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IMPACT OF FII'S INVESTMENT ON THE INDIAN CAPITAL MARKET

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ABSTRACT

The Indian economy has witnessed paradigm shift post liberalization, since 1991. Opening of many sectors necessitated policy measures to encourage the foreign institutional investment (FII) in India. FIIs have been allowed to invest in all securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India. The number of FIIs registered with SEBI was 3 in 1992-93 and since then it has increased to 1713 in 2009-2010. The FIIs have been playing a significant role in the Indian capital market in capital formation and economic development of the country. The present work is an attempt to assess how the FIIs have contributed to the Indian capital market since 1993. S&P CNX NIFTY has been taken as a proxy for the Indian capital market. Data of FII investment was obtained from the website of SEBI and annual report of RBI. Further data was also obtained from the website of NSE. On the basis of empirical work carried out for a period 1991-93 to 2010-11 the study tries to find the correlation between net FII flows and NIFTY. The study also tries to assess the impact of FIIs investment on the market capitalization and on the basis of empirical data. In order to test the hypothesis -correlation, OLS regression technique and independent sample t-Test is carried out. The study concludes that FIIs are aiding in the promotion of Indian Capital market the market become more efficient with the growing presence of institutional investors. Further, the study also traces upon the regulatory measures adopted to smoothen the flow of investment by FIIs in India.

KEYWORDS

Foreign Institutional Investors, FII, Indian Capital market, NIFTY Index.

INTRODUCTION

Foreign Institutional Investors (FIIs) have been playing key role in the Indian Capital Market since their allowance to participate in the Indian capital market as part of India's liberalization policies. In these context necessary guidelines for investment was announced on Sep. 14, 1992. This allowed FIIs to trade in all securities after obtaining SEBI registration. The number of FIIs registered with SEBI was 3 in 1992-93 and since then it has increased to 1713 in 2009-2010. Foreign institutional investors are permitted to invest in the primary market and secondary capital markets in India by a way of Portfolio Investment Scheme (PIS) under which FIIs can acquire shares/debentures of Indian companies through the stock exchanges of India. The overall investment ceiling for FIIs is 24 percent of the paid capital of the Indian company. This limit is set as 20 percent of the paid up capital in case of public sector banks, including the State Bank of India. However, this ceiling of 24 percent can be raised up to sectorial cap/statutory ceiling, provided approval of the board is obtained and the general body of the company passes a special resolution to the effect.

The present study is an endeavor to find out the role of FIIs in the Indian capital market and to assess the relationship between Net FIIs investment and SENSEX. The Researcher has also tried to assess the impact of FIIs investment on the market capitalization. The study also traces upon the regulatory measures adopted to smoothen the flow of investment by FIIs in India.

REVIEW OF LITERATURE

Mishra P.K., Das K.B., and Pradhan B.B., (2009) in his paper entitled. "Role of FIIs in Indian Capital Market" examines the performance of the Indian capital market by empirically studying the impact of net equity investment by FIIs on stock returns. The author used monthly data on Sensex based stock return and net FII flows over a period of 17 years spanning from Jan 1993 to May 2009, provides the evidence of positive correlation between FII net flows into India and stock market return and author also found that the movements in the Indian capital market are fairly explained by the FII net inflows.

Prasanna, P.K., (2008) in his paper entitled — "Foreign Institutional Investors: Investment Preferences in India" has examined the contribution of foreign institutional investment particularly among companies included in sensitivity index (Sensex) of Bombay Stock Exchange. In this study also examined the relationship between foreign institutional investment and firm specific characteristics in terms of ownership structure, financial performance and stock performance. It is observed that foreign investors invested more in companies with a higher volume of shares owned by the general public. The promoter's holdings and the foreign investments are inversely related. Foreign investors choose the companies where family shareholding of promoters is not substantial. Among the financial performance variables the share returns and earnings per share are significant factors influencing their investment decision.

Lin, A. and Chen,C.Y. (2006) in his paper entitled, — "The Impact of Qualified Foreign Institutional Investors on Taiwan's Stock Market" has explored the relationship between qualified foreign institutional investors (QFIIs) and Taiwan's stock market and evaluates the effect of QFIIs' investment transactions on Taiwan's stock market. By taking the date of easing regulatory restrictions on foreigners' stock investment holdings as a cutoff point, the research uses the highest and lowest 10 stocks of QFII holdings in three industry sectors as sample portfolios to study the prior- and post event returns.

Soumyen,S. (2006) in his paper entitled, — "Foreign Capital Inflow into India: Determinants and Management", held that the surge in inflows has not been matched by a corresponding growth in the absorptive capacity of the Indian economy. The major reason is the persistent slowdown of industrial activity since 1997. At the same time, the Reserve Bank of India (RBI) has been reluctant to let the rupee find its market-clearing level under the circumstances. This has resulted in steady accretion to our foreign exchange reserves (FER) over the last few years.

Ananthanarayanan, S. (2004) in his paper, — "Foreign Institutional Investors and Security Returns: Evidence from Indian Stock Exchanges", held that as part of its initiative to liberalize its financial markets, India opened her doors to foreign institutional investors in September, 1992. This event represents a landmark event since it resulted in effectively globalizing its financial services industry. We study the impact of trading of Foreign Institutional Investors on the major stock indices of India. Our major findings are as follows. First, we find that unexpected flows have a greater impact than expected flows on stock indices. Second, we find strong evidence consistent with the base broadening hypothesis. Third, we do not detect any evidence regarding momentum or contrarian strategies being employed by foreign institutional investors. Fourth, our findings support the price pressure hypothesis. Finally, we do not find any substantiation to the claim that foreigners' destabilize the market.

Sivakumar, S. (2003) in his paper entitled, — "FIIs: Bane or boon?" has analyzed the net flows of foreign institutional investment over the years, in his paper also discusses the nature of FII flows based on research, explores some determinants of FII flows and examines if the overall experience has been stabilizing or destabilizing for the Indian capital market.

Kumar, S.S.S., (2002) in his research paper – “Role of Institutional Investors in Indian Stock market” observed that the main reason behind the development of the stock market in India in the last 15 years has been the growing participation of Institutional Investors and the Indian Mutual funds combined together and the total assets under their management amounts to almost 18% of the entire market capitalization. This paper examines the role of these investors in Indian Stock market and finds the market movement with the help of using the direction of the funds flow from these investors. To study the role of FIIs regression test and Granger Causality test was carried out by the researcher. On the basis of regression results they concluded that the direction of the flow of funds from FIIs and the mutual funds lead to market rise or fall. On the basis of empirical work carried out the author concluded that the market become more efficient with the growing presence of institutional investors.

OBJECTIVE OF THE STUDY

1. To study the structure and functioning of FIIs since 1992-93 in the Indian capital market.
2. To study the role of Foreign Institutional Investor in the growth and development of Indian capital market since 1992-93.
3. To identify the shortcoming in the existing legal framework for FIIs investment in the Indian capital market to ward off volatility.
4. To examine the relationship between the FIIs equity investment pattern and Indian stock indices especially National stock exchange’s CNX-Nifty index.

HYPOTHESIS

- H0: There is no significant impact of FIIs in the promotion of Indian capital market.
- H1: There is significant impact of FIIs in the promotion of Indian capital market.
- H0: There is no significant impact of FIIs in the promotion of Indian Capital market.
- H1: There is no significant impact of FIIs in the promotion of Indian Capital market. .
- H0: There is no significant impact of FIIs investment on CNX-Nifty index
- H1: There is significant impact of FIIs investment on CNX-Nifty index.

DATA SOURCES AND METHODOLOGY

To fulfill the present research objectives data of FII investment was obtained from the website of SEBI and annual report of RBI. Further data was also obtained from the website of National Stock exchange (NSE). Market capitalization data has also been obtained from the website of NSE, the reason for choosing the market capitalization indices is that, returns only incorporate the price changes, whereas market capitalization takes into consideration not only price data but volume of trading as well. In order to test the data empirically correlation, OLS regression technique and independent sample t-Test is carried out by the researcher.

RESULTS AND DISCUSSIONS

The present study is carried out to ascertain the role of FIIs in the Indian capital market. To fulfill this objective data were collected from the website of NSE and test was carried out to find if there is any impact of FIIs on the CNX-Nifty index. The table given below shows the net FIIs investment and the corresponding CNX-Nifty index value.

TABLE-1: NET FIIS INVESTMENT & CNX-NIFTY INDEX

Financial Year	NSE-CNX NIFTY	FII-Equity (INR Crore)
1992-93	840.99	13.4
1993-94	884.6	5126.5
1994-95	1202.87	4796.3
1995-96	965.26	6942
1996-97	1005.75	8545.6
1997-98	1087.34	5267
1998-99	956.62	-717.2
1999-00	1369.01	9669.5
2000-01	1336.49	10206.7
2001-02	1007.13	8072.2
2002-03	1036.1	2527.2
2003-04	1428.13	39959.7
2004-05	1805.26	44122.7
2005-06	2503.4	48800.5
2006-07	3572.44	25235.7
2007-08	4896.6	53403.8
2008-09	3731.03	-47706.2
2009-10	4627.76	110220.6
2010-11	5583.54	110120.8

Source: website of NSE & SEBI

To test the impact of FIIs in the promotion of the Indian Capital Market, trend analysis using multiple linear regression model fitted with the econometric technique of ordinary least square (OLS) of the type.

$$Y = \alpha + \beta t + r t d$$

Where α , β and r are constant and t = time. The above formulation is adopted on the ground that we are interested in growth and not in absolute change. In the equation mentioned above if β is found to be statistically significant, than one can accept the hypothesis that there is a significant impact of FIIs on the Indian Capital Market reject otherwise.

Thus by applying linear regressions on net FII investment and CNX-Nifty index value the following summary table has emerged

TABLE-2: MODEL SUMMARY

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.648a	.419	.386	1225.3908

- a. Predictors: (Constant), Net FII Investment
- b. Dependent Variable: CNX-Nifty index

It can be observed from the above table that all explanatory variables, taken together explain nearly 42 percent ($R^2 = 0.419$) of the total variables in the capital market of India is established each year. This means that whatever changes have happened in the CNX-Nifty index for period under review the FII investment are responsible up to 42%. This implies that there are many other macro economic factors which have indirectly affected of CNX-Nifty index in India, but FII’s investment is a major factor. Therefore, it may be inferred that according to the model made on the basis of linear regression, FII investment have affected the CNX-Nifty index value from the coefficients of the model as shown above. It can be observed from the table-3 that the value of t statistics is 2.399 which is significant at 5 percent level of significance which means that the null hypothesis is not accepted and the alternate hypothesis there is significant impact of FIIs on the CNX-Nifty index is accepted meaning thereby that FIIs are aiding in the promotion of Indian Capital market.

TABLE-3: COEFFICIENTS

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1473.408	332.595		4.43	.001
Net FII Investment	.071	.007	.266	3.507	.050

a. Dependent Variable: CNX-Nifty index

Further to find out the relationship between FIIs investment and the CNX-Nifty index Pearson Correlation test is carried out. From this it established that the correlation between Net FIIs investment and CNX-Nifty index is .266. This shows that there is a moderate positive relationship between Net FIIs investment and CNX-Nifty index. Hence there is a moderate impact of FIIs investment in the fluctuation of the CNX-Nifty index for period under study.

The present study is also dedicated to find out the relationship between FIIs investment and the market capitalization on the basis of the empirical work carried out the following table has emerged.

TABLE-4: CORRELATIONS BETWEEN FIIS & MARKET CAPITALIZATION

		NET_FII_INVEST	MARKET CAPITALISATION
NET_FII_INVEST	Pearson Correlation	1	.666*
	Sig. (2-tailed)		.013
	N	13	13
MARKET CAPITALISATION	Pearson Correlation	.666*	1
	Sig. (2-tailed)	.013	
	N	13	13

*. Correlation is significant at the 0.05 level (2-tailed).

From the above table it is observed that the correlation between market capitalization and the net FII investment is .666. This shows that there is a good relationship between these two variables and both are positively correlated. Thus it can be established on the basis of the above results that there is significant impact of FIIs investment in the promotion of the Indian capital market.

Finally to ascertain the difference between the Investment made by the FIIs in the debt and the equity segment independent sample t-Test is carried out on the basis of the empirical work the following table has emerged.

CONCLUSION

This paper examines the inter-linkages among stock market, market capitalization, and net FII investment by applying multiple linear regression model fitted with the econometric technique of ordinary least square, correlation and independent sample t- test to find out the significant difference between FIIs investment in the debt and the equity segment. The results indicate that there is there is significant impact of FIIs on the CNX-Nifty index, there is a moderate impact of FIIs investment in the fluctuation of the CNX-Nifty index for period under study and finally on the basis of the results obtained it can be ascertained that there is significant difference between the investment made in the debt and the equity by the FIIs. These findings suggest that the authorities can focus on domestic economic policies to promote the development of the capital market and ensure the safety of the investors.

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