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Impact of FII on Indian Stock Market

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Abstract: A stock market or equity market is the aggregation of buyers and sellers (a loose network of economic transactions, not a physical facility or discrete entity) of stocks (shares); these are securities listed on a stock exchange as well as those only traded privately. A stock exchange is a place to trade stocks. Companies may want to get their stock listed on a stock exchange. Other stocks may be traded "over the counter", that is, through a dealer. Many developing countries, like India, restricted the flow of foreign capital till the early 1990s and depended on external aid and official development assistance. Later, most of the developing countries opened up their economies by dismantling capital controls with a view to attracting foreign capital, supplementing it with domestic capital to stimulate domestic growth and output. Since then, portfolio flows from foreign institutional investors (FII) have emerged as a major source of capital for emerging market economies (EMEs) such as Brazil, Russia, India, China and South Africa (BRICS). Since the beginning of liberalization (1991) Foreign Institutional Investors (FII's) have gained a significant role in Indian stock markets. Global investors now ardently seek India as their preferred location for investment. The dawn of 21st century has shown the real dynamism of stock market and the various benchmarking of sensitivity index (Sensex) in terms of its highest peaks and sudden falls. In this context present paper examines the contribution of foreign institutional investment in sensitivity index (Sensex). It also attempts to understand the behavioral pattern of FII 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. We attempted to explain the impact of foreign institutional investment on stock market and Indian economy

Keywords: BSE Sensex, Indian Economy, Foreign Institutional Investment, stock market, investment.

INTRODUCTION

The term Foreign Institutional Investor is defined by SEBI as under: "Means an institution established or incorporated outside India which proposes to make investment in India in securities. Provided that a domestic asset management company or domestic portfolio manager who manages funds raised or collected or brought from outside India for investment in India on behalf of a sub-account, shall be deemed to be a Foreign Institutional Investor. "Foreign Investment refers to investments made by residents of a country in financial assets and production process of another country. Entities covered by the term '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 etc. (fund having more than 20 investors with no single investor holding more than 10 per cent of the shares or units of the fund)" (GOI -2005). 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'. The term is used most commonly in India to refer to outside companies investing in the financial markets of India. International institutional investors must register with Securities & Exchange Board of India (SEBI) to participate in the market. One of the major market regulations pertaining to FII involves placing limits on FII ownership in Indian companies. They actually evaluate the shares and deposits in a portfolio.

OBJECTIVES

- 1.To study the behavioral pattern of FII in India during 2001 to 2013.
- 2.To study the trend of FII investment in n Indiaequity and debt market
- 3. To know the volatility of BSE Sensex due to FIIs.
- 4.To find out the relationship between the FIIs investment and stock market

WHY FIIs ARE REQUIRED?

FIIs contribute to the foreign exchange inflow as the funds from multilateral finance institutions and FDI (Foreign direct investment) are insufficient. Following

are the some advantages of FIIs.

- It lowers cost of capital, access to cheap global credit.
- It supplements domestic savings and investments.
- It leads to higher asset prices in the Indian market.
- And has also led to considerable amount of reforms in capital market and financial sector.

INVESTMENTS BY FIIs

There are generally two ways to invest for FIIs.

• **EQUITY INVESTMENT:** 100% investments could be in equity related instruments or up to 30% could be invested in debt instruments i.e.70 (EquityInstruments): 30 (Debt Instruments)

• **100% DEBT:** 100% investment has to be made in debt securities only.

EQUITY INVESTMENT ROUTE: In case of Equity route the FIIs can invest in the following Instruments:

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

100% DEBT ROUTE: In case of Debt Route the FIIs can invest in the following instruments:

- Debentures (Non-Convertible Debentures, Partly Convertible Debentures etc.)
- Bonds
- Dated government securities
- Treasury Bills
- Other Debt Market Instruments

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

HISTORY OF FIIs

India opened its stock market to foreign investors in September 1992, and in 1993, received portfolio investment from foreigners in the form of foreign institutional investment in equities. This has become one of the main channels of FII in India for foreigners. Initially, there were terms and conditions which restricted many FIIs to invest in India. But in the course of time, in order to attract more investors, SEBI has simplified many terms such as:-

- ❖ The ceiling for overall investment of FII was increased 24% of the paid up capital of Indian company.
- ❖ Allowed foreign individuals and hedge funds to directly register as FII.
- ❖ Investment in government securities was increased to US$5 billion.
- ❖ Simplified registration norms.

REGULATION RELATING TO FII OPERATION

- ❖ Investment by FIIs is regulated under SEBI (FII) Regulations, 1995 and Regulation 5(2) of FEMA Notification No.20 dated May 3, 2000. SEBI acts as the nodal point in the entire process of FII registration.
- ❖ FIIs are required to apply to SEBI in a common application form in duplicate. A copy of the application form is sent by SEBI to RBI along with their 'No Objection' so as to enable RBI to grant necessary permission under FEMA.
- ❖ RBI approval under FEMA enables a FII to buy/sell securities on stock exchanges and open foreign currency and Indian Rupee accounts with a designated bank branch.
- ❖ FIIs are required to allocate their investment between equity and debt instruments in the ratio of 70:30. However, it is also possible for an FII to declare it a 100% debt FII in which case it can make its entire investment in debt instruments.
- ❖ All FIIs and their sub-accounts taken together cannot acquire more than 24% of the paid up capital of an Indian Company. Indian Companies can raise the above mentioned 24% ceiling to the sectoral Cap / Statutory Ceiling as applicable by passing a resolution by its Board of Directors followed by passing a Special Resolution to that effect by its General Body. Further, in 2008 amendments were made to attract more foreign investors to register with SEBI, these amendments are:
- ❖ The definition of “broad based fund” under the regulations was substantially widened allowing several more sub accounts and FIIs to register with SEBI.
- ❖ Several new categories of registration viz. sovereign wealth funds, foreign individual, foreign corporate etc. were introduced,
- ❖ Registration once granted to foreign investors was made permanent without a need to apply for renewal from time to time thereby substantially reducing the administrative burden,
- ❖ Also the application fee for foreign investors applying for registration has recently been reduced by 50% for FIIs and sub accounts also, institutional investors including FIIs and their sub-accounts have

been allowed to undertake short-selling, lending and borrowing of Indian securities from February 1, 2008.

DISCUSSION

INFLUENCE OF FII ON INDIAN STOCK MARKET

Positive fundamentals combined with fast growing markets have made India an attractive destination for foreign institutional investors (FIIs). Portfolio investments brought in by FIIs have been the most dynamic source of capital to emerging markets in 1990s. At the same time there is unease over the volatility in foreign institutional investment flows and its impact on the Stock market and the Indian economy. Apart from the impact they create on the market, their holdings will influence firm performance. For instance, when foreign institutional investors reduced their holdings in Dr. Reddy's Lab by 7% to less than 18%, the company dropped from a high of around US$30 to the current level of below US$15. This 50% drop is apparently because of concerns about shrinking profit margins and financial performance. These instances made analysts to generally claim that foreign portfolio investment has a short term investment horizon. Growth is the only inclination for their investment. Some major impact of FII on stock market:

- They increased depth and breadth of the market.
- They played major role in expanding securities business.
- Their policy on focusing on fundamentals of share had caused efficient pricing of share.

These impacts made the Indian stock market more attractive to FII & also domestic investors. The impact of FII is so high that whenever FII tend to withdraw the money from market, the domestic investors fearful and they also withdraw from market.

FOREIGN INSTITUTIONAL INVESTMENT

Capital flows into emerging markets are influenced more by global than domestic forces. The global cues with the likes of the US Fed tapering maneuver the capital flows to a large extent. While the domestic macroeconomic policy actions have ensured resumption of capital flows into the country, specific measures undertaken by SEBI to smoothen the process of investment have been instrumental in encouraging the flows. With the economy on its road to recovery and investor optimism at a new high acting as enablers, the conditions seem encouraging for the flow of foreign capital. FII investments into India have grown remarkably since 2009-10. India received a total FII net investments of `51,649 crore during 2013-14 compared to `1,68,367 crore in 2012-13, showing a decline of 69.3 percent. In US dollar terms, the net investments amounted to USD 8,876 million in 2013-14. The combined gross purchases of debt and equity by FIIs increased by 12.8 percent to `10,21,010 crore in 2013-14 from `9,04,845 crore in 2012-13. The combined gross sales by FIIs increased by 31.6 percent to `9,69,361 crore from `7,36,481 crore during the same period in previous year. The cumulative net investment of FIIs in Indian markets amounted to USD 180,405 million as at the end of March 2014 compared to USD 171,529 million in 2012-13, registering an increase of 5.2 percent. An analysis of the FII net investments reveal that the majority is invested in equity. This has been the trend over the years except 2011-12. In 2013-14, the FII net investments into equity segment declined by 43.1 percent to `79,708 crore from `1,40,033 crore in 2012- 13. In the debt segment, the FII net investments was {`28,061} crore in 2013-14 as compared to `28,334 crore in 2012-13.

Table-1: Investments by Foreign Institutional Investors (Equity and Debt)(Rs. Crore)

Year /month	Net Investment By FIIs		
	Equity	Debt	Total
1	2	3	4
2008-09	-47706	1895	-45811
2009-10	110220	32438	142658
2010-11	110121	36317	146438
2011-12	43738	49988	93725
2012-13	140033	28334	168367
2013-14	79708	-28061	51649
13-Apr	5414	5334	10748
13-May	22169	5969	28138
13-Jun	-11027	-33135	-44162
13-Jul	-6086	-12038	-18124
13-Aug	-5923	-9773	-15695
13-Sep	13058	-5678	7380
13-Oct	15706	-13578	2128
13-Nov	8116	-5984	2133
13-Dec	16086	5290	21376
14-Jan	714	12609	13323
14-Feb	1401	11337	12741
14-Mar	20077	11586	31663

Similar to the previous year, the net FII investment was the highest in the last quarter of the financial year. The highest net investment was registered for the month of March 2014 (`31,663 crore) followed by May 2013 (`28,138 crore) and December 2013 (`21,376 crore). All these months were led by a dominant share of FII investment in equity markets viz., 63.4 percent, 78.8 percent and 75.3 percent respectively. In the debt segment too, net investments were the highest in the last quarter of 2013-14. Month wise trends of the net investments into the debt segment show that the investment was the highest in January 2014 (`12,609 core) followed by March 2014 (`11,586 crore), and February 2014 (`11,337 crore) SEBI (Foreign Portfolio Investors) Regulations, 2014 have been notified on January 07, 2014 to provide for an easier registration process and operating framework for the foreign entities. The new class of investors, FPIs, would encompass all FIIs, their sub-accounts and qualified foreign investors (QFIs). The total net investment of QFIs in equity and corporate debt, was `583 crore and `1,520 crore respectively in 2013-14. In USD million terms, this corresponds to USD 97 million and USD 253 million respectively

Table-2: Investment by Foreign Institutional Investors

Year	Gross Purchase (Rs. crore)	Gross Sales (Rs. crore)	Net Investment (Rs. crore)	Net Investment (USD mn.)	Cumulative investment (USD)mn
1	2	3	4	5	6
1992-93	18	4	13	4	4
1993-94	5,598	467	5,127	1,638	1,638
1994-95	7,631	2,835	4,796	1,528	3,167
1995-96	9,694	6,980	8,575	2,036	7,635
1997-98	15,554	6,980	8,575	2,432	7,635
1998-99	18,695	12,737	5,,958	1,650	9,285
1999-00	16,116	17,699	-1,584	-386	8,899
2001-02	56,857	46,735	10,122	2,474	11,373

2002-03	74,051	64,118	9,933	2,160	13,532
2003-04	50,071	41,308	8,763	1,839	15,372
2004-05	47,062	44,372	2,689	566	15,372
2005-06	1,44,855	99,091	45,764	10,005	25,943
2006-07	2,16,951	1,71,071	45,880	10,352	36,294
2007-08	3,46,976	3,05,509	41,467	9,363	45,657
2008-09	5,20,506	4,89,665	30,841	6,820	52,477
2009-10	9,48,018	8,81,839	66,179	16,442	68,919
2010-11	6,14,576	6,60,386	-45,811	-9,837	59,081
2011-12	8,46,438	7,03,780	1,42,658	30,251	89,333
2012-13	9,92,599	8,46,161	1,46,438	32,226	121,559
2013-14	9,21,285	7,36,481	1,68,367	18,923	140,482
2014-15	10,21,010	9,69,361	9,69,361	31,047	171,529

EFFECTS OF FIIs ON INDIAN ECONOMY

Let us study the positive and the negative side of this rise of investments by FIIs one by one.

POSITIVE IMPACT

It has been emphasized upon the fact that the stock market reforms like improve d market transparency, automation, dematerialization and regulations on reporting and disclosure standards were initiated because of the presence of the FIIs. But FII flows can be considered both as the cause an d the effect of the stock market reforms. The market reforms were initiated because of the presence of the m and this in turn has led to increased flows.

1. ENHANCED FLOWS OF EQUITY CAPITAL

FIIs are well known for a greater appetite for equity than debt in their asset structure. For example, pension funds in the United Kingdom and United States h d 68 per cent and 64 per cent, respectively, of their portfolios in equity in 1998. Not only it can help in supplementing the domestic savings for the purpose of development projects like building economic and social infrastructure but can also help in growth of rate of investment, it boosts the production, employment and income of the host country.

2. MANAGING UNCERTAINTY AND CONTROLLING RISK

FIIs promote financial innovation and development of hedging instruments. These because of their interest in hedging risks, are known to have contributed to the development of zero-coupon bonds and index futures. FIIs not only enhance competition in financial markets, but also improve the alignment of asset prices to fundamentals. FIIs in particular are known to have good information and low transaction costs. By aligning asset prices closer to fundamentals, they stabilize markets. In addition, a variety of FIIs with a variety of risk-return preferences also help in dampening volatility.

3. IMPROVING CAPITAL MARKETS

FIIs as professional bodies of asset managers and financial analysts enhance competition and efficiency of financial markets. By increasing the availability of riskier long term capital for projects, and increasing firms' incentives to supply more information about them, the FIIs can help in the process of economic development.

4. IMPROVED CORPORATE GOVERNANCE

Good corporate governance is essential to overcome the principal-agent problem between share-holders and management. Information asymmetries and incomplete contracts between share-holders and management are at the root of the agency costs. Bad corporate governance makes equity finance a costly option. With boards often captured by managers or passive, ensuring the rights of shareholders is a problem that needs to be addressed efficiently in any economy. Incentives for shareholders to monitor firms and enforce their legal rights are limited and individuals with small share-holdings often do not address the issue since others can free-ride on their endeavor. FIIs constitute professional bodies of asset managers and financial analysts, who, by contributing to better understanding of firms' operations, improve corporate governance.

NEGATIVE IMPACT

If we see the market trends of past few recent years it is quite evident that Indian equity markets have become slaves of FIIs inflow and are dancing to their tune. And this dependence has to a great extent caused a lot of trouble for the Indian economy. Some of the factors are:

1. **POTENTIAL CAPITAL OUTFLOWS**

"Hot money" refers to funds that are controlled by investors who actively seek short-term returns. These investors scan the market for short-term, high interest rate investment opportunities. "Hot money" can have economic and financial repercussions on countries and banks. When money is injected into a country, the exchange rate for the country gaining the money strengthens, while the exchange rate for the country losing the money weakens. If money is withdrawn on short notice, the banking institution will experience a shortage of funds.

2. **INFLATION**

Huge amounts of FII fund inflow into the country creates a lot of demand for rupee, and the RBI pumps the amount of Rupee in the market as a result of demand created. This situation leads to excess liquidity thereby leading to inflation where too much money chases too few goods.

3. **PROBLEM TO SMALL INVESTORS**

The FIIs profit from investing in emerging financial stock markets. If the cap on FII is high then they can bring in huge amounts of funds in the country's stock markets and thus have great influence on the way the stock markets behaves, going up or down. The FII buying pushes the stocks up and their selling shows the stock market the downward path. This creates problems for the small retail investor, whose fortunes get driven by the actions of the large FIIs.

4. ADVERSE IMPACT ON EXPORTS

FII flows leading to appreciation of the currency may lead to the exports industry becoming uncompetitive due to the appreciation of the rupee.

BSE SENSEX AND FII INVESTMENT CORRELATION

Sensex is the commonly used name for the Bombay Stock Exchange Sensitive Index – an index Composed of 30 of the largest and most actively traded stocks on the Bombay Stock Exchange (BSE). The term FII is used most commonly in India to refer to outside companies investing in the financial markets of India. FII investment is frequently referred to as hot money for the reason that it can leave the country at the same speed at which it comes in. In country like India; statutory agencies like SEBI have prescribed norms to register FIIs and also to regulate such investments flowing in through FIIs.

Table-3: RELATIONSHIP BSE SENSEX VALUE AND NET INVESTMENT OF FII (IN INR CRORES)

Year	**Sensex Value (Closing Value of the year**	**Net FII Investment (Equity+ Debt)**
2001	3262	12498.8
2002	3373	3677.9
2003	5839	35153.8
2004	6603	42049.1
2005	9398	41663.5
2006	13787	40589.2
2007	20287	80914.8
2008	9647	-41215.5
2009	17465	87987.6
2010	20509	179674.6
2011	15455	39352.8
2012	19426	163350.1
2013	21170	62288

CONCLUSION

On the basis of above discussion and data analysis, it is clear that the FIIs are influencing the Sensex movement to a greater extent. Further it is evident that the Sensex has increased when there are positive inflows of FIIs and there were decrease in Sensex when there were negative FII inflows.

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