Impact of Foreign Institutional Investments on Indian Stock Market

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Abstract - The Foreign Institutional Investors (FIIs) have emerged as noteworthy players in the Indian stock market and their growing contribution adds as an important feature of the development of stock market in India. In developing country like India has been advised to develop their stock markets. It was suggested that these investments would help the stock markets directly through widening investor base and indirectly by compelling local authorities to improve the trading systems.

Keywords: Stock Market, Foreign Institutional Investors, Capital Market

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INTRODUCTION

A well-recognized stock market of any country has considered being an important part on the development of economy (Bohra & Dutt, 2011). Returns on stock market are combination of domestic as well as foreign investments. In which domestic or local investors seizes greater knowledge about Indian financial markets than that of foreign investors who belongs to some other country (Chakraborty, 2007). Stock market provides investors large number of scripts with huge degree of risk, return and liquidity. There are wide range of options among the investors whether domestic or foreign investors in terms of assets which inducing more savings, increased competition, enhanced risk elements as well as enhanced the Gross Domestic Products (GDP) of the country, which is an important indicator of a growing economy. Foreign capital plays significant role for every national economy, regardless of its level of development (Goudarzi & Ramanarayanan, 2011).

FII is defined as an institution organized outside of India for the purpose of making investments into the Indian securities market under the regulations prescribed by SEBI. „FII" include "Overseas pension funds, mutual funds, investment trust, asset management company, nominee company, bank, institutional portfolio manager, university funds, endowments, foundations, charitable trusts, charitable societies, a trustee or power of attorney holder incorporated or established outside India proposing to make proprietary investments or investments on behalf of a broad-based fund. FIIs can invest their own funds as well as invest on behalf of their overseas clients registered as such with SEBI. These client accounts that the FII manages are known as „sub-accounts".

FOREIGN INSTITUTIONAL INVESTORS (FII'S)

Since 1990-91, the Government of India embarked on liberalization and economic reforms with a view of bringing about rapid and substantial economic growth and move towards globalization of the economy. As a part of the reforms process, the Government under its New Industrial Policy revamped its foreign investment policy recognizing the growing importance of foreign direct investment as an instrument of technology transfer, augmentation of foreign exchange reserves and globalization of the Indian economy. Simultaneously, the Government, for the first time, permitted portfolio investments from abroad by foreign institutional investors in the Indian capital market. The entry of FIIs seems to be a follow up of the recommendation of the Narsimhan Committee Report on Financial System. While recommending their entry, the Committee, however did not elaborate on the objectives of the suggested policy. The committee only suggested that the capital market should be gradually opened up to foreign portfolio investments.

LITERATURE REVIEW:

Various researchers have given an emphasis conceptually and empirically on the area of FIIs and its importance in Stock market which influences the Sensex. Agrawal P.R have evaluated about the impact of regulatory framework and determined how FIIs' action imposed reaction to Indian capital market. The author found that the correlation between FIIs' action and market reaction is so perfect that the stocks which have gone up the maximum are the stocks which are at a premium in the GDR market.

In India, the purchase of domestic securities by FIIs first allowed in September 1992 as part of the liberalisation process that followed the balance of payment crisis in 1990-91. Now days, a significant portion of Indian corporate sector's securities are held by Foreign Institutional Investors, such as pension funds, mutual funds and insurance companies. Chakrabarti (2001) conducted the pair-wise Granger Causality tests between FII inflows and returns on the BSE National Index. He found that portfolio investment from FIIs was more an effect than a cause of market returns in India Stanley Morgan (2002) has examined that FIIs have played a very important role in building up India's forex reserves, which have enabled a host of economic reforms. The study notes that FII 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 influences of FIIs. The study 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.

Mukherjee, Bose and Coondoo (2002) studied the cause-and-effect relationship between FII flows and returns on the Indian equity market. They found that FII flows to and from the Indian market tend to be caused by returns in the domestic equity market and not the other way round.

Investment Conditions and Restrictions for FIIs:

A Foreign Institutional Investor may invest only in the following:-

(a) Securities in the primary and secondary markets including shares, debentures and warrants of companies, unlisted, listed or to be listed on a recognized stock exchange in India.

(b) Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed or not listed on a recognized stock exchange.

(c) Dated Government securities.

(d) Derivatives traded on a recognized stock exchange.

(e) Commercial paper.

(f) Security receipts.

Channels of Foreign Institutional Investments in India:

Portfolio investments in India include investments in American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs), Foreign Institutional Investments and investments in offshore funds. Before 1992, only Non-Resident Indians (NRIs) and Overseas Corporate Bodies were allowed to undertake portfolio investments in India. Thereafter, the Indian stock markets were opened up for direct participation by FIIs. They were allowed to invest in all the securities traded on the primary and the secondary market including the equity and other securities/instruments of companies listed/to be listed on stock exchanges in India.

CONCLUSION:

In this paper we found that FII is a vital component which helps in the development of financial market and the overall financial development thereby allowing the capital flows available in a country to pursue its trajectory of economic growth [7]. Form all the above discussions and data analysis of the study it is inferred that there has been growing presence of the FII inflows in the Indian stock markets which is evident through the net cumulative investments and at times of recession there has been a decline in the inflows. It is also clear from the study that there is an increase in the number of FII registered with SEBI.

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