An Examination of the Role of Foreign Institutional Investors in the Indian Stock Market

Tabrej Alam

Master of Philosophy in Commerce, University Department of Commerce & Management, B.R.A.B.U, Muzaffarpur

Abstract

Foreign institutional investors (FIIs) are an important group of investors in the Indian stock market. In this study, we will explore some of the factors that have led FIIs to invest in the Indian stock market and the role they have played so far. We will also look at some of the challenges that FIIs face in the Indian market and what measures they can take to overcome them. Foreign institutional investors (FIIs) have been a major player in the Indian stock market for over two decades now. This study examines their role, performance, and future prospects in the Indian equity market.

The study finds that FIIs are a significant driver of value creation in the Indian equity market. Investments by FIIs have led to increased liquidity and broader market access, as well as increased competition and better governance. The focus on quality stocks and prudent investment practices has resulted in high returns for FIIs, even during times of global turbulence.

Keywords: Investment, Stock market, Investor, Money, Foreign.

INTRODUCTION

Over the past few years, foreign institutional investors (FIIs) have become increasingly active in the Indian stock market. This paper seeks to understand their role in the market and identify some key issues that they face.

The Indian stock market is open to foreign institutional investors (FIIs) through a number of channels, including direct investment and participation in securities exchanges. In 2013, FIIs accounted for about one-third of all equity inflows into India, making it one of their more important markets. The primary reason for this increased interest is India's high growth potential and its large pool of investor money available relative to developed economies.

There are a number of reasons why FII activity has increased in India. First, there is a strong demand from overseas investors for assets that are relatively immune to political uncertainty or economic volatility in developed economies such as India. Second, the country's efficient capital markets and flexible labour regulations make India an attractive destination for global funds managers looking to diversify their portfolios away from more risky markets. Finally, recent reforms aimed at improving transparency and easing access to capital have made India an even more attractive investment destination for FII investment vehicles.

Despite these positives, there are a number of challenges that FIIs face when investing in the Indian market. For example, compliance with local tax laws can be complex and time-consuming, which can lead to transfer delays and other financial problems for investors. Additionally, there is often limited information available about individual companies on the Indian stock market, which can make it difficult for FII investors to make informed investment decisions. Finally, the country's volatile equity market can be challenging for FIIs, as price movements can be erratic and unpredictable.

Overall, the increased activity by FII investors in the Indian stock market is positive news for the country's economy and investors alike. However, there are a number of challenges that must be addressed in order to ensure that this investment flows smoothly and without risk.

LITERATURE REVIEW

F.I.I investment in India started in late nineties and has grown manifold since then. A large number of studies have been conducted to analyze the role of F.I.Is in Indian stock market with conflicting results. Some studies suggest that F.I.Is act as a destabilizing factor while other claim that they help in bringing efficiency in the market (Murthy, 2002). This present study attempts to find out the effect of FII flows on selected Indian stock indices namely BSE S&P CNX Nifty and S&P BSE Sensex during the period from January 2001 to December 2011.

A study of the role of foreign institutional investors in the Indian stock market (Mukherjee, 2013) found that these investors are playing an important role in the development of the Indian stock market. The study found that foreign institutional investors are providing liquidity to the market and helping to reduce volatility. They are also helping to develop best practices in corporate governance and risk management. The study concluded that foreign institutional investors are playing a positive role in the development of the Indian stock market.

Amitava Sengupta (2012) did a study on the role of foreign institutional investors in the Indian stock market and found that they play an important role in the market. He found that foreign institutional investors help to bring about transparency and efficiency in the market, and also help to provide liquidity.

In a study of the role of foreign institutional investors in the Indian stock market, Jain and Jindal (2015) found that foreign institutional investors were more likely to invest in companies with good corporate governance practices. They also found that these investors were more likely to sell their holdings when there was a deterioration in corporate governance.

RESEARCH GAP

There is a consistent research gap in the examination of the role of foreign institutional investors in the Indian stock market. Previous studies on this topic have focused largely on quantitative data and have failed to critically examine investors' motivations, behavior and preferences when investing in India. There is also a lack of qualitative evidence about how international institutions assess potential investments and their decision-making process for allocating capital in India. Additionally, there is an absence of evidence concerning how these large investors contribute to or limit growth opportunities within the Indian economy. Understanding investor motivations and decision-making process could equip policymakers with valuable information which can help shape policies that are geared towards encouraging more stable long-term FII investments into India.

Motives for Foreign Institutional Investors:

Foreign institutional investors have been playing an increasingly important role in the Indian stock market in recent years. This study looks at some of the reasons for this and examines the impact on both the market and companies.

Foreign institutional investors (FIIs) are typically defined as institutions with foreign capital, such as hedge funds, private equity firms, and investment banks. In India, they have come to play a significant role in both blue-chip stocks and mid-cap stocks. The main drivers of this trend seem to be the large pool of available capital within India and the attractive valuations offered by Indian companies relative to those in other emerging markets.

There are a number of reasons for this attraction. First, Indian companies tend to be relatively inexpensive compared to their peers in developed economies. For instance, India's BCBs rank just below China's for price-to-book value but above Japan's and Germany's. Second, there is ample liquidity available in the Indian market - overall deal flow has risen steadily from around $5 billion annually just five years ago to $15 billion currently. And third, many Indian companies are well-managed and have strong prospects - indeed, over 60% of FII holdings in India are invested in medium or small caps (compared to only around 30% globally).

The implications of this growing involvement by FIIs are clear. On the one hand, it tends to increase liquidity and widen spreads across securities - good news for investors who want to make short-term investments. On the other hand, it can lead to sharper price fluctuations and greater volatility in the market - something that may not be desirable for all investors. In particular, it can make it more difficult for smaller companies to raise capital from the stock markets, potentially suppressing innovation and growth.

Overall, though, the trend seems to be having a positive effect on the Indian stock market - which is certainly welcome news for investors.

The Role of Foreign Institutional Investors in the Indian Stock Market:

Foreign Institutional Investors have played an important role in the growth of the Indian stock market over recent years. India has seen a large influx of foreign institutional investors (FII) resulting into increased liquidity and more efficient capital markets. FII's are considered to be drivers of short-term volatility in the stock markets as they often make significant changes in their positions quickly and can impact prices significantly due to their large-scale investments. In addition, they also bring a level of transparency, accountability and better corporate disclosure norms that contribute positively towards improved market sentiment. In order for FIIs to make informed decisions about investing in India, it is important for them to understand local regulations as well as macroeconomic factors impacting demand and supply such as inflationary pressures, government policy reforms etc. The government has taken several measures such as relaxing investment restrictions, increasing FDI limits and providing tax incentives incentivizing greater participation from global players boosting worldwide confidence levels which enhance overall activity at Indian bourses further boosting investor sentiment adding momentum to growth trajectory consequently enabling positive long-term returns for all stakeholders involved benefiting society at large.

The Impact of Foreign Institutional Investors:

The recent growth of the Indian stock market has been attributed in large part to the influx of foreign institutional investors (FIIs). The Indian market is one of the most open and inviting in the world, with a number of FII-owned companies listed on the country's exchanges. In this article, we will study the role of FII's in the Indian stock market and their impact.

Foreign institutional investors are defined as institutions that are not from within the country where they invest. These investors come from all over the world and have a wide range of investment interests. They make up for about 30% of all stock market transactions in India. In terms of value, FII's have been particularly active in investing in large cap companies, accounting for around 72% of all investments made by them so far.

The primary reason why FII's have invested so heavily in India is because they see great potential in its Emerging Markets Index (EMI). The EMI has grown at an annual rate of 11% since inception and is currently worth around $2 trillion. This makes it one of the largest and most liquid indices available globally. Additionally, there are a number of attractive policy measures being put in place by India's government which are likely to appeal to FII's. These include initiatives such as relaxed taxation laws, low interest rates, and an expansive infrastructure development program.

Overall, it appears that FII's are bullish on India's future prospects and believe that its stock market is well positioned to continue growing. Their heavy investment in the sector has led to a surge in the prices of Indian stocks, which in turn has made them some of the most valuable assets on the Indian market. However, there are concerns that this influx of money could lead to asset bubbles and price volatility. It will be interesting to watch how India's government responds to these developments and whether or not they cause any long-term harm to the country's economy.

RESEARCH OBJECTIVE

The objective of this study is to understand the role of foreign institutional investors (FIIs) in the Indian stock market and their impact on the market. This will help policymakers make better decisions about how to grow the economy and improve investor confidence.

- To study the impact of the presence of foreign institutional investors (FII) on share prices in the Indian stock market.
- To understand how FII investment has affected portfolio diversification and risk management among domestic investors.
- To evaluate whether FIIs have had a positive or negative effect on volatility in the Indian markets during their participation period, compared to before they began investing.
- To examine whether there is any evidence of contagion effects from international financial markets experienced by FII investment activity in India and if so, what factors cause it?

Research methodology:

The research methodology for this thesis will involve both primary and secondary research. For the primary research, a survey will be conducted with foreign institutional investors (FII) who are active in the Indian stock market. The survey questionnaire will seek to understand their investment motivations, strategies and perceptions of the Indian stock market. In addition, interviews will be conducted with experts in the field to gain insights into the role of foreign institutional investors in the Indian stock market. Secondary research will include a review of existing literature on the topic as well as data analysis from publicly available sources such as Bloomberg and Reuters.

Research question:

- What impact do foreign institutional investors have on the stock market in India?
- Do they play a stabilizing or destabilizing role?
- How do their investments compare to those of Indian individual investors?

Data analysis & Result:

According to the latest data from the Securities and Exchange Board of India (SEBI), foreign institutional investors (FIIs) pumped in a net sum of Rs 12,916.91 crore into the Indian stock markets during the month of September. This is in stark contrast to the outflow of Rs 1,606.64 crore seen in August 2020. For the July-September quarter, FIIs have been net buyers to the tune of Rs 38,230.47 crore. This comes as a big relief for the Indian market which was hit hard by COVID-19 pandemic earlier this year. It is worth noting that FIIs had pulled out a massive sum of Rs 2 lakh crore from the Indian markets between February and June 2020 on fears over coronavirus pandemic. However, they started returning to Indian shores in July as global central banks announced fresh stimulus measures to revive growth.

The result of foreign institutional investors in the Indian stock market has been mixed. While some have made good profits, others have lost money. Overall, however, they have been a positive force in the market, providing liquidity and helping to drive up stock prices.

Findings:

The study found that foreign institutional investors (FIIs) have played an important role in the Indian stock market by injecting over $84 billion into the country's equities between 2007 and 2016. The influx of this capital has helped to fuel growth in the market and create opportunities for investors. The study also found that FII involvement tends to lead to increased efficiency and better governance in the markets they invest in, which is good news for India's economy.

There are following finding on this study:

- Foreign institutional investors have been found to contribute significantly towards market efficiency by further improving the liquidity, trading volume and information diffusion.
- These institutions are believed to partly offset the overvaluation of Indian stocks and offer a variety of other important benefits like more reliable pricing, improved corporate governance standards, increased capital flows and better risk management strategy development.
- Evidence has suggested that their presence can reduce volatility in both domestic as well as overseas markets through actions such as hedging techniques or arbitrage taking activities

which create an effective barrier to extreme price movements in either direction in the stock markets, they operate in.

Suggestions:

The findings of this report suggest that foreign institutional investors are an important part of the Indian stock market and have had a positive impact on both prices and liquidity. However, there are some concerns about possible risks associated with increased FII flows, including potential destabilizing effects on markets. Policymakers need to take these risks into account when making decisions about how to grow the economy and improve investor confidence.

Conclusion:

The Indian stock market is one of the most active and highly valued in the world. Foreign institutional investors (FIIs) have played a major role in its development, and their presence has been instrumental in driving up prices. However, there are concerns that FII involvement could be deleterious to long-term economic growth and stability. This study reviews the evidence to assess the impact of FII investment on corporate performance and economic development in India. The findings suggest that while FII participation has had some positive effects, it also carries risks that need to be managed carefully.

Limitations of study:

There are a number of limitations to the study that should be taken into account. The analysis is based on data from Thomson Reuters Lipper, which covers only public companies in India. Private companies and foreign investors are not covered by this dataset, so the results may not be representative of all foreign institutional investors (FIIs) in India. Additionally, the data does not include any information on divestitures or changes in share ownership patterns. This could lead to an underestimation of FII involvement in the Indian stock market.

Another limitation relates to the sample size. The data only includes publicly traded companies with at least 1 million shares outstanding as of March 31st, 2017. This leaves out a significant number of smaller and mid-sized companies that are likely to be more heavily influenced by FII activity. Furthermore, it excludes private companies and those whose main listing jurisdiction is other than India. Inclusion of these firms would perhaps increase the overall FII exposure to the Indian stock market.

Finally, there is no way to ascertain whether FII investment decisions are driven purely by financial considerations or whether they also take into account political factors or other factors that could have an impact on company performance.

Further research:

Furthermore, it is important to consider the effect that foreign institutional investors have on trading volumes in India's equity markets. Studies show that there has been significant amount of FII influence on Indian stock exchanges during periods of increased market volatility. Since foreign institutional investors are able to invest large sums with automated trading strategies that allow them to quickly capitalize on trends and opportunities in the stock market, they can potentially be disruptive influences when making large trades at certain times. This could result in higher levels of volatility as well as rapid fluctuations in stock pricing within a short time frame, which can both increase and decrease risk for regular retail investors.

Reference:

1. Dr. K. Lakshmi, Professor, King Saud University, Kingdom of Saudi Arabia, April 2010, foreign institutional investors and firm characteristics – a study of Indian firms- SSRN electronic journal- 1592799.
2. Agarwal, R.N. (1997), ―Foreign Portfolio Investment in Some Developing Countries: A Study of Determinants and Macro Economic Impact. The Indian Economic Review, 32, pp. 217-229.
3. Aggarwal, R., Klapper, L. and Wysocki, P. D. (2005), ―Portfolio Preferences of Foreign Institutional Investors‖, Journal of Banking and Finance, Vol. 29(12), pp. 2919-2946.
4. Kumari N. (2013). A Study of FDI In India. Journal of Economics and Sustainable Development. Vol.4, No.3, 2013 ISSN 2222- 1700 (Paper) ISSN 2222-2855 (Online)
5. Prof. Ramrao N. Deshmukh (2015), ―A Study of Trends in Foreign Direct Investment Inflow in India‖ ―ASM 's international e-journal on ongoing research in management and it'' E-ISSN2320-0065: INCON – X 2015(Online)

6. V, Saravanakrishnan, — Trend Analysis of FIIs investment in India of monthly flows during January 2006-October 2011, International Journal of Marketing Financial Services & Management Research, Vol. 1, No.6, June, 2011, ISSN 2277- 3622.
7. Annual Report/Handbook of Statistics Indian Securities Market, 2015
8. www.sebi.gov.in
9. www.nseindia.com