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An Analytical Study On Impact Of Fiis Investment On The Return Of Indian Stock Market

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Abstract: The investment of capital that flows from one country to another country is known as foreign investment. Inflow of foreign investment is normally encouraged in the capital scarce economies because it complements and stimulates domestic investment. In India, foreign investment were allowed in 1991 either through stock market investment in listed companies referred to as Foreign Institutional Investors (FIIs) investment or directly in listed and unlisted companies referred to as Foreign Direct Investment (FDI). The objective of this paper is to study the impact of FIIs investment on the return of Indian stock market. For this purpose Pearson correlation has been applied and it is found that there is no relationship between returns of Indian stock market (BSE & NSE) and Foreign Institutional Investors cash inflows (investments).

Keywords: FII Inflows, Stock Market, Investment, etc.

1.1 Introduction:

A critical challenge for any economy is the allocation of savings to available investment opportunities. Economies that do this well can exploit new business ideas to spur innovation, create jobs and wealth at rapid pace. [**1**] In contrast, economies that manage this process poorly dissipate their wealth, fail to support business opportunities and witness decline in their economic growth rate. In fact, healthy investment in the economy has positive impact on economic growth and leads to enlarged market size, which in turn attracts further capital inflow. In this context, if domestic capital falls short of required capital investment in the economy, foreign capital inflow fulfils this gap and plays a critical role in explaining growth of the host country. It not only accelerates the economic growth by supplementing domestic capital but brings in various other benefits to the host country like technology, skill development and latest know-how.

1 Joo, B. A and Mir, Z. A. (2014). Impact of FIIs Investment on Volatility of Indian Stock Market: An Empirical Investigation, *Journal of Business & Economic Policy*, 1(2), pp. 106-114.

The investment of capital that flows from one country to another country is known as foreign investment. Inflow of foreign investment is normally encouraged in the capital scarce economies because it complements and stimulates domestic investment. In India, foreign investment were allowed in 1991 either through stock market investment in listed companies referred to as Foreign Institutional Investors (FIIs) investment or directly in listed and unlisted companies referred to as Foreign Direct Investment (FDI). Among two former plays a dynamic role in shaping the stock market indices and stock prices of various companies in the host country. FDI is considered as a developmental tool and helps in achieving the self-reliance in various sectors, thereby leads to overall development of economy.

1.2 Stock Markets - An International Comparison

Indian stock market is one of the developing markets in the world. A comparison of Indian stock market with the important developed and developing markets is presented in table below: The table shows the information as on 31st March 2015.

Table 1.1 Stock Markets - An International Comparison

Particulars	U.S.A.	U.K.	Japan	Germany	Singapore	China	India
No. of Listed Companies	4102	2199	3470	665	472	2494	5191
Market capitalization ($ mn)	18668333	3019467	3019467	1486315	414126	3697376	1263335
Market Capitalization Ratio	103.62	119.02	61.76	43.72	150.75	44.24	68.60
Turnover ($mn)	21375280	2488566	3605393	1225530	156445	5826506	622479
Turnover Ratio	114.50	114.50	97.95	82.45	37.78	157.58	49.27

Source: NSE ISMR 2015, Market Capitalization Ratio is the ratio of market capitalization with GDP, Turnover Ratio is the turnover of a country's stock exchanges as a percentage of market capitalization.

Until the 1980s,**2** there was a general reluctance towards foreign investment or private commercial flows as India's development strategy was focused on self-reliance and import substitution and current account deficits were financed largely through debt flows and official development assistance. A major development in our country, post 1991 has been liberalization of the financial sector, especially that of capital markets. After the launch of the reforms, foreign institutional investors (FIIs) from September 14, 1992, with suitable restrictions, were permitted to invest in all securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India and in schemes floated by domestic mutual funds. A positive contribution of the FIIs has been their role in improving the stock market infrastructure and the SEBI assured its contribution towards its development.

Hence, in this age of transnational capitalism, a significant amount of capital is flowing from developed world to emerging economies. Positive fundamentals combined with fast growing markets have made India an attractive destination for foreign institutional investors (FIIs). Although the Foreign institutional investors (FIIs), whose investments are often called 'hot money' because they can be pulled out at anytime, have been blamed for large and concerted withdrawals of capital from the country at the time of recent financial crisis, they have emerged as important players in the Indian capital market. With over 20 million shareholders, India has the third largest investor base in the world after the USA and Japan. Over 9,000 companies are listed on the stock exchanges, which are serviced by approximately 7,500 stockbrokers. The Indian capital market is significant in terms of the degree of development, volume of trading and its tremendous growth potential, as stated by (Mehra Saniya 2007)**3**. So basically, one can compute the correlation coefficient between the BSE Sensex and FII flows. Studies found a strong correlation between BSE SENSEX and FII activity in Indian Capital Markets. This strong positive correlation always grabs the headlines. It is because of the volatile nature of investors sentiments that FIIs are tracked so closely. It would not be prudent to drive away foreign investors from investing in our country.

1.3 Investment by FIIs:

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2 Mukherjee, D. (2007). Comparative Analysis of Indian Stock Market with International Markets, Great Lakes Herald by Great Lakes Institute of Management, Chennai, 1(1), pp. 39-71.

3 Mehra, S. (2007). "Stock Market India", available at http://www.ai-stockmarketforum.com/showthread.php?t=229 (accessed 11 Jan 2012).

There are generally two ways to invest for FIIs.

Equity investment: 100% investment could be in equity related instruments or up to 30% could be invested in debt instruments i.e. 70 (Equity Instruments): 30 (Debt Instruments).

- **i.** Securities in the primary and secondary arcade including shares which are unlisted, listed or to be listed on a recognized stock exchange in India.
- **ii.** Units of schemes floated by the Unit Trust of India and other domestic mutual funds, whether listed or not.
- **iii.** Warrants

A. 100% Debt: 100 %investment has to be made in debt securities only. In case of Debt Route the FIIs can invest in the following instruments.

- i. Debentures (Non-convertibles Debentures, Partly Convertible Debentures etc.)
- ii. Bonds
- iii. Dated government securities
- iv. Treasury Bills
- v. Other Debt Arcade Instruments

It should be noted that external companies and individuals are not eligible to invest through the 100% debt route.

1.4 Foreign Institutional Investors (FIIs) in India

FIIs means an entity established outside India with an intention to make investment in Indian securities market by managing savings collectively on behalf of investors for obtaining immediate return. In simple terms, Foreign Institutional Investment is an investment by a resident entity in one country in the equity and debt securities of an enterprise which is a resident in another country without an objective of lasting interest in enterprise but immediate capital gain.

Securities Exchange Board of India, Foreign Institutional Investors Regulations Act 1995 defines Foreign Institutional Investors as "an institution established or incorporated outside India which proposes to make investment in India in securities."[4]

Foreign Institutional Investors can invest in all securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or to be listed on the stock exchanges in India, schemes floated by mutual funds,

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[4] Securities and Exchange Board of Indian Foreign Institutional Investors Regulation. (1995), p 5.

government securities, derivatives traded on stock exchange, commercial papers and security receipts.

2. Literature Review:

Walia et al., (2012) have mentioned that FIIs have gained a significant role in Indian stock markets. In this context present study examines the contribution of foreign institutional investment in sensitivity index and also attempts to understand the behavioral pattern of FII during the period of 2001 to 2010 and examine the volatility of BSE Sensex due to FII. The data for the study uses the information obtained from the secondary resources like website of BSE sensex. The study results point towards presence of positive relationship between foreign institutional investment and progress of the Indian economy.

Deol (2016) examined the determinants of foreign portfolio investment by FIIs in India by taking macroeconomic fundamentals into consideration. The study used regression analysis for annual data spanning 1993 and 2014. The study also examines the determinants of the foreign portfolio investment using quarterly data for period 1993-2014. The study takes into consideration foreign direct investment in India, domestic real GDP growth, domestic inflation, credit worthiness of Indian economy, domestic nominal effective exchange rate, domestic stock market returns, world GDP growth and world interest rate while examining the determinants of the foreign portfolio investment flows to India.

Kumar and Anand (2018) studied the impact of FIIs on Nifty 50 from July 2015 to February 2018 by dividing it into pre and post demonetization periods. Tools like ADF test, Granger's causality test, correlation and regression have been used. The results showed a moderately positive correlation between the two variables. There was no causality before demonetization, but causality was seen after demonetization. A regression equation has been formulated to determine the relationship between FII and Nifty 50 after demonetization.

Jacob and Kattookaran (2019) examined the impact of institutional investment flow and stock returns using monthly data over the period of 2007 to 2018. Various econometric tools have been applied to prove the causal relationship between Foreign Institutional Investors and Domestic Institutional Investor flows on Sensex return. The Auto Regressive Distributed Lag model shows that DIIs and FIIs have positive statistically significant influence on Sensex return. Overall, it was found that the institutional investment collectively impacted the stock market return.

Madaan and Shrivastava (2020) investigates herding behavior and its persistence among foreign institutional investors (FIIs) in the individual stocks of the energy sector of Indian stock exchange by focusing on post turmoil period. The study also examines the relation of herding with the individual return, market return, trading volume and conditional volatility of individual and market return. The presence of herding is investigated by Lakonishok et al. (1992) model, value-based and count-based herd ratio measure among FIIs in individual stock of energy sector post turmoil period. Further, run test was employed to check the persistency in herding and multivariate distributed lag to investigate the relationship with the market determinant. The result indicates the existence of herding in most of the companies and strong persistence in all the companies. The intensity of buy side herding is higher than sell side. Herding and individual return both are significant driving forces of FIIs herding, while trading volume and market volatility in few companies exhibit inverse relationship. This study is limited to investigation of energy sector stock. Stock market is significantly influenced by FIIs and their propensity to herd may generate instability in the stock market. Therefore, regulatory authority should continuously monitor the flow of fund by FIIs. Herding in the individual stock of the energy sector was not previously performed.

3. Research Methodology:

3.1 Research Design:

The present research is descriptive and exploratory in nature, since its attempts to describe the impact of FIIs investment on the return of Indian Stock Market.

3.2 Data Collection:

The present study is based on secondary data analysis where data of FIIs and stock market indices from 2005 to 2015 are analysed.

3.3 Objective of the study:

1. To study the impact of FIIs investment on the return of Indian stock market.
2. To assess the impact of FIIs cash inflows on the volatility of the secondary markets in India specifically the BSE and NSE.

3.4 Hypothesis of the study:

1. There is no relationship between returns of Indian stock market (BSE & NSE) and Foreign Institutional Investors cash inflows (investments)

4. FII Flows and Indian Stock Market

Table 1.2: FII Flows and Indian Stock Market

Period	FII Flows (US $ million)	BSE Sensex	CNX Nifty
2005-06	9926	13786.91	2513.44
2006-07	3225	20286.99	3572.44
2007-08	20328	9647.31	4896.59
2008-09	-15017	17464.81	3731.02
2009-10	29048	20509.09	4657.76
2010-11	29422	15454.92	5583.54
2011-12	16813	18842.08	5296.71
2012-13	17134	10123.20	5732.62
2013-14	18647	10764.39	6015.37
2014-15	19031	12541.24	6664.53

Source: Bulletins of Reserve Bank of India, Fact sheets of DIPP, Govt. of India

Above Table 4.9 shows information pertaining to flow of FII (in terms of US $ million) in India and BSE SENSEX and CNX NIFTY for a period of ten years. It is observed that the inflows declined during the year 2006-07, 2008-09 and 2011-12. While during the year 2010-11 high rise was observed in the inflows of FIIs. In addition to this the flow of BSE SENSEX indicated increasing trend except during the period 2007-08 and 2010-11. Furthermore the flow of CNX NIFTY indicated increasing trend except the years 2008-09 and 2011-12. From the study results it is evident that FIIs highest flow was observed in the year 2010-11.

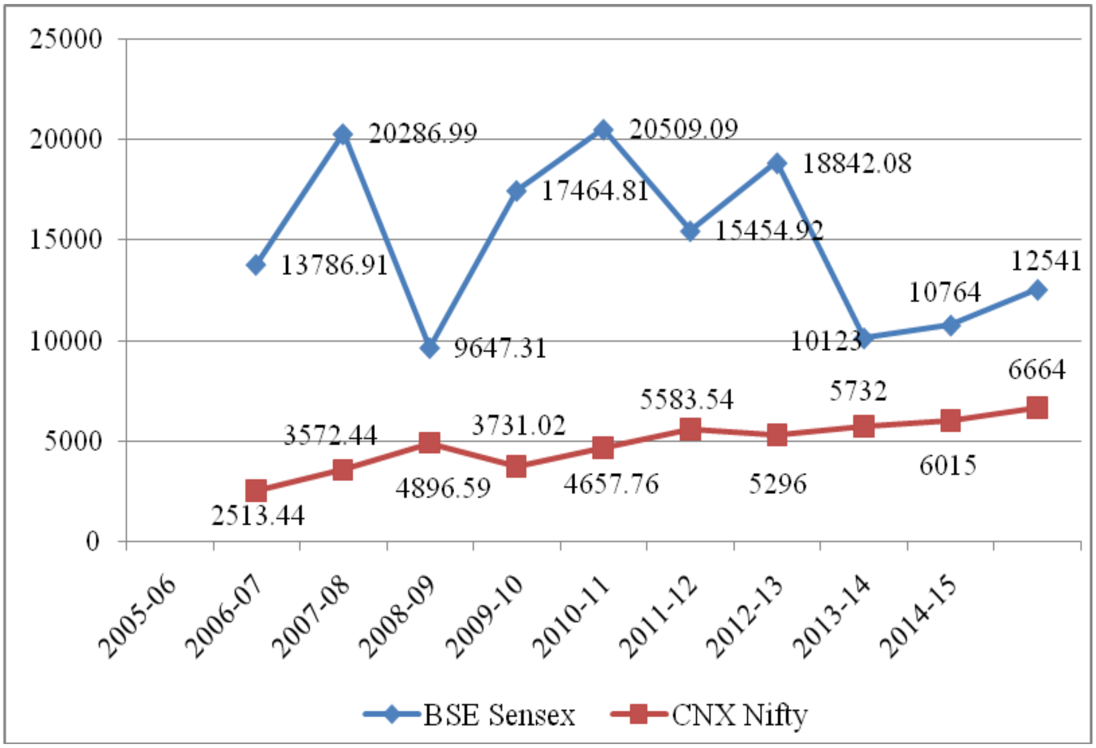

Fig 1: FII Flows and Indian Stock Market

4.2 Relationship between FII Flows and BSE and NSE indices

In order to determine the direction and strength of relationship between the net FII flows in the Indian bourses i.e. BSE and NSE, the data was obtained for each month of the study period i.e. 2005 to 2015. The relationship between the FII flows and BSE and NSE indices was studied using Pearson's Correlation Coefficient determination. The statistical analysis was carried out using SPSS 18.0 software. The correlation matrix is presented in following

Tables 4.10.1 to **4.10.11**.

Relationship between FII flows and BSE and NSE indices Year 2005

Table.1.3: Correlation Co-efficient between FII flows and BSE and NSE indices during the year 2005

		FII Inv - 2005	BSE - 2005	NSE - 2005
FII Inv	Pearson Correlation	1.000	.254	.256

– 2005	(r^2)			
	Sig. (2-tailed)		0.425	0.423
	N	12	12	12
BSE – 2005	Pearson Correlation (r^2)	.254	1.000	.993**
	Sig. (2-tailed)	0.425		0.000
	N	12	12	12
NSE – 2005	Pearson Correlation (r^2)	.256	.993**	1.000
	Sig. (2-tailed)	0.423	0.000	
	N	12	12	12

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

The relationship between FII flows and BSE and NSE indices during the year 2005 is shown in above **Table**. The results show that there is positive relationship between FII flows and BSE index with $r^2 = 0.254$, $p>0.05$ and also with NSE index with $r^2 = 0.256$, $p>0.05$. Although the relationship between FII flows and BSE and NSE indices was positive, it was not significant at $p=0.05$ level.

The overall growth in the investment of the FIIs in the Indian markets over a period of 2005 to 2015 shows that largely the FIIs have shown significant confidence in the Indian markets in general and the economy in particular. The increased investment of FIIs during the study period with a marginal exception of 2008 (due to international problem like sub-prime crisis in US) shows that there is positive relationship between the returns of Indian stock market (BSE & NSE) and cash inflows of FIIs. Hence, the hypothesis, which states that "There is no relationship between returns of Indian stock market (BSE & NSE) and Foreign Institutional Investors cash inflows (investments)" is **rejected**.

5. Conclusion:

The capital investment by FIIs is motivated not only by the domestic and external economic conditions but also by short run expectations, primarily developed by what is known as 'market sentiment'. These short run expectations in return develop an element of speculation and high mobility in FII's capital flows and as such give rise to volatility in stock market of host country. The common belief about equity market is that price or return indices in stock markets are frequently subject to extended deviation from fundamental values with subsequent reversals and that these savings are largely influenced or created by the mobility of foreign capital flows. In such a situation small investors have serious concern that whether prices accurately reflect their expectations about the present value of future cash flows. The persistent anomaly calls into question market rationality and is evidenced by stock market volatility, stock market crashes and market overreactions.

The results show that there is significant positive relationship between FII inflows and the movement of BSE and NSE indices during the study period i.e. 2005 to 2015. However, apart from a couple of years most of the times the relationship appeared to be positive between the FII flows and the index movement. This indicates that the Indian markets are robust markets that are attracting the foreign investment consistently.

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