



Impact of Foreign Institutional Investors on Indian Stock Market

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ABSTRACT

The term 'Foreign Institutional Investors' is most commonly used in India to refer the companies that are established or incorporated outside India and are investing in the financial markets of India by registering themselves with the Securities & Exchange Board of India (SEBI). The term FII include overseas pension funds, mutual funds, investment trusts, asset management companies, nominee companies, banks, institutional portfolio managers, university funds, endowments, foundations, charitable trusts, charitable societies, a trustee or power of attorney holder incorporated or established outside India proposing to make proprietary investments on behalf of a broad-based fund (i.e., fund having more than 20 investors with no single investor holding more than 10% of the shares or units of the fund). FII can invest their own funds as well as invest on behalf of their overseas clients registered as such with SEBI. Foreign Institutional Investment is basically short-term in nature and mostly made in the financial markets. Since the entry into Indian market the influence on stock market by FII proved with help of their increasing number year by year and volume of net investments. The major falls in the Indian Stock market are also associated with the net investments of FII.

Keywords : FII, BSE SENSEX, SEBI

INVESTMENT RESTRICTIONS

There are generally two ways to invest for FII. 100% investments could be in equity related instruments or up to 30% could be invested in debt instruments i.e. 70 (Equity Instruments): 30 (Debt Instruments) 100% investment has to be made in debt securities only¹

In case of Equity route the FII 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, and
- Warrants²

In case of Debt Route the FII 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.

- 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 norms².

GUIDELINES FOR FIIs

FIIs allowed to invest by the Government Guidelines in all securities in both primary and secondary markets and schemes

floated by mutual funds. Single FII to invest 5 per cent and all FII allowed to invest 24 per cent of a company's issued capital. Broad based funds to have 50 investors with no one holding more than 5 per cent.

The objective was to have reputed foreign investors, such as, pension funds, mutual fund or investment trusts and other broad based institutional investors in the capital market In June 1997 aggregate portfolio investment limit of FII and NRIs / PIOs / OCBs enhanced from 5 per cent to 10 per cent and the ceilings made mutually exclusive³. Common ceilings would have negated the permission to FII. Therefore, separate ceilings were prescribed in February 2000 Foreign firms and high net-worth individuals permitted to invest as sub-accounts of FII. Domestic portfolio manager allowed to be registered as FII to manage the funds of sub-accounts.

The objective was to allow operational flexibility and also give access to domestic asset management capability⁴.

2007 FII allowed to invest USD 3.2 billion in Government Securities (limits were raised from USD 2 billion in two phases of USD 0.6 billion each in January and October).

June, 2008 While reviewing the External Commercial Borrowing policy, the Government increased the cumulative debt investment limits from US \$3.2 billion to US \$5 billion and US \$1.5 billion to US \$3 billion for FII investments in Government Securities and Corporate Debt, respectively.

October 2008 While reviewing the External Commercial Borrowing policy, the Government increased the cumulative debt investment limits from US \$3 billion to US \$6 billion for FII investments in Corporate Debt.

October 2008 Removal of regulation for FII pertaining to restriction of 70:30 ratio of investment in equity and debt respectively.

October 2008 Removal of Restrictions on Overseas Derivatives Instruments (ODIs)

March 2009 E-bids platform for FIIs to bid for allotments under over all FII debt limits.

August 2009 FIIs allowed to participate in interest rate futures

March 2011 Market regulator SEBI raised the overall investment limit for foreign institutional investors in corporate bonds to \$40 billion.

January 2013 The Reserve Bank of India vide circular RBI/2012, hadenhanced the limit for investment by FIIs in the Government Debt Long Term category by US\$ 5 billion to US\$ 15 billion and the Corporate non-infrastructure debt category by US\$ 5billion.FIIs registered with SEBI is presented in table 1,

YEAR	NO OF FIIS	CUMULATIVE FIIS
1992-93	0	0
93-94	3	3
94-95	153	156
95-96	197	353
96-97	86	439
97-98	57	496
98-99	-46	450
99-2000	56	506
2000-01	21	527
2001-02	-37	490
2002-03	12	502
2003-04	-38	540
2004-05	145	685
2005-06	197	882
2006-07	115	997
2007-08	322	1319
2008-09	316	1635
2009-10	78	1713
2010-11	9	1722
2011-12	45	1767

Source: Hand Book of Statistics on Indian Securities Market

From the above table 1 it is evident that from the year of Introduction of FIIs in to Indian Market(i.e in 1992),the FIIs registered with SEBI are increasing year by year/except in the years 1998-99 and 2001-02.

The number of FIIs registered were increased in the year 2007-08 when comparing to all other years as 322 and in the year 2008-09 the number of FIIs registered with SEBI are 316. This is the second highest number of FIIs registered in single financial year.This reached almost to 1767 by the end of December 2011.These are all because of the Indian government recognised the need of Foreign Funds for the growth of Indian economy and the government liberalized procedural aspects of registration and Investment limits enhanced to 24% in a single Indian company by any FII.The major fiIs of BSE30 Index and FII investments is presented in table 2

Table 2 Major falls of BSE 30 INDEX and FII INVESTMENTS

S.L NO.	DATE	BSE	GROSS PURCHASES	G R O S S SALES	NET INVESTMENT
1	21-01-2008	1408.35	4972	6328	-1356
2	24-10-2008	1070.63	2162	2509	-347
3	17-03-2008	951.03	3546	3674	-129
4	06-07-2009	870	2150	1580	568

5	22-01-2008	857	4897	7323	-2256
6	11-02-2008	833.98	8170	10015	-1846
7	18-05-2006	826	1593	2017	-424
8	10-10-2008	800.1	3017	3864	-848
9	13-03-2008	770.63	4151	4007	144
10	17-12-2007	769.48	4118	5216	-1099
11	07-01-2009	749.05	2409	3468	-1058
12	06-10-2008	724.62	2785	3831	-284
13	17-10-2007	717.43	6833	5679	1154
14	15-09-2008	710	2687	3544	-856
15	22-09-2011	704	2062	1728	334
16	21-11-2007	678.18	4817	5889	-1072
17	16-08-2007	642.7	1771	1899	-128
18	17-08-2009	626.71	1766	2740	-974
19	27-06-2008	600	4236	4705	-469
20	24-02-2011	545.92	3317	3330	-13
21	27-02-2012	477.82	3079	3622	-543
22	16-11-2010	444.55	3161	3844	-683
23	04-02-2011	441.92	3087	3133	-46
24	12-11-2010	432	3103	2992	110

Source: SEBI Monthly Bulletins

From table -2 it is evident that the major falls in Indian Stock Market are coincided with the withdrawal of funds by FIIs from the Stock Market. The highest fall of BSE history in single intra-day session is happened on 21st January 2008 with 1408 points in that day the FII Net Investments are Rs. 1356 crore. On October 2008 also 1070 points dropped and the Net FII Investments are Rs.347 crore, we can see that the major falls are accompanied by the withdrawal of investments by FIIs. Take the case on January 22, 2008, the Sensex lost almost 857 points. Here, the net sales by FIIs was Rs. 2256 Crores. This is a major contributor to the fall on that day. But contrary to that day, take the case on January 21, 2008, the Sensex lost 1408 points and the gross sales was Rs. 6328 Crores and the purchases were Rs. 4972 Crores, the NET INVESTMENT is (-1356). So this can be concluded that after the fall of market, FIIs had invested again into the market.

We often hear that whenever there is a rise in market, it is explained that it is due to foreign investors' money and a decline in market is termed as withdrawal of money by FIIs. Usually, the mode of operations of FIIs is borrowings from countries where interest is low (like Japan) and invest in booming markets like India⁵.

But the **Sub-Prime Crisis** and other economic conditions had caused a liquidity crunch for these institutions. They were forced to withdraw money from Indian market to repay loans they had taken⁶. These withdrawals had caused panic in market, and even domestic Players were seen offloading their portfolios.

The FII's increased role had changed the pace of Indian stock market. It brought, both, quantitative and qualitative change. It had also increased the market depth and breadth. The emphasis on fundamentals caused efficient pricing of shares.

Many qualitative tests like regression tests had proved that there is direct relation between market movements and fund flows of FIIs. In this, we will analyze the investments in different months and years, and tries to find the impact of FIIs in stock market⁷.The yearly net investments FIIs and BSE Sensex is presented in table 3.

TABLE 3 Yearly Net Investments of FII and BSE SENSEX

Year	GROSS PURCHASE OF FII	GROSS SALE OF FII	NET PURCHASE/SALE OF FII	CLOSING VALUES OF SENSEX
	Rs. In Crores	Rs. in Crores	Rs.in Crores	(in points)
1992	17	4	13	2615
1993	5593	466	5126	3346
1994	7631	2835	4796	3927
1995	9694	2752	6942	3110
1996	15554	6979	8574	3085
1997	18695	12737	5957	3659
1998	16115	17699	-1584	3055
1999	56856	46734	10122	5006
2000	74791.68	68,421.60	6,370.08	3,972.00
2001	51,761.20	38,651.00	13,128.20	3,262.00
2002	46,479.10	42,849.80	3,629.60	3,377.00
2003	94,412.00	63,953.50	30,459.00	5,839.00
2004	1,85,672.00	1,46,706.80	38,965.80	6,603.00
2005	2,86,021.40	2,38,840.90	47,181.90	9,398.00
2006	4,75,624.90	4,39,084.10	36,540.20	13,787.00
2007	8,14,877.90	7,43,392.00	71,486.30	20,287.00
2008	7,21,607.00	7,74,594.30	-52,987.40	9,647.00
2009	6,24,239.70	5,40,814.70	83,424.20	17,465.00
2010	7,66,283.20	6,33,017.10	1,33,266.80	20,509.00
2011	6,11,055.60	6,13,770.80	-2,714.20	15,455.00
2012	6,41,320.50	5,38,370.50	1,02,950.00	19,420.70

Source: bseindia.com Hand book of Statistics on Indian Securities Market SEBI Monthly Bulletins

Conclusion :

From the above table 3 it indicates clearly the growth of Foreign Institutional Investment and impact on BSE 30 Index in India, the FII investments were majorly driven by prevalent economic policies. It gained pace from the year 2003, and continued to gain for some years. In the year 2008, FII investment suffered a steep decline following sub-prime crisis. Subsequently, growing Indian markets again fascinated FIIs to invest and in the year 2010 the net invest-

ment reached to a level of Rs 133266.30 crore which is highest amount since year 2000. Later in 2011, Net inflows by FIIs turned negative as the gross sales crossed the gross purchase. Supported by robust economic reforms, FIIs turned back to Indian equities for investment. The net investment by FIIs in the year 2012 is amounted to Rs 1,02,950.00 crore.

Since the introduction of FIIs in the year 1992 in to India with liberalisation policies it shows its impact on stock market returns¹⁵. In the year 1998, the gross purchases are Rs.16,115 crores and the gross sales are Rs.17699 crores, the net investment is negative (i.e, disinvestment is more than investment while observing the data as year wise, in that year the net investments of FII are (-1584) Crores, the same year BSE Sensex fall almost 16.65% from the previous year. And the very next year the Sensex index increased to 5000 mark almost 63% from the previous year and the net positive investments in that year are Rs.10,122 Crores.

Similarly in the year 2008 the Sensex lost almost 10000 points (i.e.52%) from the previous year. In that year the purchases of FII are Rs.7,21,607 Crores, the sales are 7,74,594 Crores and the Net Investments in the year 2008 are Rs. 52,987 Crores. Because of disinvestment of FIIs the stock market reached almost bottom of 8000 mark recovered to 9398 points at close. The very next year the FII investments are Rs. 83,424 Crores and the sensex raised and reached to 17,465 points by the end of 2009 to analyze the relationship of Indian stock market and FII investments, The researchers have calculated correlation between the indices and FII data for 20year period.

The correlation between FII AND SENSEX comes out at about 0.68 which is significantly positive. That means each one rupee investment by FII would move up Sensex by about 0.68 point. To sum up, we can safely say FIIs have been major drivers for Indian markets and would continue to remain so

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