when the prices are declining thereby jacking-up the asset prices and sell when the asset prices are increasing. Hence, there is a possibility of bi-directional relationship between FII and the equity returns. **Prasanna (2008)** has examined the contribution of foreign institutional investment particularly among companies included in sensitivity index (Sensex) of Bombay Stock Exchange. He also examined the relationship between foreign institutional investment and firm specific characteristics in terms of ownership structure, financial performance and stock performance. It is observed that foreign investors invested more in companies with a higher volume of shares owned by the general public. The promoter's holdings and the foreign investments are inversely related. Foreign investors choose the companies where family shareholding of promoters is not substantial. Among the financial performance variables the share returns and earnings per share are significant factors influencing their investment decision.

Objectives of the Study

1. To examine the investment trend of FIIs towards Indian capital market from 2000-2016.

2. To examine the influence of FIIs on Indian capital market proxied by BSE Sensex

Methodology:

In the light of the objectives set up above, the following methodology is desired for the purpose. The data for the study has been mainly the secondary sources of relevant organizations like BSE, SEBI, RBI, Ministry of Finance etc. The data was analyzed by the statistical technique - Karl Pearson's Coefficient of correlation. The methodology has been augmented by the use of diagrams and graphs to espouse the results.

HYPOTHESIS

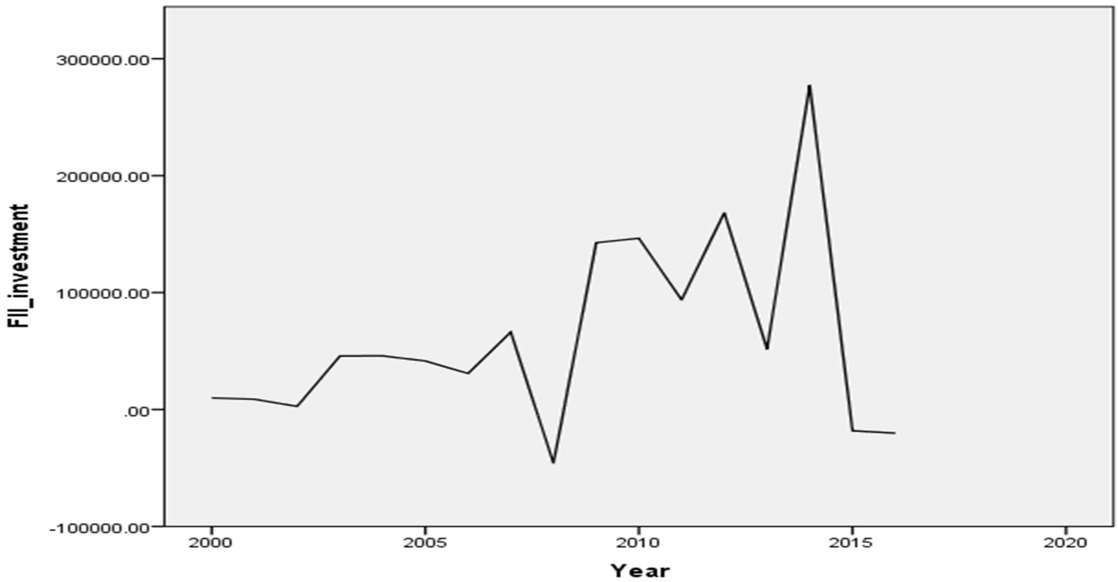
H1: There is positive correlation between FIIs investment and BSE Sensex from 2000-2016.

Table-1

Trend and pattern of FII investment in India from 2000-2016

year	FII investment (in crores) Rs	Change in FII investment	Percentage change
2000	9933	-189	-1.86
2001	8763	-1170	-11.78
2002	2689	6074	-69.31
2003	45764	43075	1601.89
2004	45880	116	0.25
2005	41467	-4413	-9.618
2006	30841	10626	-25.62
2007	66179	35338	114.58
2008	-45811	-111990	-169.22
2009	142658	188469	-411.41
2010	146438	3780	2.649
2011	93725	-52713	-35.99
2012	168364	74639	79.63
2013	51649	-116715	-69.32
2014	277460	225811	473.20
2015	-18175	-295635	-106.55
2016	-20217	-38392	-211.23

Source: SEBI Handbook of Statistics various issues.



The past data relating to FII investment reveals that there was not any investment in 1991-92. There was a paltry investment of Rs 13 crores in 1992-93. However, over a period of time they have shown a consistent positive increasing trend except few years like 2008 as shown in the above tabulated data The recent data revels that in 2014-15 FII net investment was Rs 277460 crores, in 2015-16 it was Rs -18175 crores and in 2016-17 it was Rs-20217 crores. Presently the major part of the investment in Indian capital is attributed to institutional investors among whom the FII's are of primary importance.

Table-2

Sensex Values (Closing Points) and Net FII investment from 2000-2016

Year	Sensex value (closing points)	Net FII Investment (in crores)
2000	3972	9933
2001	3262	8763
2002	3377	2689
2003	5838	45764
2004	6602	45880
2005	9397	41467
2006	13786	30841
2007	20286	66179
2008	9647	-45811
2009	17464	142658
2010	20509	146438
2011	15454	93725
2012	19426	168364
2013	21170	51649
2014	27499	277460
2015	26117	-18175
2016	26626	-20217

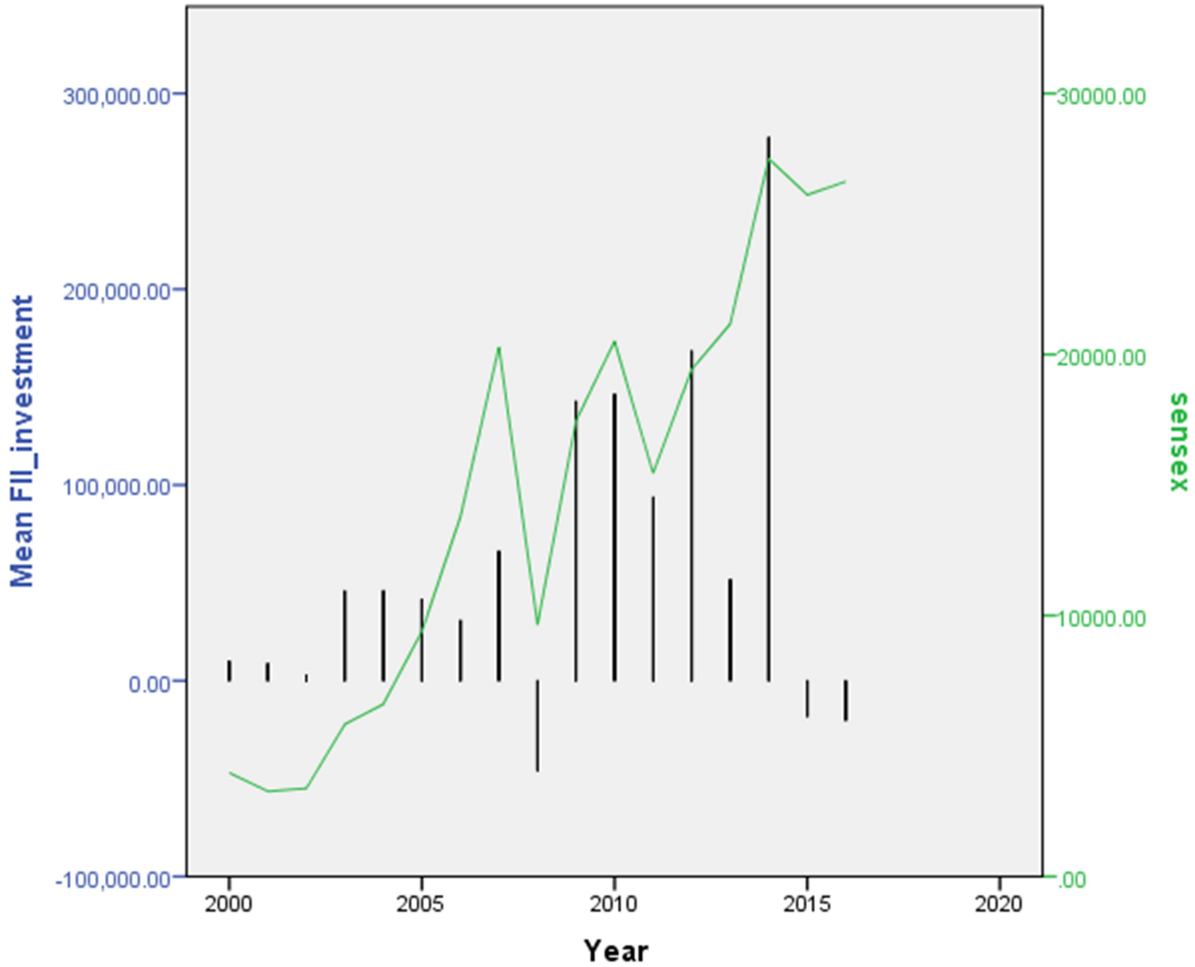
Table-3

YEAR	Sensex X	x $(X-\overline{X})$	x^2	FII Y	y $(Y-\overline{Y})$	Y^2	Xy
2000	3972	-10759.29	115762410	9933	-51690.9	2671953400	556158039
2001	3262	-11469.29	131544708	8763	-52860.9	2794279102	606277682
2002	3377	-11354.29	128919995	2689	-58934.9	3473327291	669164656
2003	5838	-8893.294	79090680.3	45764	-15859.9	251537734.1	141047122
2004	6602	-8129.294	66085422.9	45880	-15743.9	247871683.8	127987128
2005	9397	-5334.294	28454693.7	41467	-20156.9	406302277.6	107523053
2006	13786	945.2941	893580.969	30841	-30782.9	947589467.5	29098933.2
2007	20286	5554.705 9	30854757.4	66179	4555.05 9	20748560.89	25302012
2008	9647	-5084.294	25850046.7	-45811	-107435	11542266586	546230839
2009	17464	2732.705 9	7467681.44	142658	81034.0 6	6566518689	221442249
2010	20509	5777.705 9	33381885.3	146438	84814.0 6	7193424574	490030687
2011	15454	722.7058 8	522303.792	93725	32101.0 6	1030477978	23199624
2012	19426	4694.705 9	22040263.3	168364	106740. 1	11393440158	501113182
2013	21170	6438.705 9	41456933.4	51649	-9974.94	99499451.47	-64225712
2014	27499	12767.70 6	163014313	277460	215836. 1	46585204288	275573131 8
2015	26117	11385.70 6	129634298	-18175	-79798.9	6367871013	-908567274
2016	26626	11894.70 6	141484028	-20217	-81840.9	6697939653	-973473924
TOTAL	25043 2		114645800 2	104760 7		108290251906.9 4	485403961 3

N= 17
$\overline{X}$=14731.29412
$\overline{Y}$= 61623.941

$$r = \sum xy \div \sqrt{\sum x^2 y^2}$$
$$= 4854039613 \div \sqrt{1146458002 \times 108290251907}$$
$$=0.435646$$

From the above statistical calculations it shows that there is a positive correlation between FII Investment and BSE Sensex Movement from 2000-2016. The correlation value is 0.435646.



Results and Discussions.

On the basis of the above data analysis, it is clear that the FIIs are influencing the Sensex movement to a greater extent. It is evident that Sensex has increased with the increase in FIIs inflows and decreased with fall in FIIs inflows. It was found that FIIs flourished in the Indian capital market during 2000-2016 and have always posted positive trend lines except the years 2008, 2015 and 2016. The Karl Pearson's correlation test has been used indicating thereof positive correlation between FII Investment and Sensex movement and the correlation value is 0.435646. The results obtained corroborates with a similar study conducted by Devi. The researcher has also observed a positive correlation between the two variables. Moreover, our results are also similar to those put up by another study conducted by Jain et al. (2012). However, the value of Co-efficient correlation is far higher at 0.7464. Observance of higher correlation is attributed to the study period adopted by the researcher (Jain et al) which is 2001 to 2010 which captures only one year of recession. Withdrawals by FIIs in recessionary period has created a cascading effect on withdrawals by domestic investors and this has happened more during the years 2009-2013 which is captured by our study (2001-2016). Moreover, there was a negative Investment pattern of FIIs during 2015 and 2016.

CONCLUSION

The study conducted observed that FIIs have shown an increasing trend during 2000-2016 except the years 2008, 2015 and 2016. It was also observed that FII investment and movement of BSE Sensex are correlated. According analysis and findings, FIIs have positive influence on Indian capital market during the study period. Therefore, the alternate hypothesis is accepted. It is pertinent to note that inspite of political differences and lack of infrastructural facilities, India is considered as one of the best investment destinations by FIIs because Indian economy is emerging one therefore, the growth potential of securities is higher. The higher and safer returns in the Indian stock market (perhaps the single most factor) influence the decisions of FIIs towards the Indian stock market. The other factors includes that Indian rupee is showing strong resilience over dollar, high GDP growth rate, high interest rates, high liquidity, mandatory corporate governance for listed companies, international credibility of SEBI in the least possible time, regulatory legal framework, disclosure-based regime of regulations, closeness of Indian Accounting standards to International Standards, electronic transactions on real time basis, 21 are Indian firms out of 100 rapidly emerging global markets, T+2 rolling settlement as opposed to T+3 which is followed in NYSE.

Considering the potential of Indian Capital market the policy makers should provide more opportunities and reasons to FIIs for investing in Indian capital market by suggesting and implementing prudential norms. Moreover, the authorities related to Indian capital market like SEBI, NSE, BSE, RBI etc should bring further changes in rules and regulations to attract more and more FIIs while protecting the large interest of small and domestic investors.

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