

Impact of Foreign Institutional Investors (FIIs) on Indian Capital Market

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Abstract: FIIs are investors or an investment fund which are registered outside the country in which it is investing. It includes hedge funds, insurance companies, pension funds and mutual funds. It also includes banks, large corporate buyers or representatives of large institutions. Most developing economies have high volume of FIIs and these economies provide high growth potential than in developed economies. This study aims to find out whether there exists any significant relation between the Indian stock market (NSE-CNX NIFTY) and FII. We have used correlation to find out the extent of relationship between two variables and to validate the impact of FIIs on Indian Stock Market. We have further done some statistical analysis to find out the dominance of FIIs in Indian stock market. The paper concludes that FIIs affect the Indian stock market, and thus the Indian economy.

Keywords: FIIs, CNX NIFTY, Stock Market, Net Investments

I. Introduction

Foreign Institutional Investor (FII) means an institution established or incorporated outside India which intends to make investment in securities in India. They are registered as FIIs in accordance with Section 2 (f) of the SEBI (FII) Regulations 1995. In India FIIs investment started in September 1992. This was the landmark event since it led to effectively globalizing the financial services industry. In the beginning mutual funds, pension funds, investment trusts, Asset management companies, nominee companies and incorporated/institutional portfolio managers were allowed to invest in Indian stock markets directly. But later registered university funds, endowment, foundations, charitable trusts were also included. Since then, FII flows which shape a part of foreign portfolio investments have been gradually mounting an importance in India. The FIIs are major institutional investors in Indian capital market. Movement in the SENSEX has clearly been driven by the behaviour of foreign institution investors. The existence of foreign institution investor in the SENSEX companies and their active trading patterns, their part in determining the share price movements must be substantial. Indian stock markets are known to be slender and shallow in the sense that there are a small number of companies whose shares are actively traded. Although there are 4700 companies listed with stock exchange. The BSE SENSEX has only 30 companies, trading on whose shares are seen as symptomatic of market movement. This shallowness also means that the FIIs can also influence the behaviour of other retail investors, who have a propensity to follow the FIIs when making their investment decision. The Indian stock markets are both shallow and slender and the movement of stocks depends on restricted number of stocks. As FIIs acquire and sell these stocks there is a high degree of volatility in the stock markets. If any set of expansion encourages outflow of capital that will augment the vulnerability of the circumstances.

1.1.1 SEBI Guidelines for FIIs

All foreign institutional investors including pension funds, mutual funds, asset management companies and portfolio managers were permitted to invest in Indian capital market fulfilling the following conditions:-

- The FIIs are required to obtain certificate of registration from the SEBI. For grant of certificate SEBI checks the applicant's track record, professional competence, financial soundness, experience, general reputation of fairness and integrity
- They have to obtain approval from RBI under Foreign Exchange Regulation Act (FERA), 1973.
- Certificate of registration is granted for period of 3 years and after it can be renewed.
- FIIs are permitted to invest in securities in the primary and secondary markets including shares, debentures listed or to be listed on a recognized stock exchange in India; and
- Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognized stock exchange or not.

A registered foreign institutional investor shall pay a fee of US \$ 10,000 for every block of three years after grant of registration during which the registration subsists. The fee mentioned in shall be paid at least one month before expiry of the period of three years. "SEBI has over 1450 foreign institutional investors registered

with it. The FIIs are considered as both a elicitor and a catalyst for the market performance by encouraging investment from all classes of investors which further leads to growth in financial market trends under a self-organized system”-Economic Times. “FII’s net investments in Indian equities and debt have touched record highs in the past financial year, backed by expectations of an economic recovery, falling interest rates and improving earnings outlook. FIIs net investments in Indian equities and debt stood at US\$ 7.46 billion in 2016-17 (upto April 14, 2017). Cumulative value of investments by FIIs during April 2000-December 2016 stood at US\$ 183.69 billion.”-IBEF.org.

1.2 OBJECTIVE OF THE STUDY

The objective of this study is to find out whether there exists any significant relation between the Indian stock market (NSE-CNX NIFTY) and FII.

1.3 RESEARCH METHODOLOGY

In this paper descriptive research has been used, data from different websites have been collected like NSE, NSDL, money control and RBI. Firstly data has been collected for 10 years to show the relationship between the two variables and then month wise data has been collected and compared. Correlation is used to see the impact of FIIs on Indian Stock. Further statistical analysis is also used to find out whether FIIs have emerged as the most dominant group of investors in Indian Capital market or not.

1.4 ANALYSIS

To find out the whether FIIs affect the Indian stock market and Indian economy, correlation has been calculated between Closing Index of FII and FII inflows. Correlation has been calculated for the data from 2006-2016, month wise from April 2015-March 2016, and day wise from 16 March-2015 to 31 March 2015. Firstly, the analysis starts with data of past 10 years which includes closing Index of CNX NIFTY and total inflows of debt and equity by FIIs from the year 2006-2016.

Table 1: Correlation between Closing Index of CNX NIFTY and total inflows of debt and equity by FIIs (2006-2016)

Year	Closing Index of CNX NIFTY	FII Inflows(in Cr.)
2006	3966.4	41467
2007	6138.6	30840
2008	2959.15	66179
2009	5201.05	-45811
2010	6134.5	142658
2011	4624.3	146438
2012	5905.1	93726
2013	6304	168367
2014	8282.7	51649
2015	7946.35	277461
2016	8185.8	-18176
	Correlation	0.165709494

From the table the correlation between closing Index of CNX Nifty and FIIs inflows has been calculated. The correlation comes out to be 0.1657 which indicates positive relationship between the two variables- Indian Stock Market represented by Closing Index of CNX Nifty and FII Inflows.

Table 2: Correlation between Closing Index of CNX NIFTY and total inflows of debt and equity by FIIs (April 2015-March 2016)

Month	Closing Index of CNX NIFTY	FII Inflows (in Cr.)
Apr-15	8181.5	7,864.36
May-15	8433.65	-4,796.25
Jun-15	8368.5	-8,192.92
Jul-15	8532.85	2,298.05
Aug-15	7971.3	-19,772.07
Sep-15	7948.9	-11,279.32
Oct-15	8065.8	3,026.66
Nov-15	7935.25	-9,029.81
Dec-15	7946.35	-2,360.02
Jan-16	7563.55	-14,356.01
Feb-16	6987.05	-12,513.12
Mar-16	7738.4	24,201.51
	Correlation	0.200783656

On the basis of Table 2 having data of 2015-2016, Correlation between closing index and FIIs inflows has been calculated which comes out to .020078 which again shows significant relationship between the Indian

Stock Market and foreign institutional investors. To get more insight of the relationship in depth study of 12 days of the month of March 2015 has been taken.

Table 3: Correlation between Closing Index of CNX NIFTY and total inflows of debt and equity by FIIs (April 2015-March 2016)

Date	Closing Index of CNX NIFTY	FII Inflows (in Cr.)
16-Mar-15	-762.55	8633.15
17-Mar-15	265.52	8723.3
18-Mar-15	-457.43	8685.9
19-Mar-15	1,428.72	8634.65
20-Mar-15	354.59	8570.9
23-Mar-15	417.41	8550.9
24-Mar-15	737.86	8542.95
25-Mar-15	813.19	8530.8
26-Mar-15	-521.23	8342.15
27-Mar-15	-320.52	8341.4
30-Mar-15	-240.34	8492.3
31-Mar-15	356.07	8491
Correlation		0.243444483

On calculating the correlation between the closing index on CNX Nifty from 16th March 2015 to 31st March 2015 and foreign institutional investor it comes out to .024344 which shows the significant relationship between the Indian stock Market and FIIs. The **Second** part of the analysis is focussed on the share of FIIs in Indian Capital market. It is done through by finding out the share of FIIs in total investment made in foreigners in India. Period of the study is five years 2011-12 to 2015-2016.

Table 4: Foreign Investment Inflows (2010-11-2015-16)

Year	Gross inflows/Gross Investments		Repatriation/Disinvestment		Direct Investment to India		FDI by India		Net Foreign Direct Investment		Net Portfolio Investment		Total	
	(` Billion)	(US \$ Million)	(` Billion)	(US \$ Million)	(` Billion)	(US \$ Million)	(` Billion)	(US \$ Million)	(` Billion)	(US \$ Million)	(` Billion)	(US \$ Million)	(` Billion)	(US \$ Million)
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
2010-11	1,643	36,047	319	7,018	1,324	29,029	783	17,195	541	11,834	1,394	30,293	1,935	42,127
2011-12	2,200	46,552	650	13,599	1,550	32,952	518	10,892	1,032	22,061	856	17,170	1,877	39,231
2012-13	1,865	34,298	399	7,345	1,466	26,953	387	7,134	1,079	19,819	1,466	26,891	2,544	46,710
2013-14	2,186	36,047	318	5,284	1,868	30,763	569	9,199	1,300	21,564	297	4,822	1,597	26,386
2014-15	2,712	44,290	605	9,864	2,107	34,426	110	1,799	1,996	32,627	2,499	40,934	4,496	73,561
2015-16	3,641	55,559	699	10,652	2,943	44,907	585	8,886	2,358	36,021	(272)	(4,130)	2,086	31,891

Notes:

1. Data for 2013-14 are provisional.
2. Data from 1995-96 onwards include acquisition of shares of Indian companies by non-residents under Section 6 of FEMA, 1999. Data on such acquisitions are included as part of FDI since January 1996.
3. Data on FDI have been revised since 2000-01 with expanded coverage to approach international best practices.
4. The total investment in the last column is the sum total of net Foreign Direct Investment and net Portfolio Investment.

Source: RBI

Table 5: Trends in Foreign Portfolio Investment

Year/Month	Gross Purchases	Gross Sales	Net Investment	Net Investment*	Cumulative Net Investment*
	(` crore)	(` crore)	(` crore)	(US \$ mn.)	
1	2	3	4	5	6
2010-11	9,92,596	8,46,158	1,46,438	32,226	121,559
2011-12	9,21,285	8,27,562	93,725	18,923	140,482
2012-13	9,04,845	7,36,481	1,68,364	31,047	171,529
2013-14	10,21,010	9,69,361	51,649	8,876	180,405
2014-15	15,21,346	12,43,886	2,77,460	45,698	226,103
2015-16	13,24,418	13,42,593	-18,175	-2,523	223,588
Apr 15-Dec 15	10,16,118	10,31,430	-15,313	-2,160	223,951
Apr 16-Dec 16	10,78,053	10,98,269	-20,217	-2,827	220,760

Source: SEBI, NSDL & CDSL

Notes:-

1. With the commencement of FPI Regime from June 1, 2014, the erstwhile FIIs, Sub Accounts and QFIs are merged into a new investor class termed as “Foreign Portfolio Investors (FPIs)”. All existing FIIs and SAs are deemed to be FPIs till the expiry of their registration.
2. * Conversion rate: The daily RBI reference rate as on the trading day has been adopted. (If the trading day is a bank holiday, immediately preceding day’s reference rate has been used).

Table 6: Foreign Portfolio Investment in Equity and Debt Segment

Source: SEBI, NSDL & CDSL

Year/Month	Equity (crore)	Debt (crore)	Total (crore)
1	2	3	4
2010-11	1,10,121	36,317	1,46,438
2011-12	43,737	49,988	93,725
2012-13	1,40,031	28,333	1,68,364
2013-14	79,709	-28,060	51,649
2014-15	1,11,333	1,66,127	2,77,460
2015-16	-14,172	-4,004	-18,176
Apr 15-Dec15	-18,666	3,354	-15,313
Apr 16-Dec16	16,071	-36,288	-20,217

Note: With the commencement of FPI Regime from June 1, 2014, the erstwhile FIIs, Sub Accounts and QFIs are merged into a new investor class termed as “Foreign Portfolio Investors (FPIs)”. All existing FII sand Sasare deemed to be FPI still the expiry of their registration.

Chart 1: Chart depicting the investment made by FIIs in Equity and Debt from 2010-2011 to 2015-2016.

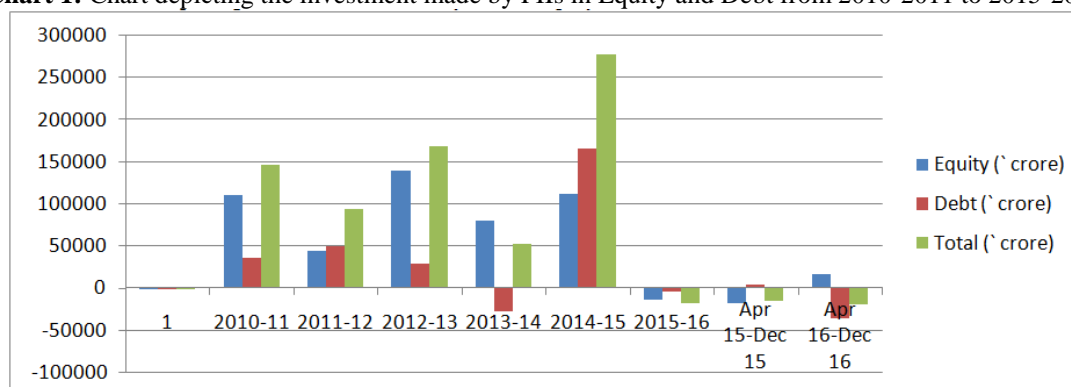


Table 4: Share in Total Foreign Investment (In bn)

YEARS	FII NET INVESTMENT	% SHARE IN TOTAL INVESTMENT	% INCREASE OR DECREASE	TOTAL FOREIGN INVESTMENT
2011-2012	856	46		1,877
2012-2013	1,466	58	12	2,544
2013-2014	297	19	-39	1,597
2014-2015	2,499	56	37	4,496
2015-2016	-272	-13	-43	2,086

There was rise in total foreign investment in the year 2012-2013 and therefore a rise in FIIs is noticed. The rise was almost 12% from the previous year. However, in the year 2013-2014 total investments fell and so as FIIs. There was a sharp decline of 39% from the previous year. In the year 2014-2015 total investment rose to 4496(bn) and FIIs increased by 37% from the previous year. In the year 2015-2016 FIIs turned negative as total investment also fell to 2086(bn). Foreign portfolio investment in Equity and Debt also noticed some ups and downs. In the year 2011-2012 FPI investment in equity was 43737 cr and in Debt it was 49988 cr. In 2012-2013 these investments were 140031 cr and 28333 cr respectively. Equity investment rose while Debt investment fell. In 2013-14 equity investments were 79709 cr and debt investments turned negative (28060) cr. In 2014-15 equity investment jumped to 111333 cr and debt investments jumped to 166127 cr. In 2015-2016 both equity and debt investments turned negative.

II. Conclusion

The Indian Capital Markets have noticed some remarkable changes and reforms in last 10 years. Our analysis was focussed on the contribution of FIIs in Indian Capital market; percentage share of FIIs in total foreign investments definitely poses a proof of huge amount contribution by them. Though there isn't a very high degree of correlation found but there was positive relationship between the indices and FIIs inflows. Second half of the analysis also reveals good amount of proof showing significant amount of share of FIIs in Indian capital Market, validating the dominance of FIIs. Markets have become more efficient with the existence of institutional investors. India stock markets are an attractive investment opportunity as Indian markets are not dependent on the world economy and have a large domestic case. Moreover, Indian markets offer a wide variety in terms of sectors and companies. The only factor that determines the behaviour of the FIIs is the opportunity for profit. If they feel that a market has the potential for profit, they will invest. It is company specific success stories that have engaged FIIs in the India market.

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