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Effects of Foreign Institutional Investors on the Promotion of Indian Capital Market

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Abstract – Being a one of the fast growing economy in the world, India attracts a large sum of FII every year. These foreign investments have a great impact on the economy of India. Indian Stock Market, which is one of the indicators of the economic status, is also being affected by the foreign investments made. So this study has been done to validate the null hypothesis that there is no significant impact of FIIs in the promotion of Indian capital market and there is no significant impact of FIIs investment on BSE Sensex. Researcher take secondary data in this study and the data will be collocated through websites of NSE, BSE etc. The sample size which is taken in the research study is the financial statement of last fifteen years (2004 to 2018) of related concern from the Foreign Institutional Investments and Indian capital market. On the basis of data it is found that that there is a significant difference in respect to FIIs investment in debt and equity in Indian capital market. Although FIIs were allowed in debt in year 1997, but they have been found to be more interested in equity rather in debt as FIIs have mainly invested in equity in the whole period of this study.

Key Words: - NSE, BSE and FIIs.

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INTRODUCTION

The liberalization policies initiated in India in the early 1990s brought about radical changes in the conduct of stock market. Rising globalization, deregulation, and foreign portfolio investments made the Indian stock exchanges competitive and efficient in their functioning. With the rise of equity culture across the globe, even India which has a long history of stock exchanges, has witnessed a perceptible shift in the proportion of investor's participation in equity markets. The role of investors is the key to success of market guided economic system and since it is they who pump their savings into the markets, their investments need to be channelized to the most rewarding sectors of the economy. One of the most dominant investors groups that has emerged to play a critical role in the overall performance of the capital market are Foreign Institutional Investors (FIIs). Foreign Investment refers to investments made by residents of a country in financial assets and production process of another country. After the opening up of the borders for capital movement these investments have grown in leaps and bounds. But it has varied effects across the countries. It can affect the factor productivity of the recipient country and can also affect the balance of payments. In developing countries there is a great need of foreign capital, not only to increase their productivity of labor but also helps to build the foreign exchange reserves to meet the trade deficits. Foreign investment provides a channel through which these countries can have access to foreign capital. It can come in two forms: foreign direct investment (FDI) and foreign portfolio investment (FPI). Foreign direct investment involves direct production activities of medium to long-term nature. But the foreign portfolio investment is a short-term investment mostly in the financial markets and it consists of Foreign Institutional Investment (FII).

REVIEW OF LITERATURE

Andy Lin Chih-Yuan Chen (2006) in his paper entitled, "The Impact of Qualified Foreign Institutional Investors on Taiwan's Stock Market" has explored the relationship between qualified foreign institutional investors (QFIIs) and Taiwan's stock market and evaluates the effect of QFIIs' investment transactions on Taiwan's stock market. By taking the date of easing regulatory restrictions on foreigners' stock investment holdings as a cutoff point, the researcher uses the highest and lowest 10 stocks of QFII holdings in three industry sectors as sample portfolios to study the prior- and post-event returns.

Batra Amit (2003) attempted to develop an understanding of the dynamics of the trading behavior of FIIs and returns in the Indian equity market in his work entitled, "The Dynamics of Foreign Portfolio Inflows and Equity Returns in India". Daily and monthly data have been analyzed to explore the trading behavior of FIIs and the impact of their trading biases upon stock market stability. The author found that there is strong evidence that FIIs have been positive feedback investors and trend chasers at the aggregate level on a daily basis. However, there is no evidence of positive feedback trading on a monthly basis. There are almost no joint dynamics between long horizon returns and net equity purchases. The result also indicates that foreign investors have a tendency to herd on the Indian equity market even though they all may not do it on the same day. In times of pressure in the stock market on account of a financial crisis in the region there is excessive sell side herding on the average and on either side of the market during a crisis may be lower than that in the immediately preceding period. On investing the impact of trading imbalances across days, the author does not find any significant evidence that would make it possible to attribute equity market instability to FIIs.

Bohra and Dutt (2011) aims at understanding the behavioral pattern of FII by identifying the Decade trend analysis of FII investment in India, and attempts to present the correlation between FII turnover and turnover of different individual groups of shares in BSE sensex in his paper entitled, "Foreign Institutional Investment in Indian Capital Market: A Study of Last One Decade". The author found a positive correlation between stock market and investment of FII's in a relation that sensex follows the investment behavior of FII's, but there are some exception seen in year 2005 and 2008. It also shows that positive or negative movement of FII's leads to a major change/shift in the sentiments of domestic or related investors in market and suggests the policy implication that the authorities can focus on domestic economic policies to stabilize the stock market.

Chakrabarti Rajesh (2006) through a paper entitled "Foreign Institutional Investments" focuses upon the contribution of foreign investment in Indian equity market as well as share in GDP of the country. The Author also tries to show the relationship between FII flows and return in the Indian market with the help of cumulative FII investment and the sensex from Jan 1993 to June 2006 and he finds that FII equity investment and the stock market performance in India have been closely interlinked. The author also mentions about the government policy regarding FII flows in his paper and observed that the FII flows are believed to have a positive impact on the country's development, so much so that encouraging FII flows government constitute an expert group (2002, which reported in 2004) to suggest ways to accomplish this goal. Lastly the Author concludes that, FII flows should be viewed not in isolation but as a part of an integrated policy package for all capital receipts keeping in mind their role in the overall macroeconomic structure.

David carpenter Partner Mayer, Brown, Rowe and Maw LLP (2005) examined the regulatory framework established by Indian Government for three separate investment avenues: foreign direct investment; investment by foreign institutional investors; and investment by foreign venture capital investors in his paper entitled, "Foreign Investment in India". According to them though these investment alternatives have created ample avenues for foreign investment in India, yet they still remain subject to many conditions and restrictions which continue to hamper foreign investment in India.

Kaur Mandeep and Sharma Renu (2005) in her paper entitled, "Impact of FIIs on the volatility of share prices" observed that the stock market is increasingly becoming more centralized, concentrated and non-competitive. The FIIs have been playing an important role in this aspect. Volatility of share prices is found to have declined after the arrival of FIIs until 1997-98. It started rising again since 1998-99; this is because of decrease in FIIs during this period. Consequently, the ordinary investors have suffered heavy losses and lost interest in stock market so the investment by FIIs should be reduced. This seems possible only by increasing the domestic investor's base (industrial and corporate) and encouraging mutual funds contacting the profit taking activities of FIIs. The author also concludes that the volatility of Indian stock market has reduced after the arrival of FIIs. The author lastly states that the reduction of volatility cannot be completely attributed to FIIs, it can be noted that the reforms in capital market like screen base trading, dematerialization of shares and rolling statements have yielded results and market become less volatile.

Dhamija Nidhi (2007) undertook a study on , "Foreign Institutional Investment in India", and found that the increase in the volume of foreign institutional investment (FII) inflows in recent years has led to concerns regarding the volatility of these flows, threat of capital flight, its impact on the stock markets and influence of changes in regulatory regimes. The determinants and destinations of these flows and how are they influencing economic development in the country have also been debated. This paper examines the role of various factors relating to individual firm-level characteristics and macroeconomic-level conditions influencing FII investment. The regulatory environment of the host country has an important impact on FII inflows. As the pace of foreign investment began to accelerate, regulatory policies have changed to keep up with changed domestic scenario.

RESEARCH METHODOLOGY

Research methodology include objective of the study, sampling design, source of data collection and procedure of interpretation.

OBJECTIVES OF THE STUDY

Every study behind the objective to find out the solution of some problem the objective is:-

1. To study the role of Foreign Institutional Investors in the growth and development of Indian capital market since 2004.

2. To examine the relationship between the FIIs equity investment pattern and Indian stock indices (BSE Sensex and NSE Nifty).

HYPOTHESIS OF THE STUDY

To study the above mentioned objectives, the following hypotheses are formulated:

Ho_1. Null hypothesis-1: There is no significant impact of FIIs in the promotion of Indian capital market.

Ho_2. Null hypothesis-2: There is no significant impact of FIIs investment on BSE Sensex.

SAMPLING DESIGN

This study is based on the “Convenience Sampling”. As a sample, BSE Sensex and NSE Nifty and FII are selected as these are main leading commodity in Indian stock market Company in India. The sample size which is taken in the research study is the financial statement of last fifteen years (2004 to 2018) of related concern from the Foreign Institutional Investments and Indian capital market.

TOOLS AND TECHNIQUES

The present research is to examine the role of the FIIs in the Indian capital market. For testing the objectives, the statistical tools including Karl Pearson’s Coefficient of Correlation, Multiple Linear Regression Model and t-test have been used. The impact of FIIs on the BSE Sensex and NSE Nifty is evaluated by using linear regression model, whereas the impact of FIIs in the promotion of Indian capital market has been examined by using the Karl Pearson’s Coefficient of Correlation. To measure the difference in respect to FIIs investment in equity and debt in Indian capital market, independent sample t-test is used by comparing the mean return of debt and equity investment in the Indian capital market.

SOURCE OF DATA COLLECTION

With a view to achieve the objectives of the present study, the secondary sources of information have been utilized. The history, genesis, components, growth, performances etc. of the Foreign Institutional Investments and Indian capital market have been examined on the basis of secondary data like periodicals, magazines, text books, journals, reports, office records of various organizations like SEBI, RBI and ministry of finance, and different websites containing information and data of FIIs and Indian Capital market. Thus, research work is heavily banked on the secondary source of information.

INTERPRETATIONS OF THE PRESENT STUDY

Null hypothesis: There is no significant impact of FIIs in the promotion of Indian capital market.

Alternate hypothesis: There is significant impact of FIIs in the promotion of Indian capital market.

For the above hypothesis, market capitalization of both major indices of Indian capital market i.e. BSE Sensex and NSE Nifty as a dependant variables and Net FIIs Investment as an independent variable have been analyzed. The sample data of FIIs investments and market capitalization of both indices consists of yearly basis from 2004-05 to 2017-18. To test the above-mentioned hypothesis, we are using one-tailed Karl Pearson correlation technique has been used. Thus by applying 2-tailed Karl Pearson correlation on net FII investment and BSE Sensex market capitalization, the following summary table has emerged.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Market Capitalisation BSE (In crores)	15	40556.8	8164157	2.830E2	1808197.511
NET FIIs INVESTMENT (IN CRORES)	15	-20337.8	304901.1	2.070E4	34231.7268

Correlations

		Market Capitalization-BSE (In crores)	NET FIIs INVESTMENT (IN CRORES)
Market Capitalization-BSE (In crores)	Pearson Correlation	1	.832**
	Sig. (one-tailed)		.003
	N	15	15
NET FIIs INVESTMENT (IN CRORES)	Pearson Correlation	.832**	1
	Sig. (one-tailed)	.003	
	N	15	15

**. Correlation is significant at the 0.01 level (one-tailed).

From the above table, it is evident that correlation between market capitalization of BSE Sensex and the net FII investment is 0.832 at a significant level of 1 percent. This shows that there is a good relationship between these two variables and both are positively correlated, and thus proves that there is a good impact of FIIs investment in the promotion of Indian capital market.

Now, applying one-tailed Karl Pearson correlation on net FII investment and NSE Nifty market capitalization, the following summary table has emerged.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Market Capitalisation BSE (In crores)	15	864.6	4896.6	1.971E3	1370.7157
NET FIIs INVESTMENT (IN CRORES)	15	-43337.8	114901.1	2.070E4	34231.7268

Correlations

		Market Capitalization-BSE (In crores)	NET FIIs INVESTMENT (IN CRORES)
Market Capitalization-BSE (In crores)	Pearson Correlation	1	.763*
	Sig. (one-tailed)		.028
	N	15	15
NET FIIs INVESTMENT (IN CRORES)	Pearson Correlation	.763*	1
	Sig. (one-tailed)	.028	
	N	15	15

*. Correlation is significant at the 0.01 level (one-tailed).

From the above table, it is found that correlation between market capitalization of BSE Sensex and the net FII investment is 0.763 at a significant level of 1 percent. This shows that there is a good relationship between these two variables and both are positively correlated, and therefore, there is a good impact of FIIs investment in the promotion of Indian capital market.

The correlation between BSE Sensex and Net FIIs investment is 0.832 at a significant level of 1 percent and NSE Nifty and Net FIIs investment 0.763 at a significant level of 1 percent are positively correlated. Thus, the null hypothesis i.e. 'There is no significant impact of FIIs in the promotion of Indian capital market' is rejected and alternative hypothesis i.e. 'There is significant impact of FIIs in the promotion of Indian capital market' is accepted.

2. **Null hypothesis:** There is no significant impact of FIIs investment on BSE Sensex.

Alternate hypothesis: There is significant impact of FIIs investment on BSE Sensex.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
NET FIIs INVESTMENT (IN CRORES)	15	-43337.8	114901.1	2.070E4	34231.7268
SENSEX	15	2898.69	16568.89	6.5597E3	4643.56849

Correlations

		NET FIIs INVESTMENT (IN CRORES)	SENSEX
NET FIIs INVESTMENT (IN CRORES)	Pearson Correlation	1	.654*
	Sig. (one-tailed)		.030
	N	15	15
SENSEX	Pearson Correlation	.654*	1
	Sig. (one-tailed)	.030	
	N	15	15

*. Correlation is significant at the 0.01 level (one-tailed).

From the above results, it is found that the correlation between Net FIIs investment and SENSEX is .654. This shows that is a moderate relationship between Net FIIs investment and SENSEX. It shows that there is a moderate impact of FIIs investment in the fluctuation of SENSEX.

This positive correlation establishes the fact that the FII flows are an important driver of Indian Capital Market performance and hence, have a positive impact on country's economic development. But the extents of the movements in Indian capital market are explained by movements in FII flows and can be examined by running the regression analysis. In running the regression analysis, Sensex based monthly return have been taken as the dependent variable and the net equity investment flow by FIIs are considered as the independent variable. To test the above-mentioned hypothesis, multiple linear regression model fitted with the econometric technique of ordinary least square (OLS) has been done. Regression equation looking at relationship between BSE returns and FII flows is:

$$SRt = \alpha + \beta\ NFIIt + \varepsilon\ t$$

Where *t SR* is the Sensex based monthly return at time *t; NFII* is the net equity investment flow by FIIs at time *t;* α and β are constants; ***ε t*** is the white noise;

Thus by applying Linear regressions on net FII investment and SENSEX value the following summary table has emerged.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1.	.527a	.277	.229	4077.29003

a. Predictors: (Constant), NET FIIs Investment (in Crores)

Anova

Model	Sum of Squares	df	Mean Square	f	Sig.
Regression	9.564E7	1	9.564E7	5.753	0.030
Residual	2.494E8	12	1.662E7		
Total	3.450E8	13			

a. Predictors: (Constant), NET FIIs Investment (in Crores)
b. Variable: Sensex

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant) NET FIIs	5081.396	1165.227		1165.227	.001
INVESTMENT (IN CRORES)	.061	.020	.651	.451	.20

Dependent Variable: SENSEX

It can be observed from the above table that all explanatory variables, taken together establish a relationship nearly 30.30 percent (R1 = 30.30) of the total variables in the capital market of India in each year. This means that whatever changes have happened in the SENSEX for period under study the FI investments are responsible up to 30.30 %. This implies that there are many other macro-economic factors which have indirectly affected the SENSEX in India. Therefore, it may be inferred that according to the model made on the basis of linear regression, FII investment have affected the SENSEX value from the coefficients of the model as shown above. It can be observed from the above table that the value of t statistics is 3.124 which is significant at 3 percent level of significance which means that the null hypothesis is not acceptable and thus alternate hypothesis that there is significant impact of FIIs on the SENSEX is accepted meaning thereby that FIIs are aiding in the promotion of Indian Capital market.

FINDINGS OF THE PRESENT STUDY

Following facts have come to the light:

1. On the basis of empirical study it is found that that there is a significant difference in respect to FIIs investment in debt and equity in Indian capital market. Although FIIs were allowed in debt in year 1997, but they have been found to be more interested in equity rather in debt as FIIs have mainly invested in equity in the whole period of this study.

2. It is also found that the movement in stock indices fluctuations is not caused by FIIs investment alone. For the whole period of study (2004 to 2018) only 30.30 % of the changes have happened in stock indices of BSE Sensex due to FIIs investment and 38.3% of the changes have happened in NSE Nifty due to FIIs investment. So, we can say that the FIIs are not wholly responsible for changes in stock indices of Indian capital market and thus FIIs are aiding in the promotion of Indian Capital market.

3. The Market capitalization and the Net FIIs investment are positively correlated where market capitalization of BSE Sensex and the net FII investment is 0.654 at a significant level of 1 percent and NSE Nifty and Net FIIs investment i.e. 0.763 at a significant level of 1. Thus both the markets are positively correlated. Therefore, there is significant impact of FIIs in the promotion of Indian capital market.

RECOMMENDATIONS AND SUGGESATIONS

1. The investment in the economy should be enhanced in the face of rising demand for investible resources. This can be done by encouraging more FII inflows into the country particularly given the advantage that FII is a form of non-debt creating inflows and thus does not increase the country's debt liabilities.

2. Capital inflow restrictions may be necessary. Facilitating capital outflows have the advantage of compensating any temporary high capital inflows induced by capital liberalization measures. This requires appropriate macroeconomic policies.

3. The ability of Government to prevent and reduce financial crises also has a great impact on the growth of capital flows. Steps to address these crises should include strengthening banking supervision, requiring and ensuring more transparency in international financial transactions, ensuring adequate supervision and regulations of financial markets.

4. The fact is that developing country like India has its own challenges arising out of the very state of their social, political and economic development. To attract portfolio investments and retain their confidence, the host country has to follow stable macro-economic policies.

5. The FIIs investments, though shown an increasing trend over time, are still far below the permissible limits. One such measure in this line could be the newly announced INDONEXT, the platform for trading the small and mid-cap companies, which might bring some focus on these companies and hopefully add some liquidity and volume to

their trading, which may attract some further investments in them by the FIIs.

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