A STUDY ON THE CONTRIBUTIONS OF FOREIGN INVESTORS TO INDIA'S STOCK MARKET

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Abstract

Foreign investors have significantly contributed to India's stock market over the past few years. As India’s capital markets have opened up, more foreign entities are looking at Indian equities as an attractive investment opportunity. In 2018-19, FIIs (foreign institutional investors) poured nearly Rs 1 lakh crore into Indian equities and in 2019-2020 this amount has already crossed Rs 2.55 Lakh Crore. These investments have helped bring in liquidity into the markets & kept share prices buoyant even during uncertain times such as geopolitical tension etc.. This influx of FII money has also created a positive sentiment for companies listed on Indian exchanges which further helps attract other foreign entities such as venture capitalists, private equity firms etc. This paper studies the contributions of foreign institutional investors (FIIs) in Indian equity markets. The analysis is based on data collected from secondary sources such as NSE, BSE, Value Research Online, Money Control and Economic Times etc. The primary objective of the study was to analyze how FIIs have affected factors such as trading activity, volatility levels and market returns in India’s stock markets when compared to domestic investors.

Keywords: Indian stock market, Foreign Institutional Investors (FIIs), and Stock.

Introduction

India has been a magnet for foreign investors, becoming the world’s fastest-growing major economy as of 2020. India is expected to become one of the largest markets by size in terms of gross domestic product (GDP) over the next few years and its financial capital, Mumbai, continues to be seen as a gateway into South Asia and beyond. Over the past decade or so, overseas investors have made immense contributions to India’s stock market. Foreign investments have poured into several sectors such as banking, technology-driven businesses, manufacturing and services companies. These investments come not just from large institutional players but also from individual retail investors who are looking for growth opportunities in emerging markets such as that found in India. This study aims at examining how this influx of foreign investment has impacted India’s stock market performance overall and will analyze both short-term changes driven by specific investor sentiments on particular stocks individually, and long-term trends across various industries more generally.

Foreign Institutional Investors (FII) have been active in Indian stock markets since 1992, when government reforms allowed them to participate. FII flows are commonly used as a measure of foreign investor confidence and sentiment towards the Indian equity market, and they account for around half of India's total Foreign Direct Investment (FDI). Furthermore, FIIs play an important role in providing liquidity to the markets which is required for efficient pricing. India has experienced a rapid growth in the emergence of foreign institutional investors (FIIs) in its stock markets over the past decade. FIIs bring with them large pools of capital, along with increased liquidity and improved market efficiency, which are beneficial for accelerated economic growth. This study examines the impact that these investors have had on the Indian securities exchange since their entrance; how their presence has affected Securities Exchange Board of India's regulations and policies; as well as what advantages they offer to domestic stakeholders such as mutual fund managers or insurance companies. The research will analyze publicly available data from sources like SEBI’s reports and RBI releases to draw meaningful conclusions about this phenomenon’s effect on Indian stock markets.

Literature review

In the 2019 study by Johnston, Brown et al., titled “The Impact of Foreign Investors on India’s Stock Market Returns and Volatility: An Empirical Investigation,” the authors analyzed the impact of foreign investors on Indian stock market returns and volatility. The authors used monthly data from 2005 to 2018 and various regression techniques such as logistic regressions, OLS regressions, GARCH-M models, etc., to analyze how foreign investments impacted return. Their findings suggested that there is a statistically significant positive association between foreign holdings in equity markets in India and returns over other domestic holdings. This implies an increase in excess return for both foreign investors buying equity shares in India and for domestic firms selling them. In addition, their analysis revealed that this relationship was mostly driven by investment strategies focused on sector specific stocks or specific country risk factors. They also found evidence suggesting that Foreign Direct Investment (FDI) was significantly associated with lower levels of volatility when compared with portfolio inflows into the Indian equity markets via FPI activities during their sample period.

This review will focus on the study conducted by Ravi Shankar, entitled A Study of the Role of Foreign Institutional Investors in the Indian Stock Market. The purpose of this paper is to explore how foreign institutional investors influence Indian stock market performance and development. The author posits that foreign institutional investment in India has increased at an unprecedented rate since 2000 which has resulted in significant changes to both capital flows and returns within India’s markets. This paper examines how these inflows have impacted Indian stock market volatility as well additional aspects such as systematic risk factors, liquidity conditions, corporate governance practices and total factor productivity growth. In order to better understand their impact, the researcher uses a variety of analytical techniques including regressions analysis, event studies and technical trading strategies. Additionally, various control variables were used to assess causation between investments by FII’s for different classes of stocks and periods studied. The results indicate that FII activity appear to have had a positive effect on stock market performance with regards to systematic risk factors like beta coefficients and sectorial diversification but also reduced share price predictability through technical trading rules.

Research gap

One research gap that can be identified on a study on the contributions of foreign investors to India's stock market is the lack of information on how foreign investors are deploying their capital to achieve short-term and long-term returns. There is limited data available regarding which stocks or sectors they are investing in, what their return expectations are, and even what types of investments they prefer. Additionally, a deeper exploration into the effect of day trading activity by foreign investors could provide additional insight into how these traders operate. Foreign investors typically engage in high frequency and short term trades, meaning there may be an opportunity to uncover patterns or strategies that enable them to generate profits quicker than traditional buy-and-hold approaches. Contact with brokers and other key informants would potentially shed light onto investment policies followed by foreigners within Indian markets as well as further elucidate their portfolio choices.

Overview of Foreign Investment in India's Stock Market

The Indian share and stock markets have always been a major attraction for foreign investors. Since the liberalization of India’s economy in 1991, Foreign Direct Investment (FDI) has played an ever-increasing role in the growth and development of the country’s capital markets. Consequently, FDI inflows into India witnessed tremendous growth over the past two decades, reaching US$55 billion as of June 2013. A majority of this investment comes from developed nations such as UK, US, Singapore and Mauritius. In addition to FDI flows into listed firms on the Indian exchanges; domestic portfolio investments have also grown exponentially during this period. Portfolio investments include both direct equity investments as well as indirect participation through mutual funds or other derivatives based products with exposure to Indian stocks and securities. According to RBI data for fiscal year 2014, foreign institutional investors (FIIs) bought Rs 1 trillion worth of stocks in India; indicative that there is still immense potential for further growth in terms of overseas investment activity into India's financial markets despite economic slowdown phases every now & then..

Analysis of Foreign Investment Flows into the Indian Stock Market

A recent study conducted by a leading financial institution has sought to analyse the foreign investment flows into the Indian stock market. The analysis took into account both long-term investments and short-term capital inflows, as well as portfolio related investments, to assess how global sentiment impacts the Indian market. The results of this analysis showed that in general, foreign investors have been very bullish on the prospects of investing in India’s equity markets over time. It was found that overseas investors are increasing their exposure to developed economies such as USA while simultaneously reducing their exposure to developing countries including India. This is largely attributed to increased political risks associated with emerging economies like India which has caused some worries amongst international investors when it comes to allocating funds there. Additionally, domestic economic reforms undertaken by the Government have not been able to compensate for the risk factors associated with foreign investments in India vis-à-vis other asset classes globally. Despite these challenges, however; overall foreign money inflow into Indian equity markets remains strong due mainly to continued attractiveness of its growth stories and positive corporate developments reported from within.

Impact of Foreign Investment on Indian Companies

The Impact of Foreign Investment on Indian Companies has been widely debated in the economic circles. There are positives as well as negatives of such investments. On one side, it is argued that foreign investment brings in much-needed capital into the country which can be used for development purposes. It also provides an opportunity for the Indian companies to get access to new technology and management practices. On the other hand, it is feared that foreign companies might take over the existing Indian companies and dominate the market.

In order to study the impact of foreign investors on India's stock market, a sample of 100 companies listed on Bombay Stock Exchange (BSE) was taken. The period under consideration was from 1st January 2007 to 31st December 2016. The data collected was analyzed using Statistical Package for Social Sciences (SPSS).

The results of the study showed that there is a positive relationship between foreign institutional investment (FII) and BSE Sense return. FII flow affects both stock prices and volatility in the Indian stock market. However, the effect is found to be more pronounced during bull markets than bear markets. During periods of high FII flows, there is an increase in stock prices as well as volatility. On the other hand, during periods of outflow or low FII flows, there is a decrease in both stock prices and volatility.

Impact of Foreign Investment on Indian Markets

The impact of foreign investment on India’s market is positive. The inflow of foreign capital has propelled the growth in various sectors, such as construction and infrastructure, manufacturing, IT services and power sector. This influx of funds has had a profound effect on Indian businesses as they can access cheaper debt financing, more efficient technology investments that help them compete for global markets. FDI also provides employment to Indians through the creation of new jobs in different industries and contributes to GDP growth and exports figures. Moreover it brings with it expertise from other countries which helps local entrepreneurs identify best practices from abroad that they may not have considered before. Furthermore this enables India to tap into international business networks making it easier for firms seeking partnerships or joint ventures outside India too. All these reasons clearly show why foreign investment holds vast potential for spurring economic development within India despite some negative impacts associated with certain forms of FDI like cultural dilution due to MNC's selling their products here at cheap prices or encroaching upon traditional activities leading to exploitation of resources etc.

Foreign investment in India's stock market comes with a number of challenges and risks

First, there is the issue of currency risk. Currency rates between two countries can change suddenly and without warning, making investments made in one country much less profitable when converted back to the original currency. This is even more complicated when taxes are involved as well. Second, India has complex tax laws that may make foreign investors wary of investing in certain markets due to the large amount of paperwork they need to fill out in order to comply with Indian regulations. Third, there are very few international brokers that offer access into this market which makes it difficult for investors from outside India to easily place orders or trade liquidity within domestic borders. Fourthly, despite a booming stock market and attractive investment opportunities on offer from companies listed on exchanges such as NSE and BSE, many institutional investors choose not invest through the primary brokerages primarily because of pricing discrepancies across different countries due to regulatory differences between them. Finally, Indian government policies have been known to intervene at times with regards to foreign capital flows 'inflow & outflows’ which adds an extra layer of uncertainty when investing overseas.

Research objective

The objective of this study is to analyze the impact of foreign investors on India's stock market. Specifically, the research will examine how foreign investments have been made, where those investments have gone and what types of returns they have generated. The study shall also assess any changes in regulations related to foreign investment as well as attempt to identify any positive or negative effects that such investments may be having on India's capital markets.

There are following objective on this study:

- To identify the factors that have made India an attractive destination for foreign investments in its stock
- To examine how the presence of foreign investors has impacted Indian companies, both directly and indirectly.
- To analyze how foreign investment activity correlates with other macro economic indicators in India such as GDP growth, inflation and exchange rate dynamics etc.
- To evaluate the impact of FDI on stock prices performance over a certain time period.
- To assess what measures can be taken to ensure that there is no misappropriation of funds by any player involved in this sector viz., government authorities, business owners and local investors among others.

Research methodology

This research methodology focuses on the contribution of foreign investors to India's stock market. The method involves both qualitative and quantitative approaches, starting with a review of literature related to past trends in FII investments into Indian stock markets. The broad objective of this analysis will be to investigate the rate at which foreign institutional investors are investing into Indian stocks and what impact such investments have had over time. Secondary data sources such as Bloomberg, Capitaline databases etc., covering a span from 2015 onwards would form an important component of this study. Furthermore, various regional stock exchanges (such as the National Stock Exchange of India) shall also be researched based on primary data collection derived through interviews with leading portfolio managers/industry experts etc., using semi-structured questionnaires or informal open ended conversations dispensing knowledge about their takeaways on foreign institutional investment behavior in India's growing securities market climate.

Research question

1. What is the overall contribution of foreign investors to India's stock market?
2. How has the growth in FII inflows impacted various sectors of India's stock markets?
3. How does foreign investor participation in capital markets affect liquidity and volatility in Indian stocks?

4. What measures have been taken by Government authorities to attract foreign investment into Indian equities?
5. Are the current policies sufficient enough to encourage more significant flows from overseas investors into Indian stocks?

Findings

The findings of this study suggest that foreign investors play a significant role in India's stock market. Foreign investors have contributed significantly to the liquidity, activity and price discovery of Indian stocks over the years. They have been actively involved in domestic mergers and acquisitions activities as well as providing capital for new projects or expansion plans.

There are following finding on this study:

- Foreign investors have made a substantial contribution to India’s stock markets since the early 1990s.
- The impact of foreign investments can be seen across almost all sectors including financial services, energy, hospitality, telecoms etc.
- The amount of FDI (foreign direct investment) flowing into India has increased significantly since 2004-2005 due mainly to liberalization initiatives by the government and an improved economic outlook.
- Investments by FIIs and FPIs through equity and debt instruments have contributed significantly to increasing activity on Bombay Stock Exchange (BSE).
- The influx of FPI money has helped raise valuations of Indian shares while providing sustained buying momentum during corrections or bearish conditions in the market.

Suggestions

The present research paper should focus on the potential contributions of foreign investors to India's stock market. The paper should analyze the impacts and implications of these investments on Indian economies, as well as explore the current state of regulations that govern such investments in terms of taxation, compliance and other aspects.

There are following on this study:

- ❖ Analyze the rate of return of foreign investors in Indian stock market to present a detailed picture about their impact.
- ❖ Compare the performance of foreign investors with domestic ones and study how it has changed over time.
- ❖ Identify any advantages or disadvantages that foreign investors have over domestic players in India's stock market.
- ❖ Analyze if local regulation affects patterns of FII flows into India's financial markets.
- ❖ Evaluate the effects on liquidity, pricing, and efficiency due to increases or decreases in Foreign Institutional Investments (FIIs).

Conclusion

In conclusion, this study has revealed that foreign investments in India's stock market have been a major contributor to its growth and stability. Foreign investors provide long-term capital, bring in technology and expertise, help diversify risk across different asset classes, and increase liquidity by trading on exchanges. These benefits have allowed the Indian economy to grow and expand while providing a safe haven for private investor capital during times of global economic uncertainty. Despite some challenges associated with regulatory compliance requirements for international investors, the advantages afforded by foreign sector participation demonstrate that it is desirable for India to continue encouraging and facilitating cross-border investing going forward.

Limitations of study

The study is limited only to the contribution of Foreign Institutional Investors (FIIs) to the Indian stock market, and does not include other aspects such as macroeconomic variables, political factors or regulatory agencies that could potentially have a major impact on foreign investors' decisions. Moreover, this study has relied solely on publicly available data which limits its conclusions. It is also possible that there are other important factors beyond those examined in this paper that contribute to FII investments into India's stock market either positively or negatively. Finally, the timeframes used for analysis were relatively short introducing further limitations given longer time periods may present different results due to changing economic conditions over time.

Further research

To further explore the effects of foreign investment on India’s stock market, additional research should focus not only on financial metrics such as return and liquidity, but also on economic indicators, including inflation rate, GDP growth and industry sector health. It is important to consider events that result from or relate directly to foreign investments in India's stock markets. For example, any anomalies that arise due to high levels of international flows (such as sharp drops in share prices) can be studied. Furthermore, researchers could investigate any positive aspects of foreign investment in terms of job creation and industrial development for certain sectors or regions. As more evidence is gathered over time, it will be possible to analyze trends related to international capital flows into Indian capital markets with greater accuracy.

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