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A Study of Foreign Institutional Investments and Its Impact

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Abstract – The present study aims at exploring the determinants of Foreign Institutional Investors' (FII's) investment in India. Returns on Indian stock market have positive impact whereas US stock market returns have no significant influence on FII's investment to India. Stock market risk has negative influence on FII's inflows to India. Market capitalization and stock market turnover of India have significant positive influence only in short-run. Among macroeconomic determinants, economic growth of India has positive impact on FII's investment both in long-run and short run. But all other macroeconomic factors have significant influence only in long-run like inflation in US has positive influence whereas inflation in India has negative influence on FII's investment. Further, US interest rate has adverse impact on FII's investment while liberalization policies of India exhibited significant contribution to FII's inflows. Study concludes that FII's inflows in India are determined by both stock market characteristics and macroeconomic factors.

Keywords: Foreign Institutional Investors', India, Indian Stock Market, Impact, Economic Growth.

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INTRODUCTION

Work 1980s Indian economy has remained very shut towards the foreign investments yet it was generally acknowledged by the administration throughout 1990s that the foreign investment can play noteworthy part to push financial development. It was the time when the wave of budgetary changes additionally touched the capital market. The goal was all clear, i.e., to secure the beat of development in all financial exercises. At the starting phases of changes as to FII's the credit might be given to the New Industrial Policy, 1991 encircled by the administration to keep tabs on the criticalness of foreign guide investment to expand innovative redesigning in a globalized planet. To give further prod to foreign investment, Government of India allowed the portfolio investment made by foreign institutional speculators in India. The introductory guidelines observing the stream of capital by FII's was inferred by Narsimhan Committee Report on fiscal arrangement of India (Armstrong 2012). Figure given beneath has demonstrated the pattern of number of FII's and Net Investment made by them throughout a decade ago. The qualified information of the same has been acquired through the report distributed by Sebi.

The capital market of India was slowly opened for foreign institutional gurus. They were permitted to put resources into all exchanged securities on the essential market and auxiliary markets counting different fiscal items, viz., offers, debentures and warrants and so forth. India has dependably been an alluring terminus for foreign gurus as Indian economy has dependably been a great entertainer around other Asian nations (Lang, M.H. 2010). Be that as it may whenever an emergency has been distinguished on Indian capital market or a fiscal emergency happening at planet level, it has dependably swayed the capital streams by portfolio speculators. Subsequently ceaseless proofs are acquired via specialists showing the volatility movements on the stock market because of the conduct of foreign institutional gurus.

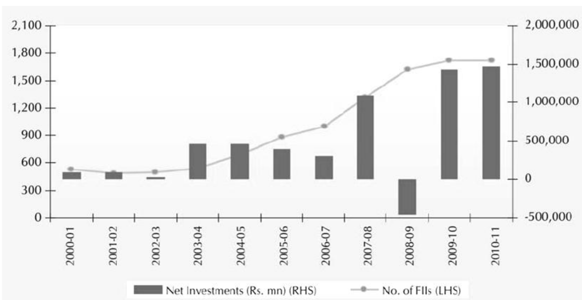

Figure: 1 Number of FII's and Net Investments

There is tremendous growth in the portfolio investments made by foreign institutional investors.

Table given below has shown the data with regard to this. The data given in the table has been obtained from the annual report published by Security Exchange Board of India.

Table: 1 Trends in FII Investment

Period	Purchases (₹ mn.)	Sales (₹ mn.)	Net Investment (₹ mn.)	Net Investment (US $ mn.)	Cumulative Net Investment (US $ mn.)
2000-01	740,506	641,164	99,342	2,159	13,396
2001-02	499,199	411,650	87,549	1,846	15,242
2002-03	470,601	443,710	26,891	562	15,804
2003-04	1,448,575	990,940	457,635	9,949	25,754
2004-05	2,169,530	1,710,730	458,800	10,173	35,927
2005-06	3,449,780	3,055,120	394,660	9,334	45,261
2006-07	5,205,090	4,896,680	308,410	6,709	51,967
2007-08	9,480,196	8,389,304	1,090,892	16,040	68,006
2008-09	6,145,810	6,603,920	-458,110	-11,356	56,650
2009-10	8,464,400	7,037,810	1,426,580	30,253	89,333
2010-11	9,925,990	8,461,610	1,464,380	32,226	121,561
Apr-11	767,320	695,360	71,960	1,616	123,175
May-11	770,460	813,220	-42,760	-948	122,227
Jun-11	806,240	757,410	48,830	1,083	123,310
Jul-11	772,180	665,660	106,530	2,399	125,709
Aug-11	695,900	774,930	-79,030	-1,766	123,943
Sep-11	648,680	667,350	-18,660	-342	123,600
Apr-Sep 2011	4,460,790	4,373,930	86,880	2,042	123,600

The foreign institutional investments incorporate abroad annuity stores, common stores, investment trusts, possession administration associations, candidate associations, banks, institutional portfolio bosses, college reserves, enrichments, establishments, magnanimous trusts, altruistic social orders, a trustee or force of law advocate holder fused or created outside India proposing to make restrictive investments in the interest of an expansive based store (Lau, S.T., 2010). In India, Foreign institutional investment is usually made on fleeting premise and in a large portion of the cases the investment by foreign institutional speculators is channelized by monetary markets. As examined above, the FII's can put resources into the instruments of essential and optional market; it is completely managed by Reserve Bank of India under Portfolio Investment Scheme (Pis). The Pis gives all guidelines and guidelines and regulation noticing the investment by FII's (Bae, K.-H., 2008).

REVIEW OF LITERATURE:

Indian stock market has seen an exceptional development in the most recent not many years. Since year 2002, Indian market has developed from a much volatile conditions to development phenomena, from a Sensex purpose of 5500 in December 2003 to 13,600 in December 2006. this has been because of not just the down home market and yet the worldwide gurus. Since January 2004 which arrived at to near 6000, Sensex has seen numerous new statures for the time of study (year 2007) and touched near 19800 in December 2007. There have been questions raised on the key qualities of the economy for such tallness of the Sensex. There are numerous different variables which donate to the positive development of the stock market (Schmidt, 2009). FII's investment is recognized to be one of the greatest prod after the investment basics. The liberalisation of the Fii streams into the Indian Capital Market since 1993 has had an impressive effect on Indian stock market (De Franco, 2011). This study is investigating the FII's investment conduct and its association with (if there is any) Sensex development.

Need of the Foreign Capital: The need of foreign investment/ foreign capital arises due to the following reasons:

1. Growth of essential infrastructure: the development of any economy depends on the available infrastructure in that country. The infrastructure facilities such as Roads, Railways, sea ports, warehouses banking services and insurance services are the prominent players. Due to long gestation period naturally individuals will not come forward to invest in infrastructure industries. Government of India could not able to raise necessary investments. To fill the gap foreign capital is highly suitable.

2. Speedy industrialization: the need for foreign capital arises due to the policy initiatives of the government to intensify the process of industrialization. For instance the government of India is gradually opening the sectors to foreign capital to expand the industrial sector.

3. To take on the initial risk: many developing countries suffer from severe scarcity of private investors. The risk problem can be diverted to the foreign capitalists by allowing them to invest. As we know the Indians are comparatively risk averse. The same risk can be transferred to foreign investors by allowing their investment where risk is more.

4. Global crucial: Globalization is the order of the day. The international agreements between countries are also the reason for the foreign capital. The multinational companies are expanding their presence to many countries; while they are entering into the foreign countries they will bring their capital. The principles of WTO and other regional associations are binding the member countries to allow foreign capital.

5. Comparative advantage: The variations in the cost of capital like interest rate are also one of the important factors which resulting in approaching foreign capital. For example; Interest rates are high in India compared with developed economies. To reduce the cost of capital, companies/organizations are now looking for foreign capital. In several countries the interest rates are very low as 1% to 3%, where as in some countries the interest rates are very high as 8% to 10% per annum.

Foreign institutional investors: In this globalized age huge measure of capital is put into advancing economies from improved planet. Huge measures of this investment are purchased to improving economies by the path of portfolio investments by foreign institutional speculators (Fii). Foreign institutional speculators have picked up a huge part in Indian capital markets. Accessibility of foreign capital relies on upon numerous firm particular components other than financial development of the nation. In this setting this study inspects the commitment of foreign institutional investment especially around associations incorporated in affectability record (Sensex) of Bombay Stock Exchange (Cohen, 2008). Additionally examined is the relationship between foreign institutional investment and firm particular qualities regarding proprietorship structure, budgetary exhibition and stock exhibition. It is watched that foreign speculators put progressively in associations with a higher volume of stakes claimed by the general open. The promoters' property and the foreign investments are conversely identified. Foreign gurus pick the associations where family shareholding of promoters is not considerable. Around the fiscal exhibition variables the stake returns and wages for every allotment are huge variables affecting their investment choice (Stuart, 2010).

Since 1990-91, the Government of India set out on liberalization and investment changes with a perspective of realizing fast and considerable budgetary development and move towards globalization of the economy. As a part of the changes methodology, the Government under its New Industrial Policy patched up its foreign investment approach distinguishing the developing imperativeness of foreign control investment as an instrument of innovation exchange, enlargement of foreign trade holds and globalization of the Indian economy. Synchronously, the Government, despite anything that might have happened before, allowed portfolio investments from abroad by foreign institutional gurus in the Indian capital market (Petkova, 2012). The entrance of FII's appears to be a catch up of the proposal of the Narsimhan Board Report on Financial System. While prescribing their passage, the Committee, however did not expound on the targets of the inferred arrangement. The trustees just recommended that the capital market might as well be progressively opened up to foreign portfolio investments.

India opened its stock market to foreign investors in September 1992 and has since 1993, received considerable amount of portfolio investment in the form of Foreign Institutional Investor's (FII's) investment in equities. This has become one of the main channels of international portfolio investment in India for foreigners. In order to trade in Indian equity markets, foreign corporations need to register with the SEBI as Foreign Institutional Investors.

TABLE: 2 FII's Investment in India

Securities and Exchange Board of India (SEBI) Data					
Gross in Rupees Crore			Net		
Year	Purchase	Sale	Rupees Crore	Millions of Dollars	Cumulative in Millions of US $
1994-95	615	710	411	416	544
1995-96	5,592	466	5,126	1,634	1,638
1996-97	7,631	8,835	4,796	1,528	3,166
1997-98	9,694	2,752	6,942	2,036	5,202
1998-99	15,554	6,979	8,575	2,432	7,634
1999-00	18,695	12,737	5,958	1,650	9,284
2000-01	16,115	17,699	-1,584	-386	8,898
2001-02	56,855	46,734	10,121	2,339	11,237
2002-03	74,051	64,116	9,935	2,159	13,396
2003-04	49,920	41,165	8,755	1,846	15,242
2004-05	47,061	44,371	2,690	562	15,804
2005-06	1,44,858	99,094	45,765	9,950	25,755
2006-07	2,17,911	1,71,696	46,215	10,248	36,008
2007-08	3,46,978	3,05,512	41,466	9,332	45,340
2008-09	4,77,515	4,50,629	26,886	6,626	51,966
2009-10*	7,91,175	7,34,748	56,427	15,234	67200

Table: indicates that every year since FII's were allowed to participate in Indian market, net inflows into India remained positive, except 1998-99. This reflects the strong fundamentals of the country, as well as the confidence of the foreign investors in the growth prospects of the Indian market. The year 2003 marked a watershed in FII investment in India as they started in this year in a big way by investing Rs. 985 crore in January itself. Meanwhile, corporate India continued to report good operational results, this along with good macroeconomic fundamentals, growing industrial and service sector led FII's to perceive great potential for the investment in the Indian economy.

Portfolio Preferences of Foreign Institutional Investors: This study tests the dynamic investment designations of U.S. common finances in rising market values after the market emergencies of the late 1990's. The Asian monetary emergency sent a sign to outside moguls about the part of guru assurance laws and firm exposures in encouraging to screen and secure their cases. This study expands the work of La Porta et al. (1997, 1998, 2000) who discover that solid mogul assurance laws, high authorization and high caliber bookkeeping divulgences have a positive effect on market development and the developing market proof of Johnson et al (2000), Mitton (2002), and Joh (2003) who show that revelation and administration were joined to exhibition before and throughout the East Asian budgetary emergency. We supplement these studies by straight testing how nation and firm-level strategies influence the post-emergency investment designation choices of U.S. common stores, a significant wellspring of capital for developing market development. Our experimental confirmation shows wide variety in strategies throughout this period that conceivably influence foreign investment streams to rising markets. In specific, we discover that (a) nation level arrangements, for example skimming trade rates and solid shareholder rights, and bookkeeping measures, and (b) firm-level arrangements that bring about better transparency and bookkeeping exposures notwithstanding aspects, for example estimate, deceivability and investigator taking after, are connected with more excellent U.S. shared store investment. Furthermore, the effect of exposures is generally professed in nations with powerless shareholder rights.

BENEFITS OF FII'S INVESTMENT:

Decreased Cost of Equity Capital: Fii inflows enlarge the wellsprings of trusts in the Indian capital markets. In a sound judgement manner, an increment in the supply of stores lessens the needed rate of return for value and improves stock costs. At the same time, it encourages investment by Indian firms in the nation.

Bestowing Stability to Indian's Balance of Payment: For advertising development in India, there is a need to increase residential investment, over and past domesticated reserve funds, through capital stream. The abundance of provincial investment over local reserve funds bring about a present record shortage and this setback is financed by the capital stream in a critical position of installment. Preceding 1991, obligation streams and official record shortage is broadly accepted to have assumed a part in the rise of equalization of installments troubles, which rolled out in 1981 and 1991. Foreign institutional investment instead of obligation making streams is paramount as more secure and more feasible component for subsidizing the present record setback.

Information Flows: The exercises of global institutional moguls help reinforce money related framework. FII's advocate current thoughts in market plan, push enhancement, development of advanced items, for example budgetary subsidiaries, improve rivalry in money related intermediation and accelerate spillover of human capital by laying open market members to advanced fiscal systems and universal best practices and frameworks.

Reinforce Corporate Governance: Domestic institutional gurus and distinct moguls, who are utilized to the progressing practices of residential corporates, frequently acknowledge such drills, indeed, when these don't measure up to the worldwide benchmarks of most effectively practices. FII's with their boundless encounter with current corporate influence practices are less tolerant of misbehavior by corporate bosses and holders (predominant shareholders). Fii investment in down home capital markets frequently lead vivacious promotion of sound corporate administration drills, enhanced effectiveness and better shareholder quality.

Enhance Market Efficiency: A huge vicinity of FII's can enhance market productivity through two channels. To start with, when ill-disposed macroeconomic news, for example awful storm, unsettles numerous down home moguls, it may be simpler for an universally broadened portfolio administrator to be more impartial in the ballpark of a nation's prospects, and participate in stabilizing exchanges. Second, at the level of unique stocks and commercial ventures, FII's might go about as a channel through which information and thoughts regarding valuation of a firm or an industry can all the more quickly spread into market. For instance, foreign speculators quickly evaluate the potential of firms like Infosys, which are essential fare situated, by applying valuation standards that won outside India for programming administrations companies.

CONCLUSION:

Comparability is one of the essential attributes of financial reporting that facilitates investment decision making and allocation of capital. However, the capital market determinants of comparability are not well understood. In this study, we examine the role of foreign institutional investors in shaping their investee firms' financial reporting comparability. Our study contributes to the extant literature by documenting foreign institutional ownership as an important determinant of the observed heterogeneity in accounting practice worldwide. Further, our study provides novel evidence of two important channels, the appointment of a U.S. independent director to the board (and audit committee in particular) and the hiring of a big-four auditing firm, through which foreign institutions can influence the reporting practices of their investee firms. Recent literature has cast doubt on the effectiveness of using country-level accounting mandates (e.g., requiring reporting under IFRS) to enact meaningful changes in the quality of companies' financial reporting. A staff report released by the SEC in July 2012 expressed similar concerns and once again emphasized the onerous costs associated with the proposed shift to IFRS. With the rapid growth in foreign investment across the globe, foreign institutional ownership could serve as a rising force in improving accounting comparability. Importantly, our results highlight the possibility of promoting foreign investment as a less costly alternative to country-level regulatory changes for improving comparability.

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