

A STUDY ON FACTORS DETERMINING FOREIGN INSTITUTIONAL INVESTMENTS IN INDIA

** Rajesh Kishanrao kenekar, Research Scholar Department of Commerce*

INTRODUCTION:

In India, the major change in the capital flows, particularly in portfolio flows, took place due to the reforms in trade and industrial policy. FIIs are entities that are incorporated outside India but invest in India. FIIs are allowed to invest mostly in secondary markets and dated Government Securities. Allowing FIIs reduced the dependence on external commercial borrowing. Private foreign capital accounted for 70.29% of the total net capital account in 2001-02 against 21% in 1985-86. There has been a consistent upsurge in FIIs since 2002-03. The inflow of FII investments has helped the stock market to rise enormously. The policies of liberalisation and reforms have led to a favourable macro-economic environment. As per the reports, net FII investments contributed to nearly 28% of the country's foreign exchange reserves. The evolution of various policy reforms on FIIs undertaken by the Indian Government made the presence of FIIs felt in the stock market of India. FIIs are generally interested in investing in capital market and this provides liquidity to capital markets and raises expectations of higher trading volume. Increase in the flow of capital would increase the stock prices. the cost of capital for a company would decrease with the higher flow of investments in the primary markets by FIIs. This would also help a corporation to have higher price earnings ratio. FII inflows are an alternative for the domestic savings and provides for the growth and performance of the economy.

LITERATURE REVIEW

- Reetika Garg and Pami Dua (2014), studied the macroeconomic determinants of portfolio flows to India and found that the FII investments are attracted by the lower exchange rate volatility and a better opportunity for risk diversification. Apart from this FIIs are also influenced by the performance of domestic companies, higher interest rate and the growth of the host country. The study was conducted on BSE and the ADR/GDR flows were also considered. Results suggest that India may be able to attract FPI flows by maintaining strong domestic growth, lower exchange rate volatility and making domestic financial market performance, less vulnerable to global shocks and this can be achieved by increasing the investor base in financial markets. Sonia Chawla and Priyanka Sharma (2014) presented a review of studies on FIIs. Though various studies have shown that FDI

investment is high in service sector, movement of FDI and FPI in India is affected by many macroeconomic variables like Balance of trade, money supply which may be M1 or M2 or M3, inflation represented in India by CPI or WPI, economic indicators like GDP or IIP, foreign exchange rate, etc., this study has conducted a review of studies so as to establish a relation between macroeconomic variables and the flow of FIIs in India Sunil Kumar (2014) analysed the trends of Foreign Institutional Investments during and beyond economic crises and found that there is a variance of FIIs which is influenced by foreign exchange reserves and market capitalisation. The impact of market capitalisation on FII was found significant in the long run. Vanita Tripathi and Shilpa Maggo (2014), investigated the determinants of foreign institutional investment in the Indian debt market using multivariate regression analysis and factor analysis to identify the major determinants of FIIs in the debt market. It was found that IIP and exchange rates were the major determinants of FII flows to debt market in India.

- Krishnan Dandapani and Edward R.Lawrence (2013) studied the effect of FII on the stock market in India and found that FII has a direct significant effect on the returns of the Indian stock. They also studied the factors influencing the FII investment in India.
- Vinod K.Bhatnagar, (2011) analysed the trends of monthly inflows of FIIs investment in India during 2004-2010, and found that, FIIs investment behaviour is determined by the stock market returns and risk in economic factors of India. Higher Sensex indices and high PE ratios are the country level factors attracting FIIs in India and there is a growth trend in FIIs investment in India
- Mishra.P.K (2010) attempted to investigate the dynamics of relationship between FIIs investment flows and the economic growth in India over the period 1993-2009. It was found that the growth of real GDP may promote FIIs investment in India. The statistical results and interpretation can be delimited by the fact that FIIs flow can also influence the economic growth of the country.
- Ashish Garg and Bodla.B.S (2009) examined the determinants of FIIs in Indian stock market and found that the Indian equity market return is the prime mover of the net FII inflows into India.
- Nidhi Dhamija (2008) made an exploratory analysis of the investment of FIIs patterns across firms to examine the role of various factors relating to individual firm level

characteristics and macro level conditions influencing FII investments. It was found that the regulatory environment of the host country plays a major role impacting the FIIs.

- Tripathi Rao and Rudra Sen Sarma (2007) studied the dynamic relationship between monetary policy, stock market and FII inflows and found that a good monetary policy stabilising the foreign exchange market to attract capital flows, together with stock market returns determine FII inflows.
- Indrani Chakraborty (2006), examined the capital inflows during post liberalisation period in India by analysing the quarterly data from 1993 to 2003. The econometric results indicated that an error correction mechanism was operating between net inflows of capital and the real exchange rate in India. A co integration relationship existed between net inflows of capital, real exchange rate and interest rate differential and the intervention of RBI in the forex market helped to prevent the volatility of the real exchange rate in spite of the volatility in the capital inflows.
- Pushpa Trivedi & Abilash Nair (2006) studied the determinants of FIIs investments inflows to India, their results indicate that the returns and volatility in the Indian Markets emerge as the principal determinants of FIIs inflow. Ram Mohan T.T (2005) had taken stock of FIIs in terms of volatility and found that the real problem caused by the variation in FIIs inflows was not due to stock market volatility but the difficulty posed in management of money supply and exchange rate.
- Kulwant Rai and N.R.Bhanu Murthy (2004) studied the role of risk, return, and inflation as determinants of FIIs. They found that stabilising the stock market volatility and minimising the expected risk in future would help attract more FIIs which will have a positive impact on the real economy.

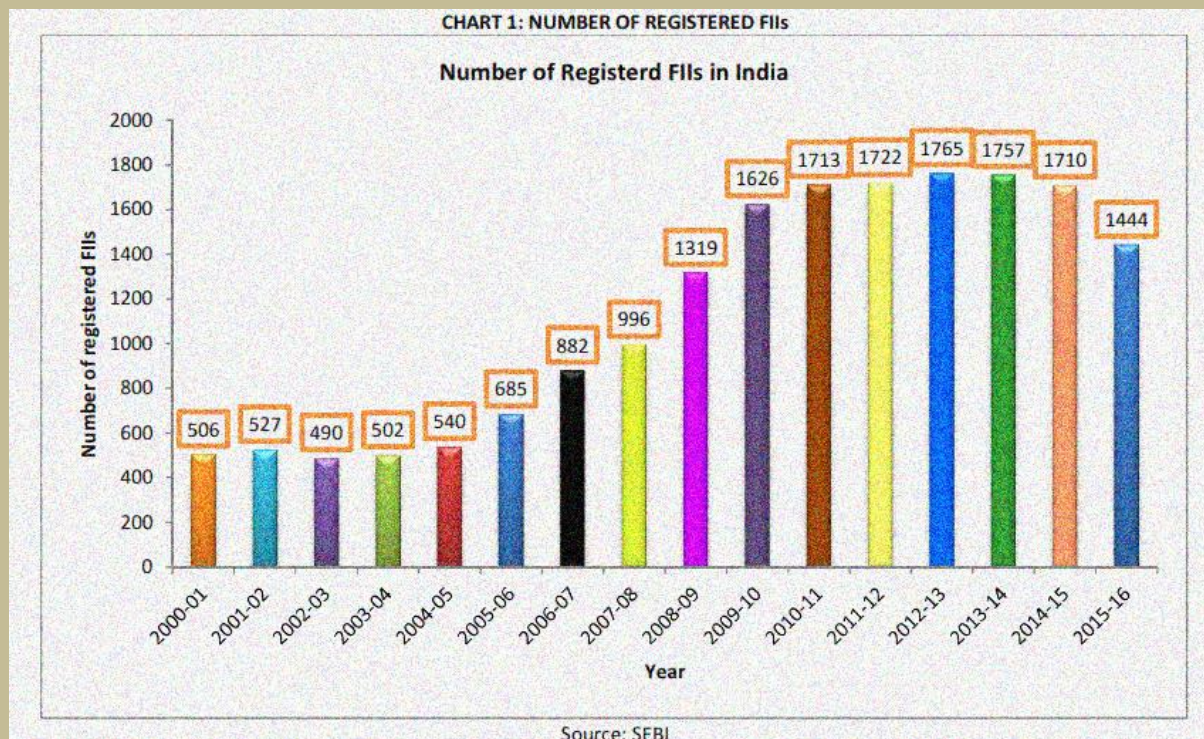
NEED FOR THE STUDY Studying the impact of major factors influencing FII flows will be more effective in helping the decision-makers, policy makers and investors. It will help to understand the market forces and to analyse a wider spectrum which is beyond the mere demand and supply levels. This will also help to understand the macro economic factors that directly or indirectly affect the appreciation / depreciation of the market and in turn could impact the investment decisions. Macro factors like inflation, monthly returns in the stock market, volatility in the stock market. Few factors affect the volatility called as the casual factors. They are macro-economic impacts, global markets, role of institutional investors and industry performance.

OBJECTIVES OF THE STUDY

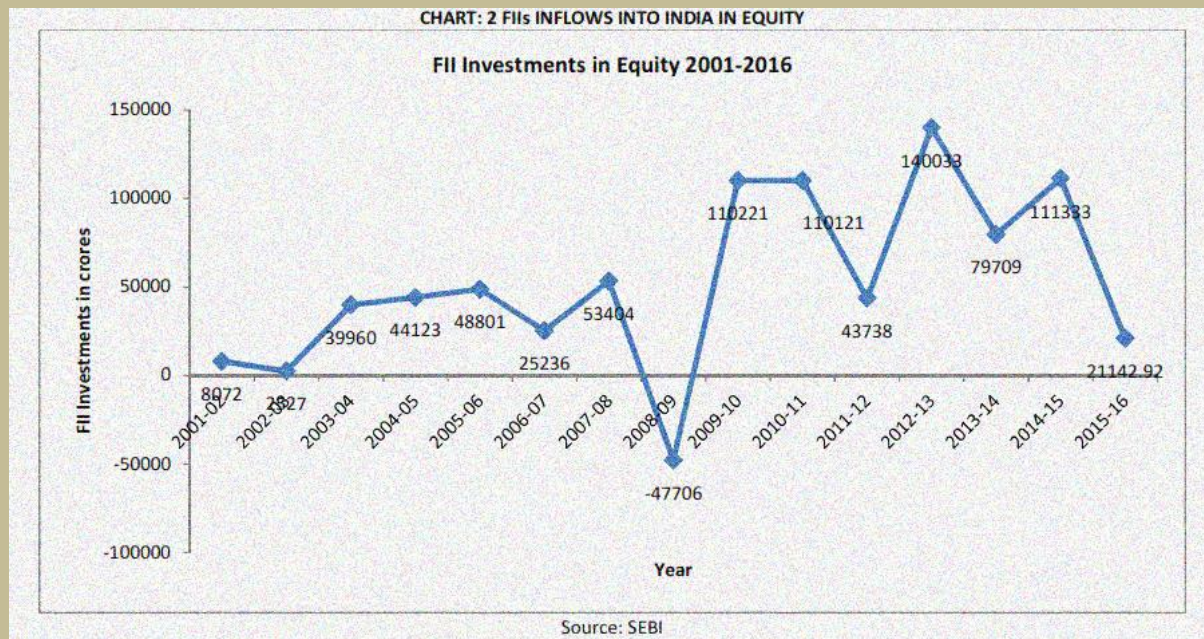
- To study the growth of foreign institutional investments in India.
- To identify the factors influencing the FII investments in India.

METHODOLOGY The required data for the study has been collected from secondary sources from the official websites of BSE, SEBI and RBI. Since the data is time series, tests for checking the stationarity was conducted. To find out the lag lengths at which the data could be analysed, Auto Regressive Distributed Lags method was followed and the cause and effect of the determinants of FII was found out using Granger causality test.

PERIOD OF THE STUDY The study was conducted for a period of 15 years from 2001-2016 and monthly data was used for the study. To find the impact of global financial crisis, the period is split up into two as April 2001 to August 2008 and November 2008 to March 2016. The month of September and October 2008 were taken as the crisis period and not considered for the study and this was decided after fitting a trend to identify the crisis period.



The above chart clearly depicts the increase in the number of FIIs registered with SEBI for the purpose of trading in India. The number registered touched a peak of 1765 in the year 2012-13 but has slowly declined to 1444 in the year 2015-16.



The above chart shows the growth in FII investments from the year 2001-02 to the year 2015-16.

- From Rs. 8072 crores in 2001-02, there was a gradual increase up to 2007-08 and the investments have touched Rs. 53404 crores.
- Due to the global financial crisis in the year 2008-09, there was a sudden fall in the net FII investments where the outflows were more than the inflows [Rs. 47706].
- The year 2009-10 has seen a sharp rise in the inflows and it has touched Rs. 110121 and it can be identified with the confidence in the Indian Stock market by the FIIs.
- FII investments touched its peak of Rs. 140033 crores in the year 2012-13.
- By the year 2015-16, there is a decline in the flows and is at Rs. 21143 crores.

DETERMINANTS OF FOREIGN INSTITUTIONAL INVESTMENT FLOWS

There is no consensus about the factors which is determined as influencing the flow of FIIs. This is because, the factors favouring or being unfavourable for attracting FIIs differ from country to country including the micro and macro-economic factors prevailing in that country. Broadly, the following are considered as the major factors influencing FII investments after reviewing previous studies in this aspect.

1. INFLATION

Inflation has an inverse relation with the foreign investment inflow, as the investor will always keep into consideration, the purchasing power of the funds invested and the inflation increase. When there is an increase in inflation rate, it leads to the decline in the purchasing power of the investor. Therefore, the investor would prefer to withdraw his funds invested. Similarly, if the inflation in foreign country increases, the purchasing power of funds invested in foreign country would decline. This would make the investor to withdraw and invest in the country where inflation is lesser.

2. INDEX OF INDUSTRIAL PRODUCTION (IIP)

IIP is also as important reflex on the growth of an economy. IIP reflects the growth of different sectors of an economy like manufacturing, mining, quarrying, power, etc. IIP in India indicates the short- term changes in the production volume of certain industrial products which are blanketed together for a particular period in relation with the base period taken for calculation. Since FIIs are motivated by the growth of the companies / sectors in which they are investing, IIP as a factor determining FII flows into India is justified.

3. INTEREST RATES IN INDIA AND OTHER COUNTRIES [MIBOR]

When the interest rates in India are high, it increases the cost of capital for a company and in turn will affect the profitability of the company. Decreasing corporate profitability, in turn, will reduce the market value of a company's equity share. This will be less attractive for domestic as well as foreign investors. In such a situation, FIIs will shift their focus from equity markets to debt markets because they will get higher returns in the debt market. Therefore, rising interest rates in an economy will affect FII investment flows in equity and equity related instruments.

4. FOREIGN EXCHANGE RATE

Foreign Exchange Rate prevailing between the currency of host country and the currency the investor's domestic currency fluctuates based on the demand and supply of currencies against each other. The exchange rate affects the effective or expected rate of return on investments. When the value of home currency is stronger, the FII investments will definitely increase. This is because; the percentage of returns of FIIs will increase with the strong value of currency and its appreciation. In other words, if the currency value of the host country is weaker or depreciates then this will give a better appreciation in the value of FII investments.

5. MONEY SUPPLY

In an economy, the amount of money in circulation at a given point of time is called as money supply. It includes cash, coins, balance in savings account, short term investments etc., held by individuals and business houses. The increase in money supply will help to reduce the interest rates and when the money supply reduces, there will be a decline in the growth of an economy. M₃ is a broader concept which includes the savings and time deposits held by banks.

6. IMPACT COST

Impact cost is otherwise called as the transaction cost which would be incurred by a buyer or seller of the stock at the time of executing the contract and it is a good measure for checking the liquidity of a market.

7. GOVERNMENT POLICIES

Investment flows of FIIs also largely depend upon the Government Policies of a country in which the investment is to be done. For Instance, when the Indian Government announced capital gains tax and minimum alternate tax for FII's that sent a very negative signal and FII's started pulling out their investments leading to volatility in the stock market. Since the Government policies cannot be measured numerically, it is not considered in this study.

CONCLUSION

The FII inflows into a country depend upon various factors and there are certain factors which are very much influential. In this study, it was found that there was unidirectional causation from FII investments towards the exchange rate and IIP in India. Also it was found that there was a unidirectional causation from money supply and CPI towards the FII inflows and there was no causation between impact cost and MIBOR towards the FII investments.

LIMITATION OF THE STUDY

The factors influencing the FII investments are very wide, but only the macro economic variables are considered for the study.

SCOPE FOR FURTHER STUDY

A study can be conducted considering micro economic variables also like the price earnings ratio, returns and volatility of the companies constituting the index.

REFERENCES

1. Ashish Garg & Bodla B.S (2009). “Determinants of Fiis Investment In Indian Stock Market”. *Abhigyan*. Vol.XXVI.No.4. Pp 12-24.
2. Indrani Chakraborty (2006), “Capital Inflows During the Post Liberalisation Period”. *Economic and Political Weekly*, January.14,2006, pp.143-150.
3. Krishnan Dandapani & Edward Lawrence (2013). “Foreign Institutional Investment In India”. *Finance India*.Vol.XXVII.No.2 Pp 409-419.