ABSTRACT

The Indian financial market has been an attractive investment destination for the investors across the globe. The frequent upsurge in the Indian stock market has made it a hot spot for both domestic and foreign investors. Similarly, the multi-faceted growth of Foreign Institutional Investor (FII) investments has made them as a major participant in the Indian stock market. The increasing participation of Foreign Institutional Investors (FIIs) certainly supplements the domestic investment, helps in achieving higher degree of liquidity, better price discovery, market efficiency etc. At the same time, FII investments are extremely volatile compared to other forms of investment flows. Any undesirable movement in FII investments is expected to have a huge adverse impact on Indian stock market. Hence it becomes very much essential to have an extensive study on the nexus between Indian stock market and FIIs investment behaviour.

The term FII investments in this research study represent net FII investments (i.e. FII inflows – FII outflows). Nifty return is also referred as Return on Nifty. The study considers the time period from April 2001 to March 2014 and uses both daily and monthly data. The frequency of the data varies with different objectives of the study. This research study has been categorized into four different segments based on the objectives framed. First, to ascertain the relationship between FII investments and stock market, the study period has been divided into six phases based on the market trends. The Correlation analysis, Granger causality test, Variance decomposition and Impulse response function etc., are carried out. Second, the expected selective stock market and macroeconomic determinants of FII investments are identified on the basis of extensive literature reviews and rationality. These
expected determinants are modeled using Autoregressive Distribution Lag (ARDL) framework. Both long-run determinants and short-run determinants of FII investments are found through ARDL cointegration approach.

Third, the impact of net FII investments on stock market volatility has been studied. Generalized Autoregressive Conditional Heteroscedasticity (GARCH) model is used to measure the impact of FII investments on market volatility as the data series exhibits the non-linear features. Finally, the study attempts to develop a forecast model for net FII investments in Indian stock market as it may be useful for various stake holders.

The result of the research study indicates that Indian stock market Granger cause net FII investments. Indian stock market return is found to be a major determinant of FII investments both in long-run and short-run whereas foreign stock market volatility is significant only in the short-run. The study shows that FII investments reduce the volatility in stock market. An autoregressive model having Nifty returns and first lag of FII investments as an exogenous variable is estimated for forecasting the FII investments. The forecast model has been evaluated and found reliable by comparing the forecast values with actual FII investments.