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IMPACT OF FOREIGN INSTITUTIONAL INVESTORS (FIIs) ON INDIAN CAPITAL MARKET

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ABSTRACT

Since Indian capital market is vast and attract investors as their investment destination. The Indian market is steadily growing and had allured domestic investors community and foreign investors group in the past. The major part of investment in Indian capital market is attributed to institutional investors among whom foreign institutional investors (FIIs) are of primary importance. One eminent concern in the matter is whether these foreign institutional investors (FIIs) regulate the Indian capital market. This paper examines whether market movement can be explained by these investors and their impact on the capital markets. FIIs, because of their short-term nature, can have bidirectional causation with the returns of other domestic financial markets such as money markets, stock markets, and foreign exchange markets. Hence, the understanding of determinants of FII is very important for any emerging economy as FII exerts a larger impact on the domestic financial markets in the short run and a real impact in the long run. The present paper is an attempt to find out determinants of foreign institutional investment in India, a country that opened its economy to foreign capital due to their foreign exchange crisis. The objective of the study is to find out whether there exist relationship between FII and Indian capital market

KEYWORDS: FII, Indian Capital Market, Correlation and Regression, Trends of FII in India

INTRODUCTION

Foreign Institutional Investors (FII) means an institution established or incorporated outside India which proposes to make investment in securities in India. They are registered as FIIs in accordance with Section 2 (f) of the SEBI (FII) Regulations 1995. FIIs are allowed to subscribe to new securities or trade in already issued securities. In the Union Budget 2013-14, announced on 28 February 2013, vide Para 95, Honorable FM announced his intention to go by the internationally accepted definition for FIIs and FDIs, as follows In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), it is proposed to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI. A committee will be constituted to examine the application of the principle and to work out the details expeditiously.

INDIAN CAPITAL MARKET

A capital market is a market where both government and companies raise long-term funds to trade securities on the bond and the stock market. It consists of both the primary market where new issues are distributed among investors, and the secondary markets where already existent securities are traded. In the capital market, mortgages, bonds, equities and other such investment funds are traded. The capital market also facilitates the procedure whereby investors with excess funds can channel them to investors in deficit. The capital market provides both overnight and long-term funds and uses financial instruments with long maturity periods. The capital market acts as brake on channeling saving to low yielding enterprises and impels enterprises to focus on performance. It continuously monitors the performance through movement of share prices in the market and the threats of takeover. This improves efficiency of resource utilization and there by increases the return on investment. As a result, savers and investors are not constrained by their individual abilities, but facilitate by the economies capability to invest and save, which inevitably enhances savings and investment in the economy.

REGULATORY FRAMEWORK FOR FII

The following entities, established or incorporated abroad, are eligible to be registered as FIIs:

- Pension Funds.
- Mutual Funds.
- Investment Trusts.
- Asset Management Companies.
- Nominee Companies.
- Banks.
- Institutional Portfolio Managers.
- Trustees.
- Power of Attorney holders.
- University funds, endowments, foundations or charitable trusts or charitable societies.

Besides the above, a domestic portfolio manager or domestic asset management company is also eligible to be registered as an FII to manage the funds of sub-accounts. The FIIs can also invest on behalf of sub-accounts. The following entities are entitled to be registered as sub-accounts:

- An institution or fund or portfolio established or incorporated outside India.
- A foreign corporate or a foreign individual.

The general permission from the RBI will enable the FIIS to:

- Open foreign currency account(s) in a designated bank (there can be more than one account in the same bank branch, in different currencies, if so required by the FII for its operational purpose).
- Open a special non-resident rupee account in which all receipts from the capital inflows, sale proceeds of shares, dividends and interest credited.
- Transfer sums from the foreign currency accounts to the rupee accounts and vice-versa, at the market rates of exchange.

- Make investment in securities in India out of the balances in the rupee accounts.
- Transfer repatriable (after tax) proceeds from the rupee account to the foreign currency accounts.
- Repatriate the capital, capital gains, dividends, income received by the way of interest and any compensation received towards sale/renouncement of rights offering of shares subject to the designated branch of a bank/custodian being authorized to deduct withholding tax on capital gains and arranging to pay such tax and remitting the net proceeds at market rates of exchange.
- Register FII is holding without any further clearance under FERA.
- There would be no restrictions on the volume of investment-minimum or maximum for the purpose of entry FIIs in the primary/secondary markets and on the lock in period described for the purpose of such investments made by FIIs. However, portfolio investment in primary and secondary markets will be subjected to ceiling of 24% of issued share capital for the total holding of all registered FIIs in any one company. Conversions, out of the fully and partly convertible debentures issued by the company will also be taken into account for the purpose. The holding of a single FII in any company would be subject to a ceiling of 5% of total issued share capital for which purpose, holding of an FII group will be counted as holdings of a single FII.
- The maximum holding of 24% for all non-residential portfolio investments, including those of the registered. FIIs will also include NRI corporate and non-corporate investments, but will not include; direct foreign investment (which are permitted up to 51% or 74% or even full in all priority sector) and investments by FIIs through the following alternatives offshore single/regional funds, global depository receipts and euro convertibles.
- Disinvestment will be allowed only through stock exchanges in India including OTCEI. SEBI may permit sales other than through stock exchanges, provided the sale prices are not significantly different from the stock market quotations, where available.
- All secondary market operations would be only through the recognized intermediaries on the Indian stock exchange including OTCEI. FIIs would not be expected to take delivery of purchased and give delivery of sold securities.
- FIIs can appoint a custodian, an agency approved by SEBI, as a custodian of securities and for confirmation of transaction in securities, settlement of purchase and sale and for information reporting such a custodian shall establish separate accounts for detailing on a daily basis the investment capital utilization and securities held by each FII for which it is acting as custodian will report to the RBI and SEBI semi-annually, as part of their disclosure and reporting guidelines.
- RBI may at any time request by an order, a registered FII to submit information regarding records of the utilization of the inward remittances of investment capital and the statement of its securities transactions. RBI and or SEBI may also any time conduct a direct inspection of the records and accounting books of a registered FII.
- FIIs investing under this scheme will benefit from a concessional tax regime of a flat tax rate of 20% on dividend and interest income and a tax rate of 10% on long-term (one or more year) capital gains.

REVIEW OF LITERATURE

Shrikanth, M. and Kishore B. (2012)[1], in their paper investigated a cause and effect relationship between FII and Indian capital market. They observed that FIIs carried the institutional flavor in terms of market expertise and fund management by way of pooling small savings from retail investors. The main objective of FIIs is maximizing returns and minimizing risk while keeping liquidity of the investments intact. They concluded that net FII inflows had a positive impact on the Indian stock market and foreign exchange reserves.

Loomba, J. (2012)[2], attempted to testify the behavior of FII trading and its effect on Indian stock market. He observed that in the course of capital market liberalization, foreign capital has become increasingly significant source of finance and institutional investors are growing their influence in developing markets. He concluded that the Indian stock markets have come in age where there were significant developments in the last 15 years make the markets at par with the developed markets.

Bohra, N. Singh and Dutt, Akash. (2011)[3], studied the behavioral pattern of FII in India and figure out the reasons for indifferent responses of BSE Sensex due to FII inflows. They found the correlation between FII investment and turnover of different individual groups at BSE sensex. They concluded that there is a positive correlation between FII investment and stock market but in year 2005 and 2008, it was also observed that positive or negative movement of FII's investment leads to a major shift in the sentiments of domestic or related investors in market.

Shukla, K. Rajeev et al (2011)[4], investigated the impact of foreign institutional investors on Indian stock indices. He revealed that India, after United States hosts the largest number of listed companies and Global investors now enthusiastically seek India as their preferred destination for investment. Many Indians working in foreign countries now divert their savings to stocks. They concluded that FIIs have significant impact on the share prices of the Midcap & Small-cap companies but small and a periodic shift in their behavior leads to market volatility.

Kaur, Manjinder and Dhillon, S. Sharanjit (2010)[5], focused on the determinants of Foreign Institutional investment in India. Market capitalization and stock market turnover of India have significant positive influence only in short-run but Stock market risk has negative influence on FIIs inflows to India. Among macroeconomic determinants, economic growth of India has positive impact on FIIs investment in both long run and short run but all other macroeconomic factors have significant influence only in long run like inflation.

They concluded that host country stock market returns (returns on Sensex) have positive and significant impact whereas home country returns (returns on S&P 500 Index) have negative but insignificant influence on FIIs investment inflows in long-run as well as in short-run.

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1 Shrikanth, Maram and Kishore Braj (2012) 'Net FII Flows into India: A Cause and Effect Study' *ASCI Journal of management*, Vol. 41 (2), pp. 107-12.

2 Loomba, Jatinder. (2012) 'Do FIIs Impact Volatility of Indian Stock Market?' *International Journal of Marketing, Financial Services & Management Research* Vol.1 Issue 7.

3 Bohra, N. Singh and Dutt, Akash.(2011) 'Foreign Institutional Investment in Indian Capital Market: A Study of Last One Decade' *International Research Journal of Finance and Economics*, Retrieved 24 Jan. 2012<http://www.eurojournals.com/finance.htm>

4 Shukla, K. Rajeev et al (2011) 'FII Equity Investment and Indian Capital Market: - An Empirical Investigation.' *Pacific business review international*.

5 Kaur, Manjinder. & Dhillon, S.Sharanjit (2010) 'Determinants of Foreign Institutional Investor's Investment in India' *Eurasian Journal of Business and Economics* 2010, 3 (6), 57-70.

Saha, Malayendu. (2009)[6], investigated the participation of foreign institutional investors and the other financial institutions in India and the performance of the Indian stock markets and she concluded that Indian stock market is regarded at par with the developed markets Moreover, it had a very unique economic model and is based on strong economic growth with huge liquidity and it is not depended on the US economy for its GDP growth.

Singh, Sumanjeet. (2009)[7], revealed that the size of net capital inflows to India increased from US $ 7.1 billion in 1990-91 to US $ 108.0 billion in 2007-08. India has one of the highest net capital inflows among the EMEs of Asia. Capital inflows, however, not an unmitigated blessing, the main danger posed by large and volatile capital inflows is that they may destabilize macroeconomic management. He concluded that the intensified pressures due to large and volatile capital flows in India in the recent period in an atmosphere of global uncertainties

Sethi, Narayan and Sucharita, Sanhita. (2009)[8], attempted to explain the effects of private foreign capital inflows (FINV) on some macroeconomic variables in India using the time series data between April 1995 to Dec 2007. They found that Foreign Direct Investment (FDI) is positively affecting the economic growth, while Foreign Institutional Investment (FII) is negatively affecting the economic growth.

Prasanna, P.K. (2008)[9], discussed role of FII in Indian Capital market and examined the contribution of foreign institutional investment particularly among companies included in sensitivity index (Sensex) of Bombay Stock Exchange. She found that Higher Sensex indices and high price earnings ratio are the country level factors attracting more foreign investment in India and the foreign investment is more in the companies with higher volume of publically held shares. The promoter's holdings and the foreign investments are inversely related.

Chittedi, Krishna Reddy. (2008)[10], analyzed a performance of the sensex Vs FIIs in the Indian stock market. She revealed that the liquidity as well as the volatility were highly influenced by FII inflows in BSE sensex so the Foreign institutional investment is the significant factor for determining the liquidity and volatility in the stock market prices. She concluded that the FIIs who have been so bullish in India for the last so many years might start looking at other cheaper emerging markets for better returns. So, it is very tough to predict that whether the sensex will sustain the momentum in future or not.

Sethi, Narayan. (2008)[11], evaluated the impact of international capital flow on economic growth, trends and composition and suggested the policy implication thereof. He observed that the foreign institutional investors (FIIs) have negative impact on growth, but it is very negligible. He concluded that India should move to influence both the size and composition of capital flows, strengthened their banking system rather than promoting financial market, banks can provide the surest vehicle for promoting long term growth and industrialization.

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6 Saha, Malayendu. (2009) 'Stock Market in India and Foreign Institutional Investments: An Appraisal' *Journal of Business and Economic Issues*, Vol.1 No.1.

7 Singh, Sumanjeet. (2009) 'Foreign capital flows into India: Compositions, regulations, issues and policy options' *Journal of Economics and International Finance* Vol. 1(1), pp. 014-029.

8 Sethi, Narayan. & Sucharita, Sanhita.(2009) ' Impact of Private Foreign Capital Inflows On Economic Growth In India: An Empirical Analysis' *Singapore Economic Review Conference* (SERC) 2009, Singapore Economic Review and National University Singapore, Swissotel-The Stamford, Singapore, held from 6th-8th August, 2009.

9 Prasanna, P.K. (2008) 'Foreign Institutional Investor: Investment preference in India' JOAAG, Vol. 3, No. 2, pp 40-51.

10 Chittedi Krishna Reddy (2008) 'Volatility of Indian Stock Market and FIIs' *The Indian Economy Review*, Vol.5, No. 31.

11 Sethi Narayan (2008). Op.cit pp.560-580.

Poshakwale, Sunil and Thapa, Chandra. (2007)[12], compared the influence of foreign institutional investments in the long and short run on Indian equity market with the main developed equity markets of the US and the UK by Using daily return series and portfolio investments made by foreign institutional investors. They found that Indian stock returns are significantly influenced by the short and long term innovations in the US and UK stock market.

Dhamija, Nidhi. (2007)[13], described 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. She suggested that as the pace of foreign investment began to accelerate, regulatory policies have changed to keep up with changed domestic scenarios.

Singh, Manmohan. (2007)[14], attempted to explain the use of participatory notes (PNs) by foreign investors, as a conduit of portfolio flows into Indian capital markets for more than a decade. The broadening of India's foreign investor base, in recent years, has a bias towards hedge funds/unregistered foreign investors who invest primarily via participatory notes (PNs).

Foreign institutional investors (FIIs) are keenly interested in the Indian equity market and have been overweight the MSCI index since 2003, while market capitalization of the large Indian stock exchanges is presently about 100 percent of GDP (around $1.3 trillion) and tax arbitrage via capital gains tax has almost disappeared since July 2004.

SCOPE OF THE STUDY

Since economic liberalization FII flows to India have steadily grown its importance. Foreign capital inflows have been acknowledged as one of the important sources of funds for developing economies that would grow at a rate higher than what domestic savings can support. This resulted in the integration of global financial markets. As a result, capital started flowing freely across national borders seeking out the highest rate of return.

India is considered as one of the best investment destination for foreign institutional investors in spite of political differences and lack of infrastructure facility etc. Since Indian market have vast potential, so it alluring and encouraging foreign investors continuously but on January 21 2008, BSE Sensex saw the largest ever fall in record, BSE shack by 2000 points intra-day due to global economic meltdown (Subprime lending crises in US). This made everyone very cautious whether the FII positions have kept Indian capital market in such a miserable condition.

Foreign portfolio inflows through FIIs, in India, are important from the policy perspective, especially when the country has emerged as one of the most attractive investment destinations in Asia. The present study focuses on FII investment pattern in the Indian capital market. It examines the factors expected to affect the investment decisions of FIIs. The Foreign Institutional Investors (FIIs) have emerged as important players in the Indian equity market in the recent past. This paper makes an attempt to understand whether there exists a relationship between FII and Equity Market.

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12 Poshakwale, Sunil. & Thapa,Chandra.(2007). 'Impact of foreign Portfolio investments on market investment market co movements: Evidence from the Emerging Indian stock market.' presented in the *Emerging Market Group ESRC Seminar on International Equity Markets Comovements and Contagion* 11 May 2007 Cass Business School, London.

13 Dhamija, Nidhi. (2007). 'Foreign Institutional Investment in India' *Research on Indian Stock Volatilty*. Vol. 14, Publisher: Emerald Group Publishing Limited.

14 Singh, Manmohan. (2007). 'Use of Participatory Notes in Indian Equity Markets and Recent Regulatory Changes' IMF Working paper, *Monetary and Capital Markets Department*, WP/07/291.

OBJECTIVE OF THE STUDY

- To find out the impact of FII on Indian capital market.
- To determine the behavior and trend of FII's on Indian stock market.
- To determine the factors that influence investment decision of FII's.
- To examine whether FIIs have any influence on BSE Sensex and CNX Nifty.

RESEARCH METHODOLOGY

The paper examines The Impact of Foreign Institutional Investors (FII) on Indian capital market. The scope of the research comprises of information derived from secondary data from Sensex, Nifty and FII investment was a natural choice for inclusion in the study, as it is the most popular market indicies and widely used by market participants for benchmarking. The study period covered under this is for the years 2000-2011. The main source of obtaining necessary data for the study was Secondary Data.

This study is empirical in nature and hence secondary data is used to conduct the research. The secondary data constitutes of daily net FII inflows and the daily SENSEX and NIFTY from BSE and NSE websites respectively. Findings are included which transmits the important points, which were gathered from the study. Regression and correlation techniques have been used for analysis purpose. The sample data consists of 2931 observations for FII, BSE Sensex and S&P CNX Nifty starting from Jan 2000 to December 2011.

HYPOTHESIS OF THE STUDY

Null Hypothesis (Ho): There is no significant impact of Foreign institutional investors (FIIs) on Indian Capital market Alternative Hypothesis (Ha): There is significant impact of Foreign institutional investors (FIIs) on Indian Capital market.

LIMITATION OF THE STUDY

Since the subject is very vast the study is mainly focused on identifying whether there exist a relationship between FIIs and Indian capital market. It is mainly based on the data available in various websites. The impact made on purely from the past eleven year's performance.

FIIs Trends in India

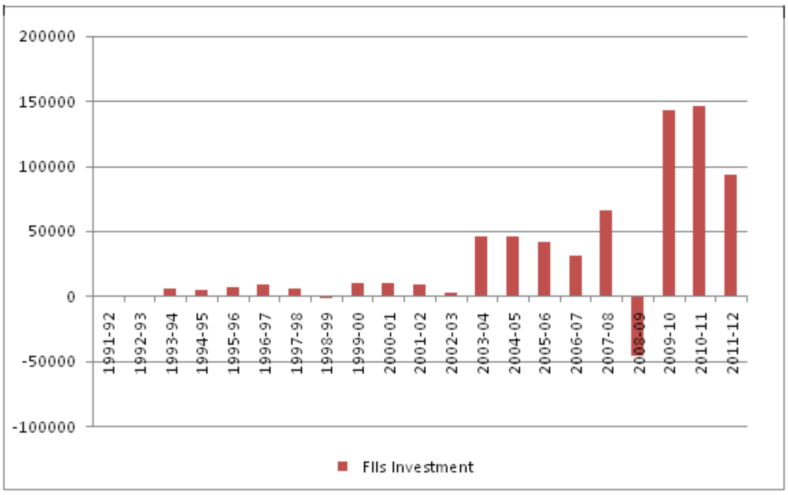
Table 1: FII Investment in Indian Capital Market (Rs in Crore)

Year	FIIs Investment	Change in FIIs Investment	% Change
1991-92	0		
1992-93	13		
1993-94	5126	5113	
1994-95	4796	-330	-6.43777
1995-96	6942	2146	44.74562
1996-97	8575	1633	23.52348
1997-98	5998	-2577	-30.0525
1998-99	-1584	-7582	-126.409
1999-00	10122	11706	-739.015

Table 1: Contd.,

2000-01	9933	-189	-1.86722
2001-02	8763	-1170	-11.7789
2002-03	2689	-6074	-69.3142
2003-04	45764	43075	1601.897
2004-05	45880	116	0.253474
2005-06	41467	-4413	-9.61857
2006-07	30841	-10626	-25.6252
2007-08	66179	35338	114.5812
2008-09	-45811	-111990	-169.223
2009-10	142658	188469	-411.406
2010-11	146438	3780	2.649694
2011-12	93725	-52713	-35.9968

Source: Various Issues of SEBI Handbook



Source: Table 1

Figure 1: Year Wise FIIs Investment

FIIs were allowed to invest in capital market securities since September 1992. However, these have invested from January, 1993 only. The net inflow has risen from Rs. 5126 crores in 1993-94 to Rs.146438 crores in 2010-11 with relative ups and downs during the period as per the above table. During the period of 19 years there has been increase in eight years while decline in the rest years It may be concluded that there are significant variations in the yearly inflow of FIIs into the Indian capital market during 1993-94 to 2011-12. During the initial year 1992-93, the FII flows started in September 1992, which amounted to Rs. 13 crores because at this moment government was framing policy guidelines for FIIs. However, within a year, the FIIs rose to 5126 i.e. 99.76% of 1992-93 during 1993-94 because government had opened door for investment in India. Thereafter, the FII inflows witnessed a dip of 6.44%. However, the year 1995-1996 witnessed a turnaround, gliding up the contribution by FII to enormous amount of Rs. 6942 crores. Investments made by FIIs during 1996-1997 rose a little i.e. 23.52% of that of the preceding year.

This period was ripe enough for FII Investments as that time the Indian economy posted strong fundamentals, stable exchange rate expectations and offered investment incentives and congenial climate for investment of these funds in India. During 1997-98, FII inflows posted a fall of 30.05 %. This slack in investments by FIIs was primarily because of the S-East Asian Crisis and the months of volatility experienced during November 1997 and February 1998. The net investment flows by FIIs have always been positive from the year of their entry. However, only in the year1998-99, an outflow nearly of Rs. 17699 crores was witnessed for the first time. This was primarily due to the economic sanctions imposed on India by Japan, US and other industrialized economies. These economic sanctions were the result of the testing of series of nuclear bombs by India in May 1998. FII investment posted a year-on-year decline of 1.86 % in 2000-01, 11.78 % in 2001-02 and 69.31 % in 2002-03. Investments by FII posted a fall of 80 % in 2002-03 as compared with investments in the period of 1999-00. Investments by FIIs rebounded from depressed levels from the year 2003-04 and witnessed an unprecedented surge. FIIs flows were recycled to India following readjustment of global portfolios of institutional investors, triggered by robust growth in Indian economy and attractive valuations in the Indian equity market as compared with other emerging market economies in Asia.

The slowdown in 2004-05 was on account of global uncertainties caused by hardening of crude oil prices and the upturn in the interest rate cycle. The resumption in the net FII inflows to India from August 2004 continued till end 2004-05. The inflows of FIIs during the year 2004-05 was Rs. 45881 crore. During 2006-07 the foreign institutional investors continued to invest large funds in Indian securities market. Strong FII flows had been a key characteristic of the period prior to December 2007. However, 2008-09 saw the highest FII outflow in any financial year since inception. This could be attributed to the global financial meltdown and the home bias of FIIs in the crisis. The gross purchases of debt and equity by FIIs declined by 35.2 per cent to Rs.6, 14, 576 crore in 2008-09 from Rs. 9, 48, 018 crore in 2007-08. The combined gross sales by FIIs also declined by 25.1 per cent to Rs.6, 60, 386 crore from Rs.8, 81, 839 crore during the same period. The total net outflow of FII was Rs.45, 811 crore in 2008-09 as against a net inflow of Rs.66, 179 crore in 2007-08. This was the highest net outflow for any financial year so far. FIIs made a record investment in the Indian equity market in 2009, surpassing the 2007 inflows.

The total net inflow of FII was Rs.1, 42, 658 crore as against an outflow of FII was Rs.45, 811 crore in 2008-09. This was the highest net inflow for any financial year so far. FIIs made a record investment in the Indian equity market in 2010-11, surpassing the 2009-10 inflows. The total net investment of FII was Rs 1, 46, 438 crore as compared to of Rs.1, 42, 658 crore in 2009-10. This was the highest net FII investments into Indian securities market in any financial year so far. Cumulative investment by FIIs at acquisition cost, which was US$ 89,335 million at the end of March, 2010, increased to US$ 1, 21, 561 million at the end of March, 2011. The total net inflow of FII was ` 93,725 crore in 2011-12 compared to 1, 46, 438 crore in 2010-11 decreased by 36%. The cumulative investment by FIIs at acquisition cost, which was USD 121.6 billion at the end of March 2011, increased to USD 140.5 billion at the end of March 2012.

No. of registered foreign institutional investors increases from the year to year when they are allowed to invest in Indian capital market Year wise registration of FIIs is given by the following table 2.

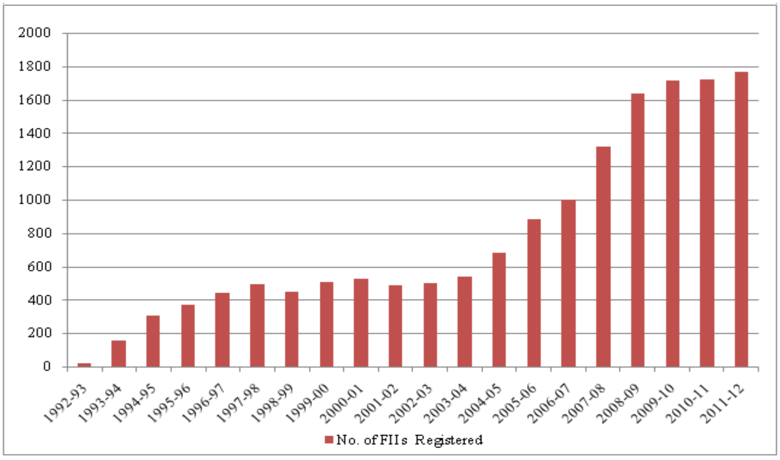
Table 2: Year Wise Registration of FIIs Registered with SEBI

Year	No. of FIIs Registered	Trend %
1990-91		
1992-93	18	
1993-94	158	777.77
1994-95	308	94.93
1995-96	367	19.15
1996-97	439	19.61
1997-98	496	12.98
1998-99	450	-9.27

Table 2: Contd.,

1999-00	506	12.44
2000-01	527	4.15
2001-02	490	-7.02
2002-03	502	2.44
2003-04	540	7.56
2004-05	685	26.85
2005-06	882	28.75
2006-07	997	13.03
2007-08	1319	32.29
2008-09	1635	23.95
2009-10	1713	4.77
2010-11	1722	0.52
2011-12	1765	2.49

Source: Compiled from Various Issues of SEBI Handbook



Source: Table 2

Figure 2: No. of FIIs Registered

From the table and figure 2 it is revealed that India is the important destination for foreign investment therefore the number of FIIs is going on increasing year to year. The number of FIIs in 1992-93 was only 18 which are increased to 1765 in 2011-12; maximum number of FIIs registered 322 in 2007-08 subsequently 316 in 2008-09. No. of FIIs registration was decreased in 1998-99 due to Asian financial crises in 1997 and subsequently in 2001-02 due to early 2000s recession in USA. Major increase in the trend of registration of FIIs in 1993-94 and 1993-94 i.e. 777.77 % and 94.93 %.

Country wise domination of FIIs registered with SEBI in Indian Capital market is as follows:-

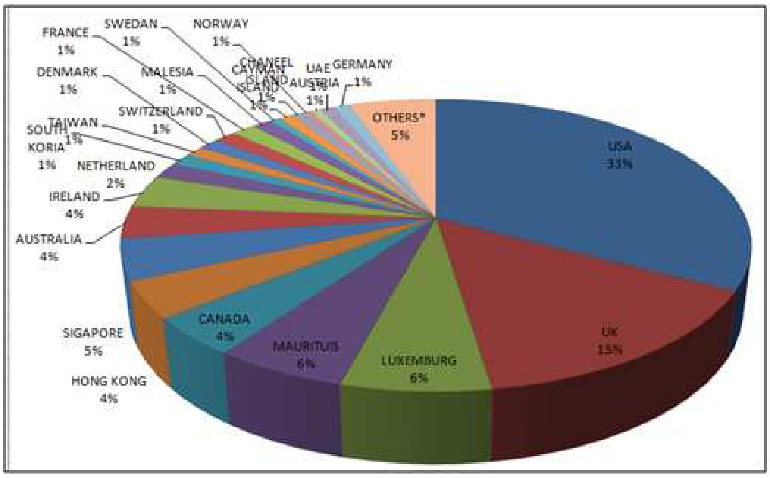
Table 3: Country Wise Domination of FIIs Registered with SEBI

Name of the Country	No. of FIIs
USA	576
UK	259
Luxemburg	113
Mauritius	101
Canada	75
Hong Kong	71
Singapore	80
Australia	63
Ireland	63

Table 3: Contd.,

Netherland	32
South Korea	23
Taiwan	21
Denmark	21
Switzerland	24
France	26
Malaysia	20
Sweden	11
Cayman Island	16
Channel Island	11
Norway	10
Austria	11
UAE	15
Germany	17
Others*	94
Total	**1753**

Source: Compiled from FII Index (sebi.org.in)



Source: Table 3

Figure 3: No. of FIIs

From the above mentioned table and Pie - chart 3 it is revealed that number of FIIs from USA is about 33% therefore any economic destabilization in USA causes heavy turmoil in Indian Stock Market. After USA numbers of FIIs are from Europe is about 27% (U.K., Luxemburg, Ireland and Netherland) which also causes the volatility in the Indian stock market and after Europe numbers of FIIs from Asia is about 15% (Mauritius, Hong Kong and Singapore) also causes the volatility in the Indian stock market.

DETERMINANTS OF FII FLOW IN INDIA

- **Risk:** Whenever risk in home market increases, the foreign investors would start to pull out their money to their home country thereby creating a deficiency of funds in domestic market, so to attract the foreign investment domestic interest rate would increase thereby to ensure that the above equality is restored.
- **Inflation:** At the time of high inflation, the real return on fixed income securities like bonds and fixed deposits declines. Thus a bond which gives say around 8.5% interest rate actually gives a real return of just 1% if the inflation is 7.5%. If the inflation increases further, the real return would decline more.

- **Interest Rates:** For the business, cost of borrowing rises this has a negative result on their profit margins. As a result they might even delay any investment activity which may be funded by borrowing to some later period when the interest rates are lower so as to reduce their investment costs. Over the past year RBI has increased the repo rate reverse repo rate, CRR and SLR. This has led to an increase in the Prime Lending Rate (PLR) and hence the general interest rate in the economy.

- **Good News /Bad News:** If say there is some bad news in the nation, which affects that is decreases the asset price, which in turn decreases the return and hence FII would withdraw from the market. However on the other hand, if there is good news, asset prices would increase; thereby increasing return and hence FII would be attracted. But the sensitivity with which investors withdraw is greater than with which they invest i.e. they would be more cautious while investing than at the time of withdrawing. This is primarily due to their basic nature of being risk averser, thus they would react more vigorously to bad news than to good news.

- **GDP of India:** Both have more or less direct relationship. The reason is change in capital account. When interest rates were high India was attracting lot of investments so the credit balance was high for that period. It kept on increasing form 2003-04 to 2007-08 and interest rates also kept on increasing from 2003-04 to 2007-08. Besides there are various other factors like rules and regulation, taxation, govt. policies etc.

Impact of FII on Economic Indicators in India-FII flow affects the economy of country

- **Balance of Payment:** A net positive swing in invisibles (due to increase in software exports and remittances sent by Indians working abroad) and increase in investments (both FDI and FII), has been improving the Balance of Payment (BOP) of the Indian economy and increasing the demand of rupee in the international currency market. In view of this the RBI had been following a policy of buying dollars (by selling rupee) in the international market, thereby avoiding an appreciation of rupee viz-a-viz the dollar.

- **Currency Fluctuation:** FIIs convert Dollars to Rupees to invest in Indian Markets- FII money comes in India at high Dollar rates. FII money would go out when Dollar dips to low values. Thereby the new nomenclature for this FII dollars let be SMART MONEY which finds more money. We'll now see some major points on Sensex from 2003 with peaks of dollar as that could trigger money push into India ideally-

Jan -May 2003 - USD/INR roughly 47-48. Sensex moved from 3000 to 6000 and dollar dipped till 43 by May. Market corrected to 4200 after that.

July - Sept 2005 - USD/INR 46 Sensex again moved from 5k to 12k and dollar dipped to 44- 43.5. Market corrected to 8800 after that.

July - Sept 2006 - USD /INR 46 -47 Sensex moved from 9k to 21k and dollar dipped to 39. Market corrected to 13k. Maybe this is confusing but from the data it seems FII dollars starts entering into India when Dollar is quoting at a price of 45-47 or tops out and this money creates the next Bull Run.

The withdrawal by the FIIs lead to a sharp depreciation of the rupee Between January 1 and October 16, 2008, the RBI reference rate for the rupee fell by nearly 25 per cent, in relative to dollar, from Rs 39.20 to the dollar to Rs 48.86. This was despite the sale of dollars by the RBI, which was reflected in a decline of $25.8 billion in its foreign currency assets between the end of March 2008 and October 3, 2008. The result has been observed sharp

Depreciation of the rupee. While this depreciation may be good for India's exports that are adversely affected by the slowdown in global markets, it is not so good for those who have accumulated foreign exchange payment commitments. Nor does it assist the Government's effort to rein in inflation.

- **Stock Market:** Mathematicians and Statisticians use a measure known as the correlation coefficient, which is used to depict a relationship between two variables mathematically. This coefficient ranges from minus 1 to plus 1. So, if we consider two variables, and the coefficient is -1, it means that when one moves up, the other moves down in the same proportion. When it is 1, it means when one moves up or down, the other also moves in the same manner, and when it is zero, it means there is no correlation. So when one moves up (or down), there's no way to figure out how the other variable will behave. So basically, one can compute the correlation coefficient between the Sensex and FII flows.

DATA ANALYSIS AND INTERPRETATION

- **BSE Sensex and FIIs**

In running the regression analysis, daily BSE Sensex has been taken as the dependent variable and the daily FII investment is considered as the independent variable. To test the above-mentioned hypothesis, linear regression model fitted with the econometric technique of ordinary least square (OLS) has been done. Regression equation looking at relationship between BSE Sensex and FII flows is as follows:

Y(BSE Sensex) = $\alpha + \beta$ (FII) + €

Y (BSE Sensex) is dependent variable, FII investment is independent variable, α is the intercept and € is white-noice (Random shock)

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.138[a]	.019	.019	5775.387	.019	57.135	1	2923	.000

[a] **Predictors:** (Constant), FII

Table 5: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	9688.501	109.117		88.790	.000
	FII	1.197	.158	.138	7.559	.000

[a] **Dependent Variable:** BSE

Interpretation

From the above table, it is found that the correlation between Daily net FII investment and Daily BSE Sensex is 0.138 which shows a very low degree of relationship between Daily FII investment and Daily BSE Sensex. The positive correlation between the two reveals the fact that the daily FII investment is an important factor in enhancing the Daily BSE Sensex of Bombay stock exchange consequently have a positive impact on Indian capital market. But the extent of the enhancement in BSE Sensex by FII flows can be examined by running the regression analysis. It can be observed from the above table that all explanatory variables, taken together establish a relationship nearly 1.9 % because the coefficient of determination r^2 is 0.019 of the total variables in the daily BSE Sensex of Bombay stock exchange.

This means that whatever changes have taken place, in the daily BSE Sensex, the FII investments is responsible up to 1.9 % only. This implies that there are many other macro economic factors have indirectly affected the daily BSE Sensex of Bombay stock exchange. The regression equation Y (BSE Sensex) = α + β (FII) + € shows that for every unit change in β (that is FII) there is 1.197 unit change in Y (that is BSE Sensex). The value of α (Alpha) is 9688.501 which show that the other factors are more responsible for this relationship. The t value is 7.559 and significant value is 0.000 which is less than 0.05, therefore the alternative hypothesis is accepted and null hypothesis is rejected. So we can say that there is significant impact of foreign institutional investment (FII) on BSE Sensex.

- **CNX Nifty and FIIs**

In running the regression analysis, daily CNX Nifty has been taken as the dependent variable and the daily FII investment is considered as the independent variable. To test the above-mentioned hypothesis, linear regression model fitted with the econometric technique of ordinary least square (OLS) has been done. Regression equation looking at relationship between CNX Nifty of NSE and FII flows is as follows:

Y(CNX Nifty) = α + β (FII) + €

Y (CNX Nifty) is dependent variable, FII investment is independent variable, α is the intercept and € is white-noice (Random shock)

Table 6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.139[a]	.019	.019	1690.319	.019	57.673	1	2923	.000

a. **Predictors:** (Constant), FII

Table 7: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2927.416	31.936		91.665	.000
	FII	.352	.046	.139	7.594	.000

a. **Dependent Variable:** NSE

Interpretation

From the above table, it is found that the correlation between daily FII investment and daily CNX Nifty is 0.139 which shows a very low degree of relationship between daily FII investment and daily CNX Nifty. The positive correlation between the two reveals the fact that the daily FII investment is an important factor in enhancing the daily CNX Nifty of National stock exchange consequently have a positive impact on Indian capital market. But the extent of the enhancement in daily CNX Nifty by daily FII flows can be examined by running the regression analysis.

It can be observed from the above table that all explanatory variables, taken together establish a relationship nearly 1.9 % because the coefficient of determination r^2 is 0.019 of the total variables in the daily CNX Nifty of NSE.

This means that whatever changes have taken place, in the daily CNX Nifty of NSE, the FII investments is responsible up to 1.9 % only. This implies that there are many other macro economic factors have indirectly affected the daily CNX Nifty of NSE. The regression equation Y (CNX Nifty) = α + β (FII) + € shows that for every unit change in β (that is FII) there is 0.352 unit change in Y (that is CNX Nifty). The value of α (Alpha) is 2927.416 which show that the other factors are more responsible for this relationship. The t value is 7.594 and significant value is 0.000 which is less than 0.05, therefore the alternative hypothesis is accepted and null hypothesis is rejected. So we can say that there is significant impact of foreign institutional investment (FII) on CNX Nifty.

FINDINGS OF THE STUDY

- Daily BSE Sensex and daily CNX Nifty has very low degree of positive correlation with daily FII's investment. This implies that there are many other macro economic factors have indirectly affected the daily BSE Sensex and daily CNX Nifty but their influence on the stock prices cannot be completely ignored. Hence both indices move in direction of FII's investment.
- Largest number of FII is from USA ultimately the foreign investment from USA is maximum.
- Economic growth i.e. IIP and GDP, inflation and interest rate are the basic parameters used by FII's to invest in any countries. FII's investments also guide to economic growth of country since they bring the much needed capital.
- FII's helped in the improvement of market efficiency. Since investment of FII's increasing therefore SEBI have to improve market trading efficiency in order to sustain FII's investment.

CONCLUSIONS

The study conducted observed that investments by FIIs and the movements of BSE Sensex and CNX nifty are quite closely correlated. According to findings and results, foreign institutional investors (FIIs) have significant impact on the movement of Indian capital market. Therefore, the alternate hypothesis is accepted. FII'S have positive impact on BSE Sensex and Nifty. However there are other macroeconomic factors also influence the bourses in the stock market, but FII is definitely one of the factors. This signifies that market rise with increase in FII's and collapse when FII's are withdrawn from the market. In the absence of any other substantial form of capital inflows, the potential ill effects of decrease in the FII flows into the Indian economy can be severe which was evident at the time of U.S subprime lending crisis. The findings of this study also indicate that Foreign Institutional Investors have emerged as the most dominant investor group in the domestic capital market particularly, in the companies that constitute in BSE Sensex and CNX Nifty.

SUGGESTIONS

Portfolio capital flows are invariably short term and speculative and are often not related to economic fundamentals but rather to whims and fads prevalent in international financial markets. There are following policy implications, which emerge from this analysis.

- India should focus on strengthening their banking system rather than promoting financial markets because FIIs are fair weather friends. Banks can provide the surest vehicle for promoting long-term growth and industrialization.

- Since financial markets in India have its vital importance, but government should try to shield the real economy from FIIs vagaries.
- The new code should Proposed to remove the current distinction between short-term investments and long-term investments on the basis of the length of holding of the assets. From an investor's point of view, there is no incentive to stay long term.
- Government should set a minimum limit as well as maximum limit, within which FII invest in India, in order to avoid volatility in Indian stock market (BSE sensex & CNX Nifty).
- Government should allow more than 10% limit in LIC, Bank, Mutual Funds, Pension Fund & other small companies to invest in India.
- Implementation of act is must & imperative in order to eschew from seasonal variation, Rules & regulation are made, but follow up is not there.

Apart from the money that is brought in, FIIs investment is a testament of increasing global investor confidence in a particular economy and capital market. For a country like India this money brought in by the FIIs adds to the foreign reserves which can be used to import oil, machinery etc.

With increased FII investment in a country and the increased confidence about the economy, FDI (Foreign Direct Investors) follow suit. How can one analyze FII investment in the stocks and benefit from it?

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