CHAPTER 7

FINDINGS, CONCLUSION & RECOMMENDATIONS

7.1 THESIS SUMMARY

The prime focus of this research was to examine the FII activities in the Indian primary market through the medium of IPOs. In our first chapter we presented an overview of our thesis as to its research context, literature gap, objectives, methodology and layout of the thesis. The second chapter carried out an extensive literature review on various aspects that needed to be analysed and referred, like past studies on liberalization and globalization, studies on FDI and FPI, studies conducted on Indian primary market and particularly on IPOs and finally an extant literature review on FPIs both in the Global and Indian context. The literature review however found almost negligible researches on FII contributions in the Indian primary market which was incidental in building up our research motive. The third chapter thus discussed in details as to the rise of Global finance in stages. It discussed the three main stages of international financial revolution, rise in the need for capital flows from one country to the other, changing place of India in the field of international capital flows, and lastly the cause and ways of entry of FPIs into the Indian capital market. Gradually we saw how FIIs started gaining increasing importance amongst the various other portfolio flows, its impacts, regulations etc. In the fourth chapter we carried out a brief overview of the Indian capital market, especially the equity market before finally attempting to get into the details of the Indian IPO market and its dominance in the Indian primary market through an empirical analysis. In the fifth chapter also we conducted our empirical analysis and examined how the FII inflows into IPOs actually affect the Indian stock
market by carrying out the research over a time period of six years and over 308 companies which came up with IPO from 2006-2011. In the sixth chapter we tried to examine the impact of FII investment proportion in each stock and its short run listing performance to identify if there is any link between the two.

7.2 RESEARCH FINDINGS

India’s approach of gradual liberalization of the capital account has worked well in many ways. India has reaped macroeconomic benefits of an open current account, and from FDI and FPI. The liberalization policy of the 90’s brought about far reaching changes in the economic fundamentals of the country. The motive behind this research was to actually take up one such major change which was the entry of the foreign portfolio flows into India post liberalization. As has already been discussed in previous chapters we firstly did an exploratory research through various literature and also from our data collected on different types of portfolio flows we found researching into FII flows as crucial for emerging markets like ours’. Due to the comparatively undeveloped market structure of emerging markets, the degree of information asymmetry among participants is relatively high in such markets and this fact might be considered worth to be exploited by FII’s primarily more so by the developed economies. However having analysed the growth of capital flows world over and related studies on them there is no conclusive evidence for or against liberalization or capital flows.

In this increasingly complex situation of the financial world it is of utmost importance to understand the workings of economic and financial system. As we know that FII’s have known to cause significant upheavals in the Indian stock market by their sudden inflows and outflows of investments at the slightest hint of prospect or trouble
respectively it was necessary to understand their intention in the capital formation of our country which is primarily done through the Indian primary market.

With growing interest of the foreign investors towards Indian capital market, a greater understanding of the dynamics of the behavior of issuers can provide ways to create and maintain the confidence of foreign investors towards Indian capital markets. Thus the research was motivated towards examining the Indian primary market and more so the IPOs and their linkage with foreign capital flows into our economy. In order to do so we mainly concentrated on three major issues:

a. The growth and importance of IPOs in the Indian economy.

b. The dominance of IPO on the Indian stock market.

c. The dominance of FII inflows into Indian IPOs and its impact on the stock market.

d. And finally the dominance of the scripts having more FII inflows in terms of their short term profitability.

Though IPO is the most common mechanism for attracting capital by the corporate but over the years we see that the growth in the number of IPOs being floated underwent a major reduction. Various factors like slowdown in industrial activities, entry point restrictions, development of other forms of primary market issues were some of the major reasons. However if we look at the volume of funds mobilized through this channel we see a rapid growth in the early 2000’ till the Global meltdown and once again a quick recovery from 2009 onwards. This quick recovery in terms of volume of capital post the global meltdown indeed needs worth mentioning and points to the fact that investor confidence both in the capital market and in Indian corporate is probably the sole driving force behind such quick reversals (Fig 11, Fig 12). The empirical
research on data collected between 2006 to 2011 also points to the fact that IPOs cast a
significant impact on stock market variables like market-capitalisation and Nifty. Thus
the Indian primary market does have a close and important link to the secondary market
which is statistically and theoretically justified. The secondary market is the platform
where already issued stocks change hands. It is a medium granting greater flexibility in
the hands of the investors and creates liquidity in the economy. But the actual capital
formation takes place in the Indian primary market be it bonds or equity. The capital
thus created here actually gains in market valuation through future expectations in the
secondary market which boosts market valuation of the company as well as its stocks.
Thus both the markets are complementary to each other.

Having done an extensive literature survey and indentifying almost negligible
researches of foreign capital inflows in the Indian primary market our research was
directed towards understanding the FII inflows into Indian primary market and its
impact on the secondary market. By applying linear regression of FII inflows into IPOs
from 2006 to 2011 on market capitalization and Nifty we observed that both these
variables were positively affected by FII inflows in IPOs. While doing so we kept GDP
as our control variable. The NSE market capitalization is a strong indicator of the
overall financial growth of an economy. On the other hand GDP is a strong indicator of
the overall economic growth. The objective of considering GDP as a regressor for this
purpose was to understand the relative macroeconomic importance of FII investments
into IPOs of India in shaping the financial growth of the economy. In our analysis we
find that the predictive capacity of the GDP is far more dominant as compared to FII
investments in IPO. This fact is important to note that though GDP stands as an
extremely fundamental factor in predicting the financial growth of an economy,
comparatively the FIIs have also played a significantly important role in dominating the
financial sector of the country. Here our goal was primarily to establish FII capital contribution (as only investments in primary market is considered) as an important macroe- economic factor influencing the market-capitalisation of a country. Since the entire market capitalisation of the economy was taken so we had considered GDP of the economy as a supporting variable reaffirming once more a strong impact of the real sector on the financial markets. However if FII investments in IPO can affect the market-capitalisation of NSE it definitely should have a strong influence on the Nifty itself being a representative index of few dominant stocks of the economy. We found that FII inflows positively affected the Nifty as well or in other words FII inflows into IPOs positively affects the market.

In earlier studies various factors have been considered in order to understand the listing performance of the IPOs. Though various researches have been conducted on the initial day listing performance of Indian IPO’s, as to their reasons of occurrence, extent etc we came across no such study whereby any attempt was made to understand the linkage between FII investment proportions and the short term listing gain or loss. Since FIIs by their net volumes of trading cause secondary market movements, we tried to analyse its effect on moving the share price of the individual scripts six months from when they are are listed. As we know that the share price movements in the capital market get largely dominated by market perceptions we tried to analyse the resulting listing gain or loss by two variables-namely FII investment proportion and the number of times the issue has been subscribed by other categories of investors. Thus we wanted to analyse how far the short run listing performance gets affected by the perceptions of the FIIs simultaneously with the market as a whole. Applying Logistic regression on all the scripts of our sample we see that FII investments in IPOs apart from being an important capital market determinant is also an important criteria in the micro level for
having caused significant impact on the listing performance of the stocks in a positive way. As has already been pointed out that various firm level and other macro aspects affect the listing performance of the stocks as per literature, our results also add a new dimension to the fact that FII investment proportions can also adequately affect the performance of the stocks. This may act as a guiding factor to the retail investors and other categories of investors before making investments in stocks in the primary market.

Thus our study marks a new dimension in the field of foreign portfolio flows through the medium of FIIs. FIIs not only finds an important place in the Indian stock market through all previous studies supporting so but also causes a significant impact on the secondary market by its investments in the Indian primary market through IPOs.

7.3 RECOMMENDATIONS

The role of portfolio flows have been debated in various literature world over. It has been widely observed that often for greater returns developed countries pour in short term capital inflows to developing countries often leading to currency appreciation and asset bubbles and the quick reversal of such flows cause acute destabilizing environment in the developing economies. Many emerging market economies started adopting various capital control measures like taxes and reserve requirements to counter such problems in order to avoid inflation, overvalued exchange rates, asset bubbles etc which is often instigated by such short term speculative flows as these countries tend to have high growth rates and are found attractive for investment purposes. However researchers believe that use of capital controls, in addition to both prudential and macroeconomic policy is justified as part of the policy toolkit to manage
inflows (Ostry et al 2010). Once the countries with open capital market do experience a financial crisis due to sudden capital outflows, often caused by external factors, it takes several years for growth to recover (Rodrik, 1998). However, there are numerous such literature which has been sited earlier which supports capital account liberalization for greater optimization of global savings, increase in financial discipline and transparency globally, greater market depth and liquidity, diversification and risk reduction, increase in market efficiency and many such instances which makes it obvious that the debate over capital account liberalization is increasing but not conclusive. In the Indian context, however, we see that deregulation and capital account liberalization has brought about many good changes than compared to the pre-liberalization era before the 1990’s with stricter controls. But it is important in this context to understand that like every other emerging economy to avoid any short run disruptions in the market and the economy the short term capital flows needs special attention and monitoring. Though the very nature of such flows is the speed and ease with which they can entry and exit, our prime concern should be to establish such macroeconomic policy framework which would be able to take benefits out of such flows on a sustainable basis. In addition to this the corporate market climate should be made such that portfolio flows finds it lucrative to invest in the Indian capital markets through the primary market mechanism. The portfolio flows which have only been adjudged to have interest in short run profits should not be taken up with a negative connotation. We have to be reminded of the fact that financial markets while reaping the benefits of liberalization and deregulation will essentially be liquid and flexible as these two factors are prerequisites for actual resource allocation which leads to growth in the long run. Instead there should be enough such incentives and mechanisms to attract foreign capital flows in the Indian primary market which will broaden and diversify the capital base of the companies. On the whole fair valuation of both the company’s balance sheets and the economy’s performance and such true projections to the investors will not only provide a sound and sustainable ground for investments but will also bring about greater stability and market efficiency.
7.4 LIMITATIONS OF THE STUDY AND SCOPE FOR FURTHER RESEARCH

This study has only considered the IPO method amongst other methods of operations in the primary market of India. Methods like private placements, FPO, rights etc have been excluded in this study. Moreover only the equity market has been considered and not the debt market.

Further research could be carried out on aspects like the following:

a. A segmentation could be done as to which sectors receive more FII inflows in the primary market.

b. A global comparison as to the extent of FII activities in the primary markets of different emerging market economies.

c. A comparative study as to the FII activities in the primary markets of both debt and equity.