

# “Impact of Foreign Institutional Investors on the Indian Capital Market”

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**Abstract – Foreign institutional investment suggests investments made by individual investors or companies in foreign lands. India has been observing a surge in FII activity since the opening of its capital markets. Owing to its high increase prospective, India has become a preferred purpose for FII activity. FIIs, convinced of India's economic growth and strong corporate earnings, are continuously investing in the country. Fast GDP growth has made India a preferred destination for foreign investors post the 2008 financial crisis. In 2010 itself, India attracted nearly US\$ 30 billion of net foreign inflows, which was just under 50 per cent of all inflows into promising Asian markets, excluding China. Foreign investors have invested Rs 6,460 crore (US\$1.45 billion) in Indian stock markets in just five trading sessions of July 2011. In the first six months of 2011, overseas investors infused around Rs 17,000 crore (US\$3.82 billion) into the Indian market, including stocks and bonds. In the same period, FIIs made investments of Rs 9,948 crore (US\$2.23 billion) in the debt market, with investments in stocks being Rs 2,670 crore (US\$ 599.79 million). This paper analyses the role ahead for the Foreign Institutional investors in the present Indian economic Scenario with the focus on the impact on the Indian Capital Market.**

**Keywords: Impact, Foreign Institutional Investors, Indian Capital Market, FIIs, Economic, Financial, Individual, Companies, Activity, Growth, Progress, Country.**

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## INTRODUCTION

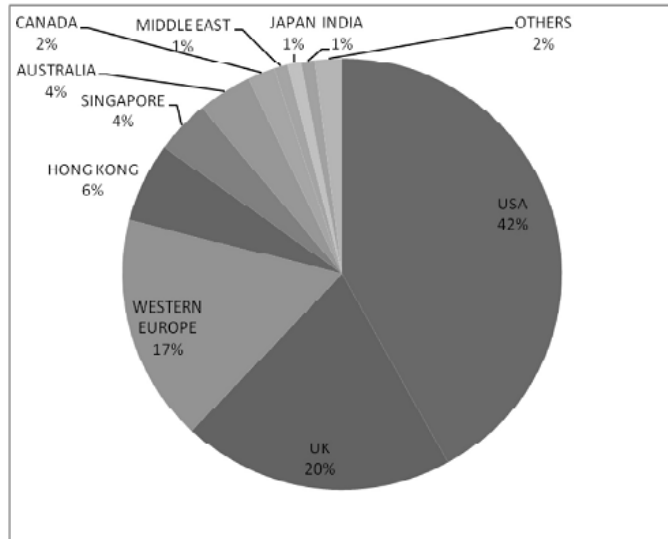
“Few nations have the development possible that India already enjoys. India holds the promise of most successful future.....” ...Klaus Schwab, Founder & Chairman, World financial Forum until the 1980s, India's improvement approach was focused on self-reliance and import substitution. Current account deficits were financed largely through debt flows and official development assistance. There was a general disinclination towards foreign investment or private commercial flows. The broad approach to reform in the external sector after the Gulf crisis was described in the Report of the High Level Committee on Balance of Payments (Chairman: C. Rangarajan). It recommended, inter alia, a compositional shift in capital flows away from debt to non-debt generate flows; strict regulation of external commercial borrowings, particularly short-term debt; discouraging unstable elements of flows from non-resident Indians (NRIs); measured liberalization of outflows; and disintermediation of Government in the flow of external assistance. After the launch of the reforms in the early 1990s, Foreign Institutional Investors [FIIs] have been allowed to invest in all securities traded on the primary and secondary markets, including shares, debentures and necessitate

issued by companies which were listed or to be planned on the stock exchanges in India and in the method floated by domestic Mutual Funds. Although one cannot expect the FIIs to take an active interest in the developmental concerns of the emerging economies. If there is any profit that accumulates to the emerging economies it will only be incidental. The main powerful force behind the actions of these institutional investors is profit. FIIs tend to invest selectively in companies that achieve good results or show potential for future profitability. This is evident from the economic crisis of 2008. As on March 31, 2011 the net equity investment by FII in India was Rs.1, 46,438 crores with the registration of 1772 Foreign Institutional Investors. Thus in this paper an effort has been made to examine the impact of foreign Institutional Investors on the Indian capital market.

## SOURCES OF FOREIGN INSTITUTIONAL INVESTMENT

Foreign Institutional investment is used to indicate an investor generally in the form of an institution or entity, which invests money in the financial markets of a country different from the one where the institution or entity was originally incorporated. FII is frequently referred to hot

money for the reason that it can leave the country at the same speed at which it comes in. In India SEBI has arranged norms to register FIIs and also to regulate such investments flowing through in the form of FIIs.



**Figure: 1 Sources of Foreign Institutional Investment**

The above chart obviously describe major portion of FIIs come from USA [42%], followed by UK [20%], Western Europe [17%], Hong Kong [6%], Singapore [4%], Australia [4%], Canada [2%], middle east countries [1%], and other countries contribute 2% of investment.

## LITERATURE REVIEW:

Rajesh Chakrabarthi (2001) found that FII flows are highly connected with equity returns and FIIs do not seem to be at informational disadvantages in India when measure up to the local investors. Paramita Mukherjee, suchismita Bose and Dipankor Coodoo (2002) found that FIIs activities exert strong expression effect and thus drive the domestic stock market in India, confirmation from causality test suggests that FII flows to and from Indian market tend to be caused by return by domestic equity market and not the other way round. Amita Batra(2003) confirmed that the trading behavior and biases of FIIs do not appear to have a undermine impact on the impartiality market. Kulwant Rai and N.R Bhanmurthy (2003) suggested that stabilizing the stock market instability and minimizing the ex-ante risk would help in attracting more FII inflows which would have positive impact on the real financial system. S. S. S. Kumar (2006) examined the role of FII in Indian stock market and found that the market movement can be explained using the direction of the funds flow from the investors. Shromon (2007) mentioned spectacular rise of the Sensex over the past few months and it also shows

how impulsive FII flows are. It is almost not possible to predict whether FIIs will be net sellers or net buyers tomorrow. The study also indicates there is no rigid relationship among FIIs and SENSEX in the market. K.P. Prabheesh (2008) recognized the existence of bidirectional causality between FII flows and stock returns and also indicated that FII flows are driven by the stock returns. Kumar Sundaram (2009) emphasizes that there was no causal relationship among the nominal exchange rate and the stock returns and FII does not have a unit root at conservative level and it also gives positive directional Granger causality results. P. K. Mishra, K. B. Das, B. B. Pradhan (2010) examined the causality among FII inflows and real financial development in Indian economy. The analysis provides the evidence of bi-directional causality running from net FII flows to real economic increase and reveals that the real economic growth of India both determines and determined by the volume of portfolio institutional investments in the country.

The review of literature reveals that only few studies have been carried out by constituting all the variables which influences the flow of FII in to the Indian economy. Hence an attempt has been made to study nature and its influence in the Indian capital market in the present scenario.

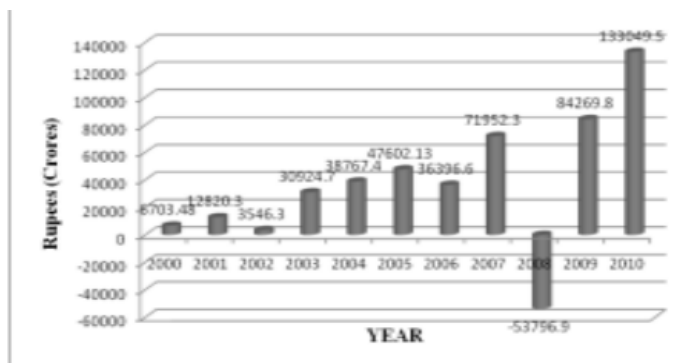
## METHODOLOGY

The study pertains on Secondary data. Secondary data is collected from BSE for BSE SENSEX, NSE for S&P CNX NIFTY and From SEBI Bulletin. The period of study taken for analysis is from 2000 to 2010. A simple linear relationship has been shown between two variables using correlation and regression as the data analysis tools. In the analysis FII is taken as Independent variable and SENSEX and NIFTY are taken as dependent variable.

## RESULTS AND DISCUSSION

**Table No: 1 Net Investment and Cumulative of FII from 2000 to 2010**

Year	Gross Purchase (Crores)	Gross sale (Crores)	Net Investment (Crores)	Cumulative Investment (\$Mn)
2010	765,509.90	632,461.00	133,049.50	29,320.79
2009	626,428.60	542,158.10	84,269.80	17,639.21
2008	719,079.50	772,876.10	-53,796.90	-13,335.90
2007	816,430.50	739,495.93	71,952.30	17,360.40
2006	473,610.90	437,213.90	36,396.60	7,985.20
2005	287,183.10	239,582.40	47,602.13	10,966.30
2004	185,562.10	146,791.00	38,767.40	9,398.36
2003	94,393.70	64,060.40	30,924.70	6,666.49
2002	46,454.10	42,878.10	3,576.30	772.80
2001	51,315.50	38,513.90	12,820.30	7,766.40
2000	75,313.90	68,611.10	6,703.48	1,794.90



**Figure 2: Net Investment by Foreign Institutional Investors**

Foreign Institutional Investors made entry into the Indian capital market during 1992. The data taken for study from 2000-2010 also reveals their movement in the Indian capital market. In all the years their Gross Purchases was higher when compared to Gross Sales. Only in the year 2008 when Global crisis hit the market gross purchases was Rs.719059.5 crores when compared to their Gross sales Rs.772876.10 crores, also their net investment was -53796.90 crores. Wherein they pulled off immediately from the market. So only they are also referred to as hot money.

## STATISTICAL ANALYSIS

For the purpose of statistical analysis we have considered 11 years data from 2000 to 2010 of FIIs net investment, BSE SENSEX, NSE S&P CNX NIFTY. Statistical analysis

is carried out to find the association between FIIs and SENSEX, NIFTY during the study period. Since the data was taken for 11 years the internal and extraneous factors have been changing overtime which might have impact on the capital market. In this study correlation and regression was used taking FII as Independent variable and SENSEX and NIFTY as dependent variable.

**Table No: 2 Analysis of Net Investment by FIIs, SENSEX and NIFTY**

Year	Net Investment	NIFTY	SENSEX
2000	6,703.48	1263.55	3972.12
2001	12,820.30	1059.05	3262.33
2002	3,576.30	1093.5	3377.28
2003	30,924.70	1879.75	5838.96
2004	38,767.40	2080.5	6602.69
2005	47,602.13	2836.55	9397.93
2006	36,396.60	3966.4	13786.91
2007	71,952.30	6138.6	20286.99
2008	-53,796.90	2959.15	9647.31
2009	84,269.80	5169.45	17464.81
2010	133,049.50	6134.5	20509.09

The above table shows the net investment by FIIs, Sensex and Nifty from 2000 to 2010. During the year 2000 net investment was 6703.48 crores nifty was 1263.55 points and was 3972.12 points. Net FIIs Sensex and nifty grew positively over the years and achieved Rs.71952.3 crores during 2007 then it experienced a sudden drift of negative investments during 2008 to the tune of Rs.-53796.9 crores. In the same period Sensex and nifty was also at the low of 2959.15 points and 9647.31 points. During the next year the market showed a positive movement as the net FIIs and Sensex and nifty was on the raising front.

**Table No: 3 Regression model for FIIs**

	Correlation with FII	R Square	Standard Error	Significance
NSE NIFTY	0.723	0.522	1413.56	0.12
BSE SENSEX	0.722	0.521	4838.71	0.12

The above table exhibits the correlation and regression values of the independent variable FIIs on the dependent variables of SENSEX and Nifty. Correlation helps to measure the degree of relationship between the variables. Correlation of Foreign Institutional Investment and NSE nifty is 0.723 and that of Foreign Institutional Investment and BSE SENSEX is 0.722. In both the cases it shows positive correlation.

**Table No: 4 Movements of FII, SENSEX and NIFTY**

Year	Net Investment	NIFTY	SENSEX
2010	133,049.50	6134.5	20509.09
2011 Up to September	10,533.8	4943.25	16453.76

From the above table it is evident that as Net Investment by Foreign Institutional Investors are rising both SENSEX and NIFTY are also rising also from the empirical analysis only 52% of Foreign institutional investment are influenced by NIFTY and SENSEX and other 48% of investment are influenced by other macro-economic variables such as inflation rate, exchange rate, interest rate, policies framed by Indian Government and the like factors.

## CONCLUSION

With the economic outlook improving worldwide, global majors are investing in India, which is ranked the most attractive country for retail investment for emerging markets. From our study on the impact of foreign institutional investments on the capital market we came to know they have got substantial effect over the stock indices. They also have the potential of influencing the process of economic development of India through the positive impacts on macro- economic fundamentals of the country. Therefore, the policy makers should provide the FIIs with more opportunities and reasons to invest in Indian markets by suggesting and implementing prudential norms.

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