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An Analytical Study to Examine the Influence of Foreign Institutional Investors on the Indian Capital Market

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Abstract

India's economy was globalised in 1991, and since then, the Indian capital market has attracted international investors, making it a desirable investment location for foreigners. Foreign investment is crucial for a country's development and essential since it expands the market's size. A well-organized financial market is a fundamental component of every country because it provides the country with the financial input it needs to produce products and services. The success or failure of a country's financial market determines the country's economic progress. The financial market is an important financial system since it is through it that a country obtains the majority of its short-term investment. In the present study we are trying to examine the influence of foreign institutional investors on the Indian capital market. This research is based on secondary data that covers 10 years, from 2012-13 to 2021-22. The study findings reveal the inverse and significant relationship between the FIIs net flow and Sensex Index.
Key Words: *Financial Market, FIIs, FIIs Net Flow, Sensex Index.*

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1. INTRODUCTION

India's economy was globalised in 1991, and the country's foreign investment policy was reformed as well. Through this, India opened the door of its capital market for the foreign investors as they enter into the Indian market. Foreign institutional investors in equities were authorized to invest in the Indian stock market in 1992, and the country received $ 4 million in foreign institutional investment in equities during the financial year 1992-93. It has been one of the most popular ways for foreigners to invest in overseas portfolio in India. After the change in foreign investment policy in 1991 the country’s balance of payment crisis and dependence on borrowed capital were reduced. After the globalization and deregulation, capital market experienced an outstanding flow in foreign investment. This enables the Indian industries to access the foreign technology, expertise and mainly the foreign capital. This national initiative contributes to the integration of the domestic economy with the global economy.

Foreign Institutional Investment refers to a short term investment made by the residents of a country in another country mostly in the financial markets. SEBI register the foreign corporations as foreign institutional investors, after that they trade in Indian equity market. In November 1995, The Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 were implemented by Securities and Exchange Board of India to control FIIs. Foreign firms must register with SEBI as Foreign Institutional Investors in order to trade in Indian securities. Foreign investors require approval of Reserve Bank of India and Foreign Investment Promotion Board if they do not register with SEBI. Registration with SEBI is must comply because of follow the certain exchange controls regulations of the Reserve Bank of India which are specific to FIIs.

The stock exchange working in India was started in the year 1875 and the oldest stock exchange of India is BSE. The commonly used name of Bombay stock exchange is Sensex and it comprise thirty largest and most active companies which dominate the Indian stock market. Indian stock exchange functioning becomes efficient and competitive with the globalization, deregulation and foreign investment. Foreign capital fulfills the gap of capital investment required in an economy. For a emerging economy it is very important to understand the determinants of FIIs because they employ a large impact on the financial market in the short term. Flow of international capital and capital controls have always an important issue for the capital market of a country. The sudden outflows inherent and abrupt of FII flows create a danger impact on equity. The capital market requires a deep understanding of FII flows since their rapid reversal endangers a country's capital market stability.

Foreign capital need is not only to provide the capital to local companies but also helps to build up the foreign exchange reserve, which is needed to meet the trade deficit. Generally FIIs invest in two ways, one in equity instrument and other is debt instrument. FIIs can invest in primary and secondary market securities, Unit Trust of India unit schemes, other mutual funds, and warrants through the equity method. FIIs can invest in Debentures, Bonds, Government Securities, Treasury Bills, and other debt instruments through the debt channel. FIIs create competition in financial market which improves the security prices. FIIs enjoy entry and exit flexibility, as well as access to both global and local markets, whereas domestic investors do not have access to global markets. FIIs have lot of cost benefit due to manipulation opportunity because of access of domestic and global market at the same time.

2. REVIEW OF LITERATURE

Stanley Morgan (2002) has examined that the FIIs have a host for economic reserves and played a crucial function in making up India's foreign exchange reserve. The Stanley Morgan report argues that FIIs have Influence on short term market in the bear market condition. However in bull market FIIs influence were reduced because the other market participants raise their involvement. This report also indicated that in a bear market, the correlation between foreign inflows and market return is high, while in a bull market, it is low.

Batra Amit (2003) conduct a study under the topic entitled, "The Dynamics of Foreign Portfolio Inflow and Equity Returns in India". The author sought to gain a better knowledge of FIIs trading behaviour and stock market returns in this study. For this purpose the author uses daily and monthly data and found strong evidence that FIIs plan to invest on positive feedback and trend chasers on daily basis. However, the author not found any evidence of monthly basis positive feedback. The author not found any joint dynamics between long term return and net equity purchase.

Arshanapalli Bala and Kulkarni Mukund S. (1997) have done a study within the title "Impact of U.S. Stock Market on Indian Stock Market". The author looked into the link between the American and Indian stock markets. From January 1991 through December 1998, the study used data from the BSE, NYSE, and NASDAQ to assess interdependence between the three indices. The study's findings show that the Indian stock market is not reliant on the stock market in the United States.

Anand Bansal and J.S. Pasricha (2009) investigated the influence of market opening to foreign institutional investors (FIIs) on Indian stock market behaviour. In this research they look at the differences in volatility after the opening of Indian market to FIIs and market return. They found that after opening of Indian market to FIIs, there is no significant change in average return but the volatility of market is significantly reduced.

P. Krishna Prasanna (2009) in his research examined the FIIs contribution in the Sensex index companies. They examined the relationship between FII and company specific characteristics like financial performance, stock performance and ownership structure. They found that FIIs invested more in companies in which general public owned higher share ownership. It means there is a inverse relationship between FIIs and promoter's ownership they also suggest that earning per share and share return are significant factor which influence their investment decision.

Kaur Mandeep and Sharma Renu (2005) conduct a study under the title "Impact of FIIs on the volatility of share prices". Because of the drop in FIIs during this era, the author noted that stock price volatility decreased with the entry of FIIs until 1997-98, but rose again after 1998-99. The author concludes that the volatility reduction cannot be completely associated to FIIs. Capital market reforms, share dematerialization etc have also the reasons to become market less volatile.

Mukherjee, Bose, & Coondoo (2002) examined the determinants of FIIs. They conclude that the Indian capital market performance is influenced by FIIs purchase and FIIs sale. The return of Indian market has an impact on flow of FIIs. They discovered that FIIs do not recognize the Indian market as a source of diversification for their investments.

Pal P. (1998) argued that foreign institutional investors (FIIs) are becoming key players in the Indian capital market, and their influence is growing. FIIs trading activity and turnover of domestic market indicate that FIIs are becoming more important because of accounted a higher and increasing share of turnover in Indian stock market.

3. Objectives of the Study

The study has following specific objectives-

i) To look at the trend of Foreign Institutional Investors (FIIs) in the Indian stock market.
ii) To Examine the Influence of Foreign Institutional Investors (FIIs) on the Indian Capital Market.

4. Research Hypothesis

H0: FIIs net flow has no significant influence on the Sensex Index (BSE).
H1: FIIs net flow has significant influence on the Sensex Index (BSE).

5. Research Methodology

Two famous stock exchanges namely National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) are existed in India. BSE (Sensex) is one of popular market in the world and is considered as a representative of Indian stock market. In this study we used the oldest and most popular index Sensex to study the Foreign Institutional Investors influence on the Sensex Index. In this paper we used secondary data which is collected from various websites like bseindia.com, sebi.nic.in and annual reports of BSE and SEBI. We collect daily FIIs inflow, FIIs outflow and FIIs net flow data from the stock exchange. All the data of FIIs inflow/outflow/netflow and BSE index values were taken for ten financial years from 2012-13 to 2021-22. For the purpose of analysis, statistical tools like descriptive statistics and regression analysis are used. In this paper we analyze the FIIs inflow/outflow influence on the Sensex index and trend of FIIs in Indian capital market. This study helps any investor to understand the market position and intimate investment timing in the capital market.

6. Data Analysis and Interpretation

6.1 Descriptive Analysis:

(Amount in Rs. Crore)

Financial Year	FIIs Inflow	FIIs Outflow	FIIs Net Investment	Sensex High	Sensex Low	Sensex Close
2012-13	647964.77	547876.93	100087.84	20203.66	15748.98	18835.77
2013-14	761039.90	686558.35	74481.55	22467.21	17448.71	22386.27
2014-15	1074332.36	1010571.80	63760.56	30024.74	22197.51	27957.49
2015-16	1057705.50	1102614.44	-44908.94	29094.61	22494.61	25341.86
2016-17	1155606.82	1130245.15	25361.67	29824.62	24523.20	29620.50
2017-18	1286877.08	1365408.54	-78531.46	36443.98	29241.48	32968.68
2018-19	1284954.44	1310956.63	-26002.19	38989.65	32972.56	38672.91
2019-20	1380095.91	1470139.45	-90043.54	42273.87	25638.90	29468.49
2020-21	1966975.68	1765598.42	201377.26	52516.76	27500.79	49509.15
2021-22	2006560.10	2280804.33	-274244.23	62245.43	47204.50	58568.51

Table 1: *Descriptive Analysis (Prepared by author)*

From the above data table 1, we found that FII buying and selling in Sensex is maximum in the financial year 2021-22 but in this year the net flow of FIIs is negative which is Rs. 274244.23 Crore. The country gets maximum net investment by FIIs in the financial year 2020-21 which is Rs. 201377.26 Crore and the maximum negative net investment in the financial year 2021-22 which is due to poor economic condition after the Corona Crises. During the 10 year period the Sensex index touches its lowest level 15748.08 in the financial year 2012-13 and the highest level 62245.43 in the financial year 2021-22. The Sensex index gets more than four times growth from the lowest point in the year 2012-13 to the highest point in the year 2021-22. The Sensex index gets its highest growth of 68.01% in the financial year 2020-21 and FIIs net investment also gets its highest amount of Rs.201377.26 in the financial year 2020-21. From the above table we conclude that the Sensex index is on increasing trend and goes to 58568.51 from 18835.77 during the ten year period. We also conclude that the FIIs inflow and FIIs outflow also on increasing trend. From the beginning to end of 10 year period the overall growth in Sensex index is 210.94%, in FIIs inflow is 209.67% and in FIIs outflow is 316.30% respectively.

6.2 Regression Analysis Between FIIs Net Flow and Sensex Index

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	0.156[a]	0.024	0.024	10846.982

a. Predictors: (Constant), FIIsNetFlow

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	7149200989.432	1	7149200989.432	60.763	.000[b]
	Residual	286141891977.377	2432	117657027.951		
	Total	293291092966.809	2433			

a. Dependent Variable: SensexIndex
b. Predictors: (Constant), FIIsNetFlow

Coefficients[a]

Model		Unstandardized Coefficient		Standardized Coefficient	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	32354.274	219.861		147.158	.000
	FIIsNetFlow	-1.055	1.35	-0.156	-7.795	.000

a. Dependent Variable: SensexIndex

The abovementioned regression analysis revealed a 0.156 correlation between FIIs net flow and the Sensex index. The value of R-Square suggests that only 2.40% of Sensex index performance is depend upon the FIIs net investment. The statistical P-value 0.000 is less than the .05 acceptable P-value which means that the model is significant for the study. The coefficient beta -1.055 suggests that a unit increase in FIIs net flow will cause of 1.055 points decrease in Sensex index. This model shows the negative relationship between FIIs net flow and Sensex index. Because of significant P-value we reject the null hypothesis Ho and accept the alternate hypothesis H1 i.e. FIIs net flow has significant influence on the Sensex index. This analysis shows that when the FIIs net flow increases in the Sensex index then the other investors sells their holdings to earn the profit and this will cause the Sensex index fall.

7. Conclusion

India opened its stock market to international investors in September 1992, and since then, the country has received significant foreign investment, mostly in equities. FIIs not gave direct benefit as of creating real investment into a country but provides large amount of capital to a country through the capital market. FIIs growing participation is one of the most important feature of the Indian stock market development. FIIs played a critical role in increasing India's foreign exchange reserves. Many factors like rupee movement, interest rates, inflation, political situation and investment regulations influenced the FIIs investment which changed the Indian stock market face. FIIs are the trendsetters in any market because they were the first one who reacts accordingly to the international situations. Whenever the risk in international market were increase then FIIs pull back their investment into the home market. For a country it is very essential to pay attention towards FIIs in the economy and understanding its key feature to predict the chances of reversal of it.

The primary goal of this research is to explore the behaviour of foreign institutional investors (FIIs) and their impact on the Indian capital market. For this purpose we tried to found out the statistical relationship between FIIs and Sensex index. For the study we used secondary data of 10 financial years period from 2012-13 to 2021-22. The data reveals a significant adverse relationship between FIIs net flow and the Sensex index. We reject the null hypothesis and accept the alternative hypothesis i.e. FIIs net flow has significant influence on the Sensex index, due to a substantial P-value. This analysis shows that when the FIIs net flow increases in the Sensex index then the other investors sells their holdings to earn the profit and this will cause the Sensex index fall. Not only the net flow of FIIs but some other factors like position of domestic investors, political situation, rupee rate in comparison to dollar and inflation etc. are also influenced the Indian capital market. In generally the investors do not observes the activities of FIIs before investing into the capital market but it is necessarily for investors to observe the FIIs investment to earn higher return from the capital market.

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