GE-INTERNATIONAL JOURNAL OF MANAGEMENT RESEARCH
VOLUME -3, ISSUE -4 (April 2015) IF-4.316 ISSN: (2321-1709)

ROLE OF FOREIGN INSTITUTIONAL INVESTORS ON INDIAN CAPITAL MARKET

1. **Ashish Varughese**

Research Scholar

Department of Commerce, C M S College, Kottayam.

2. **Riju Varkey Thomas**

Guest Lecturer in Commerce

Department of Commerce, Bishop Moore College Mavelikara.

ABSTRACT

The FIIs have been playing a key role in the Indian financial markets since their entry into this country in the early 1990s. Their importance has been growing over time as their net investment is on the rise over time. This paper analyses importance of foreign capital, the role of FIIs in Indian Equity and Debt market and compares the investment activities of FIIs and domestic institutional Investments.

INTRODUCTION

It was in 1992 India has opened up its economy and allowed Foreign Portfolio Investment (FPI) in its domestic stock markets. Since then, FPI has emerged as a major source of private capital inflow in this country. An important feature of the development of stock market in India in the last 19 years has been the growing participation of Institutional Investors, both foreign institutional investors and the Indian mutual funds combined together, the total assets under their management amounts to almost 18% of the entire market capitalization.

The FIIs have been playing a key role in the Indian financial markets since their entry into this country in the early 1990s. Their importance has been growing over time as their net investment is on the rise over time. There are many reasons why FIIs are investing heavily in Indian equity markets. They do so because we have the ability to produce goods and provide services at a lower cost also the Indian companies have tremendous growth potential inside as well outside India. The mergers and acquisitions of the MNCs by the Indian companies in recent, has proved our mettle to the world. The population of India signifies that we have never ending demand unlike developed countries where the demand is less than the supply. The purchasing power of Indian consumers has also increased during the past few years.

OBJECTIVES OF THE STUDY

The main objective of this paper is to analyse the role played by FIIs in the Indian Capital Market. The other objectives are

1. To examine the need and advantages of foreign capital.
2. To enumerate the trend of Foreign Institutional investments and government initiatives to attract foreign institutional investors.
3. To compare the investment activities of FIIs and Mutual Funds
4. To evaluate the role of FIIs in Indian Equity and Debt Market.
5. To evaluate the competitive position of FIIs in the Indian Capital Market

DISCUSSION OF FINDINGS

1. Need of Foreign Capital and Advantages of FIIs In India

Favourable Balance of Payment Position

Table 2 shows that net FPI in India positive except for two years. It leads to favourable balance of payment position without any debt. It provide foreign exchange to developing countries, it also reduces the pressure of foreign exchange gap of developing countries.

Growth of Stock Market and overall growth of the Economy

It stimulates for the domestic stock market and leads to stock market efficiency – Domestic stock market become more efficient and standard. FII leads to more competition leads to more sophisticated financial technology, adaptation of the technology to local environment and greater investment in information processing and financial services. The results are greater efficiencies in allocating capital, risk sharing and monitoring the issue of capital.

It increases the allocative efficiency of capital in the country – According to this view FPI can induce financial resources to flow from capital-abundant countries, where expected returns are low, to capital-scarce countries, where expected returns are high. The flow of resources into the capital-scarce countries reduces their cost of capital, increases investment, and raises output.

It increases the thrust to the domestic stock market prices - A higher P/E ratio leads to a lower cost of finance, which in turn can lead to a higher amount of investment. The lower cost of capital and a booming share market can encourage new equity issues. FII is a non debt creating source – more helpful for the economy. It can supplement domestic savings for improving the investment rate.

Base- broadening hypothesis (Merton 1987). This hypothesis states that increase in the investors base will leads to consequent reduction of risk in the capital market due to risk reduction

Development of basic infrastructure: the development of any economy depends on the available infrastructure in that country. Government of India could not able to raise necessary investments. To fill the gap foreign capital is highly suitable.

Rapid industrialization: the need for foreign capital arises due to the policy initiatives of the government to intensify the process of industrialization

To undertake the initial risk: many developing countries suffer from severe scarcity of private investors. The risk problem can be diverted to the foreign capitalists by allowing them to invest.

To remove the technological gap: The developing countries have very low level of technology compared to the developed countries. This raises the necessity for importing technology from the advanced countries. That technology usually comes with foreign capital when it assumes the form of private foreign investment or foreign collaboration.

2. Growth of foreign institutional investors activities and Government Initiatives

FII Initiative by the Government

Until 1980s, India's development strategy was focused on self-reliance and import-substitution. Current account deficits were financed largely through debt flows and official development assistance. However after 1990s India's policy has changed substantially from over reliance on debt creating fund to non debt creating fund mainly foreign direct investment (FDI) and portfolio flows (FPI). It was mainly because of huge Balance of Payment crisis and the recommendations of High Level Committee on Balance of Payments under the Chairmanship of Dr. C. Rangarajan[1].

Month and Year	Policy Initiatives
September 1992	Government allowed FIIs investment. Single FIIs can invest 5 percent and all FIIs allowed to invest 24 per cent of a company's issued capital.
April 1997	Aggregated limit for all FIIs increased to 30 percent, subject to special procedure and resolution. The objective was to increase the participation by FIIs.
April 1998	FIIs permitted to invest in dated government securities subject to a ceiling.
June 1998	Aggregate portfolio investment limit of FIIs and NRIs/PIOs/OCBs enhanced from 5 per cent to 10 per cent, and the ceilings made mutually exclusive.
March 2001	FII ceiling under special procedure enhanced to 49 percent. The objective was to increase FII participation.
December 2003	The FII dual approval process of the SEBI and the RBI changed to a single approval process of the SEBI.
November, 2006	FII investment up to 23 per cent permitted in market infrastructure institutions in the securities markets, such as stock exchanges, depositories, and clearing corporations.
October 2008	Removal of regulation for FIIs pertaining to the restriction of 70:30 ratio of

[1] Report of Expert Group on Encouraging FII flows and Checking the Vulnerability of Capital Markets to Speculative Flows, November, 2005.

	investment in equity and debt respectively.
March 2009	E-bids platform for FIIs.
August 2009	FIIs allowed to participate in interest rate futures.
April 2010	FIIs allowed to offer domestic government securities and foreign sovereign securities with AAA rating
August 2011	SEBI circulars for governing QFIs
Feb 2014	SEBI Foreign Portfolio Investment Regulations came into existence

Source: ISMR, SEBI bulletin various issues.

FII Investment limit

1. Each FII (investing on its own) or sub-account cannot hold more than 10per cent of the paid-up capital of a company. A sub account under the foreign corporate/individual category cannot hold more than 5per cent of the paid up capital of the company.
2. The maximum permissible investment in the shares of a company, jointly by all FIIs together is 24per cent of the paid-up capital of that company.
3. This limit of 24per cent can be raised to 30per cent, 40per cent, 49per cent or up to the FDI limits specified for that particular sector, subject to approval from the shareholders and the RBI.
4. In the case of public sector banks, the foreign ownership limit is 20per cent[2].

Investment avenues for FIIs

FIIs can invest only in the following investment avenues

1. Securities in the primary and secondary markets including shares, debentures, and warrants of companies, unlisted, listed, or to be listed on a recognized stock exchange in India
2. Units of schemes floated by domestic mutual funds including the Unit Trust of India, whether listed or not listed on a recognized stock exchange, or units of schemes floated by a Collective Investment Scheme

[2] ISRM Indian Securities Market A Review Vol. XIV November 2011

3. Dated government securities
4. Derivatives traded on a recognized stock exchange
5. Commercial papers
6. Security receipts
7. Indian Depository Receipts

Growth of Registered FIIs in India

The number of FIIs in the year 1992 was 3 within 20 years it was increased to 1765 in the year 2012. The number of Foreign Institutional Investors shows an increasing trend since their arrival. Table 1 show that within the last six years the number of registered FIIs has increased by 100 per cent and number of Sub accounts has increased by 157 per cent

TABLE 1 Registered FIIs in India

Year	Registered FII (End of March)	Net Additions	Sub Accounts	Net Additions
1993- 94	3	3		
1994- 95	156	153		
1995- 96	353	197		
1996- 97	439	86		
1997- 98	496	57		
1998- 99	450	-46		
1999 – 00	506	56		
2000 – 01	527	21		
2001 – 02	490	-37		
2002 – 04	502	12		
2003 – 04	540	38		
2004-05	685	145	1889	
2005-06	882	197	2458	569
2006-07	997	115	2922	464
2007-08	1329	322	3964	1042

2008-09	1626	316	4967	1003
2009-10	1713	78	5378	411
2010-11	1722	9	5686	308
2011-12	1765	43	6322	636
2012 – 13	1,757	-8	6,335	13
2013 – 14	1,710	-47	6,344	9

Source: Sebi Bulletin Various Issues

The Table1 shows that in the period of the global financial crisis also the number of registered FIIs has shown a significant increase.

Trend of Foreign Institutional Investments in India

India is the fifth largest economy in the world (ranking above France, Italy, the United Kingdom, and Russia) and has the third largest GDP in the entire continent of Asia. It is also the second largest among emerging nations. India is also one of the few markets in the world which offers high prospects for growth and earning potential in practically all areas of business, that's why FII statistics shows an upward trend. The Table 2 shows that only in the year 1988-99 and in 2008-09 foreign portfolio investment shows excess of sales over purchase ie net negative investment. The maximum amount of investment made by FIIs since their arrival was in the year 2010-11 that is Rs. 146,438.10 Cr and the maximum amount of net negative investment was in the year 2008-09, Rs. 45,811 Cr

TABLE 2 Trend of FII Investment in India

Year	Portfolio Investment				
	Gross Purchase	Gross Sale	Net Investment (Rs in Cr)	US ($ mn)	Cumulative (US $ mn)
1992-93			13.4	4	4
1993-94	5593	466	5,126.50	1634	1638
1994-95	7631	2835	4,796.30	1528	3166
1995-96	9694	2752	6,942.00	2036	5202

1996-97	15554	6979	8,574.50	2432	7634
1997-98	18695	12737	5,958.05	1649	9284
1998-99	16115	17699	-1,584.20	-386	8898
1999-00	568,56	46734	10,122.10	2339.1	11237.3
2000-01	740,51	64116	9,933.40	2159.8	13396
2001-02	49920	41165	8,755.60	1846	15242
2002-03	47060	44371	2,689.30	562	15804
2003-04	144858	99093	45,764.70	9950	25754
2004-05	2,16,953	1,71,072	45,881.30	10,172	35,926
2005-06	3,46,978	3,05,512	41,466.70	9,332	45,260
2006-07	5,20,508	4,89,667	30,840.40	6,708	51,967
2007-08	9,48,020	8,81,842	66,179.10	16,040	68,007
2008-09	6,14,579	6,60,389	-45,811.00	-9,838	58167
2009 -10	8,46,438	7,03,780	142,658.30	30,253	89,335
2010 -11	9,92,599	8,46,161	146,438.10	32,226	1,21,561
2011 -12	9,21,285	8,27,562	93,725.50	18,923	1,40,482
2012 – 13	9,04,845	7,36,481	168,367	31,047	1,71,529
2013 – 14	10,21,010	9,69,361	51,649	8,876	1,80,405

Source: SEBI Bulletin Various Issues

Table 2 sows that FIIs are investing large amount of fund in Indian securities the net investment by FIIs during the period was us $ 1, 40,482, such huge non debt creating investment was much helpful for India in reducing the Balance of Payment crisis.

3. Investments Activities of Mutual Fund Vs FIIs In The Indian Equity Market

Trend of Mutual Fund Vs FII Investments in the Indian Equity

Mutual funds are one the major institutional player in the Indian Capital Market, both Indian and foreign Mutual funds are operating in India, the number of asset management companies in India is also sowing an increasing trend. Mutual Funds and FIIs together contribute substantial share in the Indian equity market. Table 4 shows the comparison between FII and Mutual fund investments in India since 2000.

TABLE 4 Trend of Mutual Fund Vs FII Investments in the Indian Equity

Year	Mutual Fund Investments in Equity (In Rs. Crore)	FII Investments in Equity (In Rs. Crore)
2000-01	-2,767	10,206.70
2001-02	-3,796	8,072.20
2002-03	-2,067	2,527.20
2003-04	1,308	39,959.70
2004-05	448	44,122.70
2005-06	14,303	48,800.50
2006-07	9,062	25235.70
2007-08	16,306	53408.80
2008-09	6,985	-47,706.20
2009 -10	-10,512	110,220.60
2010 -11	-19,802	110,120.80
2011 -12	-1,358	43,737.60
Total	8110	448,706.30

Source: SEBI Bulletin Various Issues

Table 7 clearly shows tat FIIs are the predominant player in the Indian Equity Market. In the last 12 years net flow to Indian equity market by Mutual Funds and FIIs are Rs. 8110 and 448,706.30 Cr respectively ie FIIs investments are 55.33 times higher than Mutual Fund Investments The net investment by Mutual Funds are is negative for 6 out of 12 years but FIIs made negative net investments only in the year 2008-09

4. The Role of FIIs in the Indian Equity Market

Share of FIIs in NSE-Listed Companies

The role of FIIs in the Indian equity market is better understood by identifying their share in the NSE listed companies.

Table 7 Share of FIIs in NSE-Listed Companies

Sectors	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Sep-11	Average
1. Banks	18.41	19.15	14.27	16.02	17.62	18.17	17.27
2. Engineering	11.45	10.63	7.34	8.28	9.36	9.30	9.39
3. Finance	18.18	17.44	13.01	16.53	23.35	19.20	17.95
4. FMCG	11.91	14.07	12.72	14.09	16.34	17.00	14.36
5. Information Technology	14.53	16.00	12.44	11.68	21.16	17.07	15.48
6. Infrastructure	7.15	8.86	7.31	8.90	7.87	7.50	7.93
7. Manufacturing	9.57	9.46	7.28	8.79	9.41	9.60	9.02
8. Media & Entertainment	15.20	11.71	11.42	7.06	10.97	11.63	11.33
9. Petrochemicals	5.83	4.73	4.77	6.08	6.52	6.49	5.74
10. Pharmaceuticals	11.17	10.69	7.88	8.78	10.19	10.13	9.81
11. Services	13.09	10.70	8.39	8.05	7.41	9.50	9.52
12. Telecommunication	11.17	9.12	6.85	8.64	8.44	8.46	8.78
13. Miscellaneous	8.19	9.30	8.39	8.10	13.65	13.37	10.17
Total average stake of FIIs in all the Sectors	**10.78**	**10.62**	**8.40**	**9.58**	**10.32**	**10.45**	**11.28** **10.02**

Source: Compiled from SEBI Bulletin Various Issues

The table shows that FIIs Investment in the last six years shows an average 10 per cent share in the NSE- nifty companies. The FIIs Investment in the thirteen sectors of NSE- nifty companies sows an average 11.28 share. Among the thirteen sectors FIIs is having maximum investment in Finance sector followed by banking sector i.e. 17.95 and 17.27 per cent respectively, the minimum investment is in the sectors petrochemicals and Infrastructure i.e. 5.74 and 7.93 per cent respectively.

5. Role of FIIs In The Indian Debt Market

FIIs in the Indian Derivative Market Segment

The Table shows that the FIIs gross turnover in the F&O Segment of the NSE in 2010–2011 was ` 62,371,926 million, which was 10.66 per cent of the turnover of the derivatives market (` 292,482,211 million) at the NSE.

Table 7 FII share in Derivative Segment of NSE

Year	Gross No. of contracts traded	Gross Turnover of FIIs (Rs. mn)	F&O Turnover on NSE (Rs. mn)	Percentage of FII Turnover to Total Turnover on Exchange
2006-07	39875849	12,845,058	73,562,420	8.73
2007-08	93,959,764	25,035,126	130,904,779	9.56
2008-09	113,802,833	19,845,575	110,104,822	9.01
2009-10	136,495,789	34,772,177	176,636,647	9.84
2010-11	222,957,207	62,371,926	292,482,211	10.66
2011-12*	140,948,141	36,975,019	157,585,925	11.73
Total	**124673263.8**	**31974146.83**	**156879467.3**	**9.92**

Source: SEBI Bulletin * 2011-12 up to September only

The share of the FIIs' gross turnover increased to 11.73 percent of the derivatives turnover on the NSE during the year 2011–2012. The average percentage of FII turnover to total turnover on exchange for the last six years was 9.92 per cent.

6. The Comparative Share of FIIs In Indian Capital Market

Asset under Custody by FIIs

The size and robustness of the FIIs role in Indian capital markets can be better understood by looking at the assets under their custody as compared to other institutions and participants. As per the SEBI data relates t0 2011-12 the total assets held by the FIIs stood at Rs.1115648 crores as compared to Rs.648628 crores with Insurance Companies and Rs.887494 with mutual funds. The Table 10 gives the assets under custody of custodians for the latest four financial years.

Table 8 Asset under Custody by the Custodians

Year	2008-09	Per cent	2009-10	Per cent	2010-11	Per cent	2011-12	Per cent	Ave rage
FII	3,91,954	24.85	9,00,869	31.47	1106550	33.01	1115648	31.86	30.30
Foreign Depositories	71,839	4.55	1,56,616	5.47	185931	5.55	146025	4.17	4.94
FDI Investments	92,694	5.88	1,45,555	5.08	146231	4.36	225982	6.45	5.44
FVCI	16,579	1.05	17,604	0.61	24002	0.72	26398	0.75	0.78
Mutual Funds	3,78,954	24.02	5,84,628	20.42	591937	17.66	648628	18.52	20.16
Corporates	19,430	1.23	29,328	1.02	48723	1.45	45558	1.30	1.25
Insurance Companies	4,42,117	28.02	7,80,610	27.27	908112	27.09	887493	25.35	26.93
Financial Institutions	32,008	2.03	47,607	1.66	62600	1.87	60937	1.74	1.83
Banks	27,859	1.77	42,597	1.49	85863	2.56	90407	2.58	2.10
Others	104,155	6.60	157,547	5.50	191127	5.70	254566	7.27	6.27
Total	15,77,589	100	28,62,961	100	3351076	100	3501643	100	100

Source: Compiled from SEBI Bulletin Various Issues

The Table 10 clearly shows that FIIs are major institutional player in the Indian Capital Market, in the year 2011-12 they accounts for the 31.86 per cent of the total asset under custody of custodians followed by Insurance Companies and Mutual Funds with 25.35 and 18.52 per cent respectively. The average figure for the last four financial year also sows the same, FIIs, Insurance Companies and Mutual Funds accounts for 30.30, 26.93 and 20.16 percent respectively.

Conclusion

From the above analysis of data analysis it is evident that FIIs have major impact on Indian Stock Market. The impact is that even the domestic players and MFs also follow a close look on FIIs. The impact is that even the domestic players and MFs also follow a close look on FIIs. Therefore, if FIIs are confident in Indian markets, there is a general perception that market is on a good condition. Foreign institutional investment is certainly volatile in nature and its volatility has certainly posed some threats to the Indian stock market considering its influence on the market. Increase in investment by FIIs cause sharp price increase. The volatility or trend of return does not have significant impact upon the net inflow of FII into India. Therefore the policy framework for liberalizing/immobilizing FII investment should be formulated with due consideration to its impact upon the Indian capital market.

Reference

Chalapati Rao K.S, Ranganathan K.V.K and Murthy M.R. 1999. Foreign Institutional Investments and the Indian Stock Market, journal of Indian school of political economy, Vol X1, No 4 November-December.

Rahul Kumar and Chandra Prakash Gupta. Behavoiur of Stock Price in Indian Stock Market: Understanding Distribution Pattern and Parameter Estimation, Finance India. Vol XXIII. No 1, 2009. p 71- 97.

Dema, Tshering; The Real Trade-Off Between Opportunity Cost And Uncertain Profit; Scholedge International Journal of Management & Development; Mar2015, Vol. 2 Issue 3, p24-28.

Report of Expert Group on Encouraging FII flows and Checking the Vulnerability of Capital Markets to Speculative Flows, November, 2005.

Sankhanath Bandyopadhyay. Are Foreign Institutional Investors Good for Emerging Markets? Foreign Institutional Investments Perspectives and Experiences, ICFAI University Press P 42 – 48. 2006

Securities Exchange Board of India (Foreign Institutional Investors) Regulations 1995

Securities Exchange Board of India (Foreign Portfolio Investors) Regulations 1995

Handbook of Statistics on the Indian Economy. Reserve Bank of India2008 – 09.

Lebeau, Garry; A Trend Study Of The Increased Role Of Governments On The Cross Border Business Activities; Scholedge International Journal of Multidisciplinary & Allied Studies; Mar2015, Vol. 2 Issue 3, p11-15.

NSE – Indian Security Market Review, Various Issues

NSE – Fact sheet Various Issues

SEBI Bulletin Various Issues

Business Line National Daily

Economic Times National Daily

Business Standard National Daily

Websites

www.nseindia.com

www.sebi.gov.in

www.rbi.org.in