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The Impact Of FIIs On Indian Stock Market

* dr. Vinod k. Ramani

Abstract

The Indian financial market was opened to the foreign institutional investors in 1992 to widen and broaden the Indian capital market. Since then, the net investment by FIIs in India has been positive every year except in 1998-99. & 2008. During the last few years, there has been a phenomenal increase in the portfolio investment by FIIs in the Indian market. In this age of transnationals capitalism, significant amounts of capital are flowing from Developed world to emerging economies. Positive fundamentals combined with fast growing markets have made India an attractive destination for foreign institutional investors (FIIs). 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.

Keywords :

Introduction

The Indian financial market was opened to the foreign institutional investors in 1992 to widen and broaden the Indian capital market. Since then, the net investment by FIIs in India has been positive every year except in 1998-99. & 2008. During the last few years, there has been a phenomenal increase in the portfolio investment by FIIs in the Indian market. In this age of transnationals capitalism, significant amounts of capital are flowing from Developed world to emerging economies. Positive fundamentals combined with fast growing markets have made India an attractive destination for foreign institutional investors (FIIs). 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.

Foreign Institutional Investor (FII) is used to denote an investor - mostly of the form of an institution or entity, which invests money in the financial markets of a country different from the one where in the institution or entity was originally incorporated. An investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds.

Investopedia defines 'Foreign Institutional Investor - FII' as

“The term is used most commonly in India to refer to outside companies investing in the financial markets of India.”

Foreign institutional investors must register with the Securities and Exchange Board of India to participate in the market. One of the major market regulations pertaining to FIIs involves placing limits on FII ownership in Indian companies.

Objectives of the study

- To analyze relationship between FII & SENSEX.
- To analyze the trends of FII in India.
- To find out the cause and effect relationship between the FII and SENSEX.

Research methodology

Research methodology is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. Research methodology is the conceptual structure within which research is conducted. It constitutes the blueprint for the collection measurement and analysis of the data.

FII IN INDIA

For quite some time we have been talking about higher capital inflows, cost effective bank credit and double digit and sustainable growth. The first step to economic liberalization and banking sector reforms started 20 years ago when the regulator reduced SLR and CRR to improve credit flow. We have indeed achieved higher credit flow to the industry and double digit GDP growth. This growth was also supplemented by increased external capital inflow through External Commercial Borrowing (ECB/FCCB) and Foreign Investment equity participation through FDI/FII/FVCF. From all these various participants, FII's will be discussed in this report.

Since 1990-91, the Government of India embarked on liberalization and economic reforms with a view of bringing about rapid and substantial economic growth and move towards globalization of the economy. As a part of the reforms process, the Government under its New Industrial Policy revamped its foreign investment policy recognizing the growing importance of foreign direct investment as an instrument of technology transfer, augmentation of foreign exchange reserves and globalization of the Indian economy. Simultaneously, the Government, for the first time, permitted portfolio investments from abroad by foreign institutional investors in the Indian capital market. The entry of FIIs seems to be a follow up of the recommendation of the Narsinham Committee Report on Financial System. While recommending their entry, the Committee, however did not elaborate on the objectives of the suggested policy. The committee only suggested that the capital market should be gradually opened up to foreign portfolio investments.

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Market design in India for foreign institutional investors

Foreign Institutional Investors means an institution established or incorporated outside India which proposes to make investment in India in securities. A Working Group for Streamlining of the Procedures relating to FIIs, constituted in April, 2003, inter alia, recommended streamlining of SEBI registration procedure, and suggested that dual approval process of SEBI and RBI be changed to a single approval process of SEBI. This recommendation was implemented in December 2003.

Data analysis and interpretation

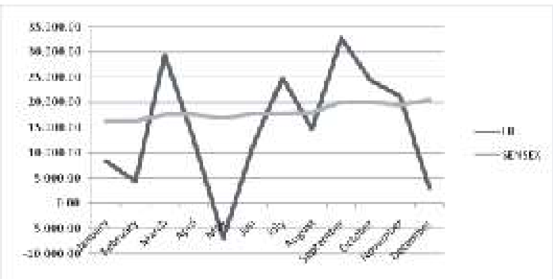
The sample data consists of 24 months' observations for FII and SENSEX starting from January 2010 to December 2011. This time period consist of recession and recovery state of situation. FII is taken as independent variable while SENSEX IS taken as dependent variable. The data is taken from various financial sites.

The relationship among these variables is studied for the year 2010 & 2011 with the help of line chart and accordingly interpretation is derived. The results and the analysis are shown below:

NET SENSEX & FII as on 2010

2010	FII	SENSEX
January	8,412.60	16357.96
February	4,363.00	16429.55
March	29,437.50	17527.77
April	12,393.10	17558.71
May	-6,986.10	16944.63
Jun	11,249.10	17700.9
July	24,724.00	17868.29
August	14,686.30	17971.12
September	32,668.00	20069.12
October	24,302.60	20032.34
November	21,210.70	19521.25
December	3,213.80	20509.09

Figure 1

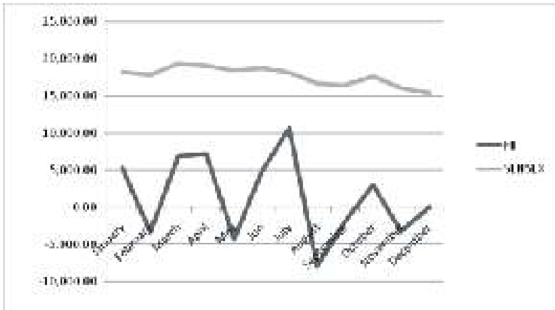


Above figure depicts the trend of net FII and Sensex during the calendar year Jan 10 to Dec 10. India saw one of the highest FII inflows, in absolute terms as well as in terms of the share of total flows in this year which we can see in the figure during the month of September. The biggest reason for the fall in FII net equity flow is the fear of rising inflation and interest rates and the way it will affect our markets and economy in coming days. Funds from developed nations are investing more in emerging markets such as China and India since these economies are growing at more than 8% at a time when developed ones such as the US and Euro zone are struggling to avoid a double-dip recession. Central bankers in the West have pledged to keep interest rates at record lows to boost employment.

NET SENSEX & FII as on 2011

2011	FII	SENSEX
January	5,363.50	18327.76
February	-3,269.80	17823.4
March	6,882.90	19445.22
April	7,196.10	19135.96
May	-4,276.00	18503.28
Jun	4,883.30	18845.87
July	10,652.90	18197.2
August	-7,902.50	16676.75
September	-1,865.70	16453.76
October	3078.8	17705.01
November	-3,263.20	16123.46
December	0	15454.92

Figure 2



Above figure depicts the trend of net FII and Sensex during the calendar year Jan 11 to Dec 11Due to The Egyptian political turmoil during January 2011, FII had pulled out huge amount of money and afterwards improvement has shown. Reason for improving FII flows might be the favourable Budget.Sensex moved between the positive and the negative terrain in view of volatility as traders rolled over positions in futures & options (F&O) segment from the near-month Dec 2011 series to Jan 2012 series.Amid lack of any major trigger from the overseas markets due to Christmas holidays, operators preferred to book profits at the fag end, leading to fall. Top heavyweight RIL was the major contributor to the Sensex fall on reports that gas output from the petro-chem giant's eastern offshore KG-D6 gas field declined to a fresh low during the week ended December 18.Overall flows to India will be lesser due to rising oil prices, high inflation and slowing growth, India cannot command as high a market share as last year.

Quarterly average of net FII and Sensex from Jan 2003 to Dec 2011

MONTH	SENSEX	FII	MONTH	SENSEX	FII
Mar-07	13072.1	360.6	Sep-09	17126.84	20,572.70
Jun-07	14650.51	1,101.70	Dec-09	17464.81	8,710.70
Sep-07	17291.1	18,788.40	Mar-10	17527.77	29,437.50
Dec-07	20286.99	8,891.10	Jun-10	17700.9	11,249.10
Mar-08	15644.44	-1,010.10	Sep-10	20069.12	32,668.00
Jun-08	13461.6	-11,094.54	Dec-10	20509.09	3,213.80
Sep-08	12860.43	-5,073.90	Mar-11	19445.22	6,882.90
Dec-08	9647.31	2,376.60	Jun-11	18845.87	4,883.30
Mar-09	9708.5	-5,890.00	Sep-11	16453.75	-1,865.70
Jun-09	14493.84	4,898.30	Dec-11	15454.92	0

Figure 3

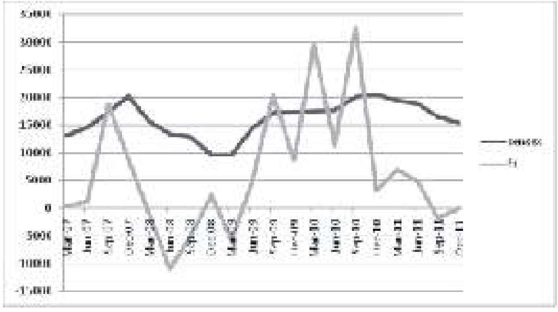


Figure shows trend of net FII and Sensex quarterly average of particular year.FII trend shows initially more or less constant but in year 2008 due to global melt down FII's out flow has gone much negative.

Conclusion

In developing countries like India, foreign capital helps in increasing the productivity of labour and to build up foreign exchange reserves to meet the current account deficit. Foreign Investment provides a channel through which country can have access to foreign capital. According to Data analysis and findings, it can be concluded that FII have moderate effect on SENSEX . But there are also other factors like government policies, budgets, bullion market, inflation, economical and political condition, etc. which have an effect on FII and ultimately to SENSEX. There is a positive correlation between SENSEX and FIIs but FIIs didn't have any significant impact on SENSEX. The null hypothesis is rejected. The data was taken on monthly basis. The data on daily basis can give more positive results (may be). Also FII is not the only factor affecting the stock indices. There are other major factors that influence the bourses in the stock market.

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