CHAPTER-II
REVIEW OF LITERATURE & RESEARCH METHODOLOGY

As a lamp-light helps in showing the way in darkness similarly existing literature on a topic helps in establishing the theoretical base or designing the research methodology for the conducting a research study. So, the existing literature has been reviewed keeping same thing in mind. The chapter has been divided in two parts. **Section-I** covers the previous manuscripts related to FII. **Section-II** is all about the research plan curved to solve the research problem under the study.

SECTION-I
REVIEW OF LITERATURE

Over the years, foreign capital flows has assumed great importance in the economic development of Indian economy. This growing significance of FII has caught the attention the policy makers and researchers. These concerns are very important for development of an economy specifically to emerging economies as some of these concerns could boost the economic development while others may help to stop deterioration of key economic indicators of an economy. The FII has provided the much needed impetus to Indian economy through growth in Indian capital market. All these developments have brought significant change in saving and investment behaviour of the people in the economy. The SEBI is the regulator for Indian capital market and it regulates the flow of foreign investment in Indian capital market. The foreign investment flows have been found to create the flux in the economy by causing fluctuation in stock prices. Some studies have tried to identify the important determinants for foreign institutional investments. These factors could also be categorised as ‘push factors’ and ‘pull factors’ representing the factors belonging to investing nation and host nation respectively.

Review of literature shows that some of the studies have examined the impact of FII on stock market returns by ascertaining the causal link between the FII and stock market returns both at national and international level. So, efforts have been made in present section to re-observe the findings of existing studies to squeeze the brief conclusion regarding the impact of FII investment and its trading strategies on stock market returns.

Studies covered for review of literature are divided in four categories. The first category includes the studies establishing FII as the causal factor. The second category summarizes the studies establishing stock market returns as the causal factor. While the
studies establishing bi-directionality of causal link between the FII and stock market return has been the part of third category. The last category throws light on studies exploring the determinants of foreign institutional investors in Indian stock market.

2.1.1 Studies Establishing FII Flows as a Causal Factor for Stock Market Returns

A number of times the business page in daily news-papers headlines i.e. ‘FII flows lift Nifty to 52-wk high’, ‘Sensex soars 400 points following heavy FII traffic’ etc. These headlines indicate the impact of the FII on Indian stock market. Previous researchers have also confirmed the impact of FII on stock markets returns by evidencing the price pressure caused by FIIs in different markets all over the world. This price pressure theory explains that huge investment by FIIs lead to rise in equity prices owing to the expectation of further surge in future FII flows. The herding behaviour of FII flows are also found to create flux in stock prices many times; hence cause flux in stock market. This all fact points out the FII as a causal having influence on stock market returns. Previous studies establishing same facts have been assembled here under:

Bose (2012) evaluated the impact of institutional investment i.e. FII and mutual funds investment on stock market returns. The study provides the evidence for causality running from FII to stock market returns while in case of mutual fund investment and stock market returns, stock returns can be held as a cause to mutual fund investment. The results of the study revealed that both the FII and mutual fund investment found to be positively correlated to concurrent stock market return which confirmed informed trading by institutional investors. The correlation of FII and mutual fund flows with lagged stock market returns confirmed the momentum and contrarian trading strategies followed by these institutional investors respectively. The study also affirmed that price pressure has significant impact only for mutual fund investment not for FII.

Pal (2005) observed the behaviour of FIIs in India in post-election phase of 2004. The study also investigated the impact of FIIs on stock prices and equity shareholding pattern in different Sensex companies during in pre and post-election periods. The study found that there was sudden reversal of FIIs flows in post-election phase of 2004 which resulted in high volatility in stock prices in Indian equity market. But at the same time, the shareholding pattern of FIIs in Sensex companies has remained the same. FIIs were also found to be the dominant shareholder in the tradable shares of the Sensex companies. The study also suggested that macroeconomic policy making should not be affected by the movements of
speculative capital and resultant stock volatility as these are not necessarily be indicators of economic growth.

Ramaratnam et al. (2013) measured the impact of FIIs on stock market in India. The study found a positive correlation (0.49) between net FII investment and BSE Sensex. The ANOVA test indicated that there is significant impact of FII inflow on the stock market index movements. It has also been proved in the study that there exists a significant difference on FII investment between debt and equity segment.

Samal (1997) appraised the role of FIIs in equity market development and its impact on equity prices in developing economies. The study specified that equity market development in developing countries does not depend upon the FIIs rather its development can be attributed to economic growth of these countries. Price movement in equity is very much influenced by the FII investment as the FIIs with huge resources at hand usually create instability in the stock market. The study also recommended that policy measures should focus more on wooing the domestic investors to participate in equity market rather than the FIIs who create volatility.

Behara (2012) estimated the impact of FIIs investment on Indian stock market mainly on equity returns, liquidity and volatility in stock market. The study revealed that FII investment has positively affected the equity returns and stock market liquidity during the study period from April 1993 to March 2009. On the other hand, results of GARCH model indicated that FIIs investment is the causal factor for increasing volatility in Indian stock market during the period from April 2002 to March 2010.

Ananthanarayanan et al. (2009) undertook the study to examine the impact of FII flows on major stock indices of India. The study confirmed the theoretical conception that unexpected flows have more impact on stock prices than the expected flows as expected flows are foreseen by the market. The study findings have supported both the base broadening hypothesis and price pressure hypothesis. At the same time the finding did not confirmed that FIIs are the feedback trader and according to findings of study FIIs can-not be paused as a reason to increase in stock market explosiveness.

Kanojia and Rani (2014) investigated the causal relation between the net FII investment and BSE 100 Index return over the period ranging from April 2000 to March 2012. The study reveals that causality runs from the net FII investment to BSE 100 Index return. The net FII investment also found to have a positive impact on return on BSE 100
Index which means that value of index increases with increase in net FII investment and vice-versa. The study also suggested that the regulatory authorities should make efforts to enhance the efficiency and stability in the stock market which will increase the investor’s confidence in the market instrument as a result investment level will go up.

Bohra and Dutt (2011) assessed the behavioural pattern of FII in India and tried to find out the indifferent responses of BSE Sensex due to FII inflows. The study indicated a positive correlation between stock market and investments of FIIs in a relation that Sensex follows the investment behaviour of FIIs. The FIIs are also found to create flux in stock market. The study observed that in case of individual group securities, FIIs had shown a positive correlation in less regulated and high capitalized securities in the market to earn high equity returns. The government scrip group and scrip’s forming part of BSE Indonext could not become an extensive part of FII inflows. The study also recommended that the authorities should focus more on domestic policies to alleviate the stock market.

Jain et al. (2012) examined the contribution of foreign institutional investment in BSE Sensex and observed the volatility of Sensex due to FII. The study period ranges from 2001 to 2010. The correlation analysis indicated the positive value between FIIs investment and movement of Sensex. The analysis indicated that the Sensex increased with positive FII inflows and decreased with negative FII inflows. So, FIIs proved to be the causing factor for the stock market instability.

Loomba (2012) evaluated the dynamics of the trading behaviour of FIIs and its effect on Indian equity market. In order to check the association between these two the Pearson’s correlation technique has been applied on daily data relating to BSE Sensex and FIIs investment. The results showed the significant positive correlation between FIIs investments and BSE Sensex (absolute change and per centage change). The study established that the high volatility associated with FIIs investment creates instability in stock market prices by infusion and diffusion of funds at once.

Kumar and Devi (2012) examined the relationship and the impact of FDI & FII on BSE Sensex and CNX Nifty through using the correlation coefficient and multiple regression techniques. The study established strong positive correlation between FDI & Sensex (.917) and FDI & Nifty (.917) at 1% significance level while the moderate correlation is established between FII & Sensex (.586) and FII & Nifty (.590) at 5% significance level. The multiple
regression model used in the study concluded that both the FDI & FII flows have significant impact on Indian stock market.

Noor and Shabbir (2014) observed the FIIs movement and also examined the relationship of FIIs trading and Indian capital market’s performance. The study found positive degree of correlation (.195) between the FII Investment and BSE Sensex which shows that FII flows are important factor of Indian stock market performance. The study confirmed the conceptual notion that FII drives the stock market performance. The study also suggested that host country has to follow stable macro-economic policies to attract FII Investment and retain the investor’s confidence in staying invested.

Bansal and Pasricha (2009) studied the impact of market liberalisations to FIIs on Indian stock market measured in terms of market returns and market volatility. The study period ranged from 23rd Jan. 1991 to 29th March 1994 has been demarcated between the period of 330 days before the opening day of stock market to FIIs (14th Sep. 1992) and 330 days after the opening day. The analyses revealed that return and volatility have wilted on account of FIIs in India. The study also proposed that as the FIIs investment is less correlated with market returns and market volatility, so the volatility in Indian stock market is not the function of FII investment flows rather it may occurs due to other factors.

Pal (1998) undertook the study with the objective to find out whether the Indian economy has actually benefitted from the huge inflow of investment by foreign institutions or not? The study concluded that the entry of FII inflows failed to boost the country’s stock market and economy. In addition to these FII inflows have increased the uncertainty and volatility about the stock market returns by introducing the capital even at the market failures and at the other time by making the huge outflow in spite of strong fundamental economic indicators. The study revealed that the instead of increasing the level of domestic savings and investment FII inflows have increased the instability in both of these indicators.

Duhan (2014) examined the impact of FII investment on BSE Sensex. The study established the FIIS as the causal factor to the SENSEX movement i.e. SENSEX goes up with the positive FII investment and goes down with the negative FII investment. The study also found high degree of positive correlation between the FII investment and Sensex i.e. +0.712. it shows that both variables moves in the same direction.

Karthikeyan and Mohanasundaram (2012) studied the impact of FII flows on Indian equity market mainly on BSE SENSEX, NIFTY and S&P CNX 500 Index. The study found a
positive correlation between the FII flows and movement of the indices in the Indian equity market. The small value of regression coefficient indicated that the FII flows are not the only determinant for movement in Indian stock indices. The study revealed that there could be various other determinants like govt. policies, budgets, bullion markets, inflation, economic and political conditions etc. to stock price movement in India.

Siddiqui and Azad (2012) examined the impact of FIIs on sectoral indices of Indian stock market indices. The study found that FIIs have positive relationship with all selected sectoral indices of BSE during the study. But this relationship is found significant only for IT, metal and auto indices while the other indices does not found to have significant relationship with FIIs. The study recommended various measures to avoid destabilisation and to increase the FII flow i.e. controlling the fiscal deficit and inflation, constructing international level infrastructure, increase in supervision & transparency of banking and financial institutions and to build the competitively advantageous companies etc.

Ramanaiah (2011) studied the growth of FII investment and its impact on stock market. The study indicated high degree of volatility in stock market due to FII investment but at the same time, established the FII investment as one of the significant contributing factor to the stock market development. The study recommended that in order to minimise the volatility impacts of FIIs, the policies and regulations should be carefully upgraded.

Kulshrestha (2014) examined the impact of FIIs on movement in major stock market indices and also examined the factor influencing the FII’s investment decision. FIIs were found to have significant impact upon the stock market indices i.e. Sensex and Nifty. The low regression scores in study indicate that changes in stock market indices must have caused by various other factors. Before investing in a country FIIs used to consider the parameters like IIP, GDP, Inflation and interest rates of economic growth of that country. The study suggested that in order to avoid volatility in stock market govt. should fix minimum & maximum limits for foreign institutional investors in India.

2.1.2 Studies Establishing Stock Market Returns as a Causal Factor for FII Flows

However, there are some other studies which contradicted the above studies on the basis of causal relationship between the FIIs Inflows and Stock market prices. The basis of reversal of causal relation could be attributed to ‘return chasing’ or ‘feedback trading’ behaviour of FIIs in various stock markets of the world. The feedback trading by FIIs refers to strategy followed by FIIs under which they used to follow the return in a particular stock
market at any given time. It can occur in both positive and negative ways. The positive feedback trading occurs when FII investment rises with increase in return and falls with decrease in return of a stock market. While, under negative feedback trading FIIIs usually adopt contrarian trading strategy. Under it, they increase the FII investment with decrease in return and vice-versa. Thus, the feedback trading show that returns have an influence over FII in a particular market. The following studies establishing the stock returns to be the cause of FIIs inflows have been compiled here under:

Bohn and Tesar (1996) examined the U.S. equity investment in 22 countries to study whether the investment is on account of portfolio rebalancing or due to return chasing behaviour. The study disproved any evidence of portfolio rebalancing by U.S. equity investors in foreign markets. The study conveyed that U.S. equity investors invest in a particular country on expectation of excess return in that foreign market although timing of this return chasing not found to be perfect. Apart of return chasing behaviour by U.S. equity investors in foreign markets they are also found to be risk avoiders in these markets during the study period.

French (2011) assessed the relationship between the net foreign equity flows and Johannesburg Stock Exchange (JSE) return. The study confirmed the return chasing behaviour by foreign portfolio investors indicated by fact that return has caused the foreign equity flows i.e. both anticipated and unanticipated during the study period. The study has negated the presence of price pressure hypothesis as there is no signal of foreign equity flows causing the JSE return revealing high fundamental pricing of stocks in JSE.

Alemanni and Ornelas (2007) analysed the impact and behaviour of foreign investors on 14 emerging markets of the world. The study gives the evidence of return granger causing the foreign flows that implies the feedback trading by foreign investors. The analysis of return chasing behaviour of foreign investors i.e. hedged and un-hedged investors reveal the instance of positive feedback trading by hedged investors and negative feedback trading by un-hedged investors. The study does not found any destabilising effects of foreign investment in the selected emerging markets so recommended not to impose any long term restriction on these inflows as they bring in more benefits than encumbrance.

Sehgal and Tripathi (2009) examined the behaviour of FIIs in Indian stock market environment. The study found that FIIs do not respond immediately to market return but follows the preserved return information as the evidence of return chasing behaviour is robust
only at monthly level, but not at daily level. On the other hand while measuring herding behaviour by FIIs the study concluded that clustering effect is more at aggregate level (at index level) compared to individual stock level. The study has established that FIIs goes by fundamentals while investing in particular scrip.

Kumar (2009) investigated the relationship between macroeconomic parameters such as exchange rate and FII with stock market returns in India. The study concluded that there is neither any co-integration between the exchange rate and stock (S&P CNX Nifty) returns nor any causal link from either side. The study also inferred the unidirectional causal link between FII and stock (S&P CNX Nifty) returns i.e. stock returns granger cause FII.

Chakrabarti (2001) discussed the nature of FII flows with the special aim to study the direction of causal relationship between FII flows and stock market returns in India. The study established a high degree correlation between the FII flows and stock market returns. The study has also perceived a regime shift in FII flows after the Asian crisis. The study found that equity returns used to follow the FII flows in pre-Asian crisis period, but the relationship turnaround (became reverse) in post-Asian period. The study has also discarded any information asymmetry to FIIs in comparison to domestic investors. The credit rating does not found to have any impact on FII in India.

Kumar (2012) studied the dynamics of foreign institutional investments and stock market returns in India through analysing the daily index of nifty and net FIIs inflows for the period January 2003 to December 2011. The study revealed bi-directional causality between the net FII inflows and stock returns in the India. The results confirm that relationship of returns causing net inflows is stronger than the net inflows causing returns. The results also satisfied the positive feedback trading hypothesis and expansion of investors’ base hypotheses. The results were contrary to theoretical conception that market responds strongly with unexpected flows than expected flows. The study found significant relationship between stock returns and both the expected and unexpected flows.

Bose and Coondoo (2004) undertook the study on ‘Impact of FII Regulations in India- A time-series intervention analysis of equity flows’. The study examined the impact of FII reforms on FII portfolio flows over the period ranging from January 1999 to January 2005. The liberalisation policies and restrictive measures (aimed at achieving greater control over FII flows) were found to have the positive/expansionary effect on net FII inflows. The study
also established that policy measures render FII investments more sensitive to the domestic market returns and raise the disinterest of FIIs.

Batra (2003) examined the trading behaviour of FIIs and Indian stock market returns on the basis of daily and monthly data. Analysis of daily data revealed that there is a strong evidence of FIIs adopting positive feedback trading and chasing trends at aggregate level but such results are not valid on monthly data basis. The study also indicated that foreign investors have a tendency to invest as a group in Indian equity market. The equity market unsteadiness cannot be attributed to trading unevenness with regard to FIIs.

Chakraborty (2007) investigated the causal relationship between FIIs flows to India and national stock market returns over the period from April 1997 to March 2005. The study revealed that national stock market returns are cause of FII flows; rather than being caused by FII flows. The study advocated that the Indian policy makers must adopt a cautious approach in further liberalizing the FII policy by introducing built-in caution within system against the possible destabilizing effects of sudden reversal of FII flows.

Gupta (2011) undertook the study “Does the Stock Market Rise or Fall Due to FIIs in India?” and examined the volatility in Indian stock market returns due to Foreign Institutional Investment. The study concluded that volatility in stock prices is associated with changing roles of FIIs investment. As because, on the one side, increasing presence of FIIs leads to better reform of stock markets in terms of transaction and trading system. On the other hand FIIs remain concerned mainly with booking profits by diversifying their portfolios in different countries, so makes the stocks prices to vary. The results from the study also confirmed that stock prices granger cause FII investment meaning thereby FIIs are feedback traders.

Saxena and Bhadauriya (2011) undertook the study to explore the causal relationship between the FII inflows and volatility in NSE indices through analysing the daily data series on FIIs inflows and S&P CNX Nifty. The study found that foreign institutional investment inflows are affected by stock market variability and these foreign institutional investment inflows do not have much impact on stock market volatility. So, the past data on stock market returns could be used to predict the present and future foreign institutional flows to India.

Sehgal and Tripathi (2009) examined the effect of home advantage in trading of both domestic mutual funds and foreign institutional investment in equity and debt segments of Indian capital market. Both mutual funds and FIIs were found to be affected by the returns in
equity segment meaning thereby both follow the positive feedback trading. But at the same
time FIIIs have responded faster than domestic mutual funds and thus eliminating the home
advantage effect to the domestic mutual funds. While in the debt market the results are just
opposite to it meaning thereby mutual funds have home advantage.

Rao and Rani (2013) explained the dynamics of FIIIs trading behaviour and effect on
Indian equity market especially in selected sectors, also with a comparative analysis of 10
preferred investment stocks of FIIIs taking the study period from 2007 to 2012. The study
inferred that there has been growing presence of FII flows in Indian stock market but at the
time of recession there has been a decline in inflows. The study showed that FIIIs held the five
maximum shareholding stakes in banks, followed by finance, media & entertainment,
information technology and service sector during the study period. Opposite to it, petro
chemical stands at last during the same period. The analysis also exhibited that IT & FMCG
sectors did not show any decline in FIIIs shareholding during the global recession of 2008.
Thus, FIIIs used to follow return of specific sectors.

Agarwal (2013) evaluated the correlation of net FII with the Sensex and net mutual
fund investment. The correlation between the net FII and Sensex (0.79661) is found to be
higher than the correlation between the net FII and net Mutual Fund investment (0.7785).
Both the Sensex and net Mutual Fund investment are found to have an impact over the net
FII. The study also suggested that domestic investors should be encouraged for the
investment as the FII creates volatility by infusing more funds at one time but with the small
clue of instability in the economy they withdraw from the market suddenly.

2.1.3 Studies Establishing Bi-Directionality of Causal Link between the FII Flows and
Stock Market Returns

The literature on FII also has several studies establishing bi-directional causality
between the FII and stock market returns. The bi-direction causality reveals that any two
variables being the part of a study causes each other. So, the studies concluding that both the
FII and stock market return cause each other are as follows:

Richards (2005) investigated the interactions of returns and investors flows in six
Asian emerging markets. The study found the foreign investors as momentum trader i.e. both
domestic and foreign returns found to influence the investment flows in selected equity
markets. This fact indicated that both the push (foreign returns) and pull (domestic returns)
factors equally determines the foreign investor flows. The result also indicated the presence
of stronger price pressure due to foreign investor flows during the study period. The strong price pressures from foreign investor flows can also cause deterioration in these emerging markets.

Adabag and Ornelas (2004) evaluated the behaviour of foreign investors trading on Istanbul stock exchange (ISE). The study found contemporaneous bi-directional relationship between net foreign portfolio inflow and US Dollar return of ISE. The study found base broadening impact of net foreign portfolio inflow as a short run concept during the study period. The study indicated the presence of negative feedback trading by net FPI. This trading strategy helps in returning the prices to the fundamentals in an economy. The study discarded any volatility in ISE on account of foreign investors.

Froot and Ramadorai (2001) appraised the dynamics of cross border institutional flows in close ended country funds of 25 developing countries. The study insists that prediction of future equity returns in local markets by cross border institutional flows can be attributed largely to information advantage. The price pressure effect existence is almost nil; it exists only for a very short duration. The study indicated the positive feedback trading by cross border institutional flow when we accounted for absolute returns; negative feedback trading when relative returns are taken in account.

Suganthi and Dharshanna (2014) examined the inter-relation between the FII, Indian stock market and the macro-economic variables. The FII and BSE Sensex were found to have bi-directional relationship meaning there by FIIs create instability in Sensex and vice-versa. The macro-economic variables i.e. IIP, WPI and Exchange rates were also found to act as catalyst for FII flow and movement in Sensex. The study suggested that while deciding policy issues policy makers should take into consideration these inter-relationship of macro-economic variables with the FIIs and indices of stock market.

Coondoo and Mukherjee (2004) examined volatility of FII, stock market return and call money rate (CMR) in India on daily basis for the period ranging from January 1999 to May 2002. The volatility in respect of the variables has been observed in three aspects i.e., strength, duration and persistence of volatility. The study observed that the volatility of call money rate (CMR) is highest among all the variables in respect of all the three aspects. The study also inferred that the strength and duration of volatility of FII flows and stock market return is almost similar as well as interrelated. Considerable amount of volatility in movements of daily values of the FII flows, stock market return and call money rate (CMR) has been observed but no change has been found in the pattern of volatility of these variables over the time.
Mitra (2010) investigated the relationship between the FII investment, stock prices and exchange rates using data on daily basis. The study revealed the bi-directional causality of FII investment with the exchange rate and stock prices movement (Nifty). The Johansen co-integration test used in the study found the long run co-integration between the FII investment, stock price movement and exchange rate. The presence of long run co-integration and bi-directional causality between the variables enhances the predictableness of the variables. The values of a variable can be predicted by using values of the other variables.

Goudarzi and Ramanarayanan (2011) studied the impact of FII on BSE 500 index. The study established the long run co-integration between the FII and BSE 500. The study also found the bi-directional causality between the two which means FII investment causes BSE 500 and also get affected by changes in BSE 500. The study commended the use of lower price limits and volume quotas to avoid the instability caused by FII. The study also acclaimed a self-insurance mechanism through establishing a fund based on Maximum Possible Loss (in case of capital outflows) to prevent same future probable crunch.

Gupta (2014) measured the correlation between BSE Index and FII inflows from 2006-07 to 2010-11. Firstly, the separate correlation has been measured for respective financial years over the study period separately then these correlation coefficients were averaged which was equal to 0.56 which indicates the moderate degree of positive correlation. So, the study established the proportionate relationship between FII inflows and BSE Index.

Paliwal and Vashishtha (2011) investigated the causal relationship between FII and BSE National index. Both the variables were found to be positively correlated. The study also established bi-directional causality between the two during the study period. However, the causal impact is robust for the alternate hypothesis that FII granger causes the BSE national Index.

2.1.4 Studies Regarding Determinants of FII in Indian Stock Market

The FII investment is increasing with the relaxation of norms regarding FII investment in India. The FII has proved a boon not only for stock market in India but it has also led to most of macro-economic indicators to magical numbers in no time. This growing importance creates curiosity in thinkers how to attract more and more FII flows in future. Since then, many studies have been undertaken on determining the factors responsible for FII flows in India. Many financial and macro-economic factors have been found to push and pull
the FII flows into India. Thus, these factors could also be categorised as ‘push factors’ and ‘pull factors’ representing the factors belonging to investing nation and host nation respectively. The studies concerning the determinants of FII have been reviewed under this category.

Srikanth and Kishore (2012) investigated the cause and effects of net FII flows on Indian financial markets using the Granger causality test. The study found the bi-directional causality between the net FII flows and BSE Sensex meaning thereby both are cause and effect of each other. FII flows were also found to be the impacting factor to foreign exchange reserves. Higher interest rates and Index of Industrial Production proved to be the significant determinants of FII flows into India, as these both factors reflect the economic growth of a nation.

Rai and Bhanumurthy (2004) examined the determinants of the foreign institutional investors in India and their impact on market returns in India by analysing the monthly data of BSE Sensex from 1994 to 2002. The econometrics models like ARMA, GARCH and TARCH were applied on the data. The study found positive relation of FII inflows with stock market returns in India and inflation rate in abroad. Various factors such as stock returns abroad, inflation rate in domestic nation and ex-ante risk in both the investing nation and recipient nation were found to be inversely associated with FII inflows in India. The study refuted any causation from FIIs inflows to the stock market returns.

Kaur and Dhillon (2010) explored the determinants of foreign institutional investment (FII) in India by analysing the financial and economic indicators of both the home (US as foreign) and host (domestic) country. The study inferred that the factors like return on BSE Sensex, market capitalization, turnover of Indian stock market, and macroeconomic factors such as Index for Industrial Production (IIP) in India and index of inflation in foreign country have positive impact on FIIs investment in India. The factors in the study such as return on stock market index of home (S&P 500), risk on Sensex return over S&P return, Wholesale Price Index (WPI) of inflation in India, US 3 month T-bill rate (USTBR) representing home country interest rate showed the negative impact on FII investment in India.

Prasanna (2008) assessed the role of foreign institutional investment particularly among companies included in sensitivity index (Sensex) of BSE and the specific characteristics of these companies which influences in attracting Foreign Institutional Investment. The study revealed that higher publicly traded shares attract more foreign
investment. Performance variables like price-earnings ratio and earning per share have significant influence on FIIs. The study also confirmed that there is no influence of foreign promoters or that of financial institutions on FIIs and there is an inverse relationship between promoters’ shareholding and FIIs.

Agarwal (1997) examined the determinants of foreign portfolio equity investment and the impact of FPI on national economies of developing countries over the time period from 1986 to 1993. The study found that index on economic activity, ex-ante risk, real exchange rate and share of domestic market in world stock market capitalization have significant effect on FII flows. In terms of magnitude, the impact of stock market returns and ex-ante risk turned out to be the major determinants of FII inflows.

Aggarwal et al. (2005) surveyed the post crisis sample of 114 US mutual funds in 1280 companies of 30 emerging markets to examine how country and firm level policies affect the investment allocation choices relative to major stock market indices. The study found that US mutual funds at country level invest more in open emerging markets with stronger accounting standards, shareholding rights, and legal framework. At the firm level these US funds invest more in the firms that adopt flexible policies such as greater accountancy transparency and the issuance of ADR. The study also advocated that steps should be taken both at country level and firm level to create such an environment conducive to foreign institutional investors.

Bhasin and Khandelwal (2014) studied the relationship between the net FII flows, exchange rate and foreign exchange reserves using the monthly data for the period September 1993 to July 2013 with the help of autoregressive distributed lag (ARDL) approach. The study holds that the net FII flow depend on exchange rate and foreign exchange reserves which means movement of exchange rate and foreign exchange reserves causes the FII flows in India. The study also established the exchange rate the main reason behind the volatility in FII flows as they consider the exchange rate before making investment.

Bhatnagar (2011) analysed the trend of FII investment in India and also attempted to know the causes of FII investment in India. The study revealed that FIIs investment is mainly based on the economic condition and growth of stock market of the country in which investment is to be made. Further, the study also established the market size, labour cost and productivity, liberalized trade policies, political scenario, operating and disinvestment
conditions to be the determinants of the FII investment in India. The study also emphasised the role of policy makers to increase the level of foreign investment in India.

**Research Gap**

Trading on the motive of present study, the literature reviewed in present study has exposed some gaps. Firstly, most of the study are general in nature they have examined the impact of FII on stock indices of different stock markets in the world. None of the study examined the impact of FII on particular scrip of a firm or on a specific sector. Secondly, the studies pertaining to determinants of FII banked only on few factors. Different studies have explored different factors responsible for FII flows. The extensive range of probable factors determining FII has not been accounted in any single study. Third problem located in the literature is contradictory findings of the studies. It makes it impossible for someone to make a general perception towards causality relationship between the FII and stock market return. Another important gap revealed during the review of literature is that most of studies in India focussed on examining the causal relationship of FII with Sensex. Not many studies have examined this relationship with Nifty or any other stock index. Therefore, the present study has been undertaken to overcome the gaps identified during the review of literature.

**SECTION-II**

**RESEARCH METHODOLOGY**

This section deals with the research methodology which has been used in the study to solve the research problem. Literature reviewed earlier has served as a guide to formulate the research path to be used in the study. First of all, the research problem under the study has been discussed, then followed by the various other aspects related to our research study i.e. objectives, variables used in the study, data sources, study period and analytical tools that have been used in the study.

**2.2.1 Research Problem**

The FII has been a burning issue in the Indian capital market since its beginning in India. The uncertainty attached with FII has continuously been the cause of concern for the analysts. Numerous studies have been undertaken since then to evaluate the impact of FII on stock market returns in India. The researchers have done an appraisable work. The causal relationship between the FII and stock market returns has been focussed in the previous studies undertaken. But the findings of these studies have caused the confusion among stakeholders. These studies have revealed contradictory results. Some studies have established the FII as the cause of stock market returns while some others have established
the stock markets returns as the cause of FII in India. So, these finding has still left the question unanswered. Most of studies found to be general in nature. These studies have left many areas untouched such as: 1.) what is the impact of FII on sector specific stock market returns in an economy? 2.) Whether the FII has caused the change in sector specific stock market returns or the sector specific stock market return has caused the FII in that particular sector? 3.) Whether the FII has caused any volatility in sector specific stock market returns? 4.) What could be done to negate the volatility impact of FII on stock market returns in India? All these questions require a critical assessment to have a complete understanding the topic under research. Keeping in view the above question present study entitled “An Analytical Study on Impact of FIIs on Stock Market Returns in India” has been undertaken to resolve the above questions.

2.2.2 Objectives of the study

The study has been undertaken with a general aim to analyse the impact of FII on stock market returns in India. While remaining under an umbrella of general aim decided, the study has also aimed at other specific objectives to be accomplished. So, the following specific objectives have been laid down under above main objective of the study:

1. To study the magnitude and trends of FII flows and sector specific stock market returns.
2. To ascertain the causal relation between the FII flows and sector specific stock market returns in India.
3. To identify the impact of FII flows on the volatility in sector specific stock market returns in India.
4. To ascertain the major determinants of FII in India.
5. To describe the important findings of the study and suggest measures for increasing FII in India.

2.2.3 Scope of the study

The present study is an attempt to ascertain the impact of FII investment on stock market returns in Indian companies. The sample covers companies from different sectors. The study is analytical in nature and performed in context of Indian stock market only. One hundred thirty (130) companies have been categorised in twelve (12) different sectors to evaluate the impact on sector specific stock market returns during the study period ranging from April 2004 to March 2014. Average monthly return of sectors has been computed on the basis of average monthly NSE prices of selected companies in these sectors. The selection of NSE is based on the fact that flow of FII was more in NSE as compared to BSE during the study
Granger Causality test has been used to ascertain the causal relation between FII investment and sector specific stock market return. The study is an attempt to ascertain the volatility in stock market returns due to FII flows. GARCH (1,1) model has been used to examine the volatility in return of different sectors. The study has also considered the determinants of FII investment in India. Various macro-economic and financial variables have been selected as determinants. Simple and Multiple Regression techniques have been used to ascertain the determinants of FII investment in India.

2.2.4 Research Design

Research design stands for advance planning of the activities or steps to be taken during the study. It describes the research path to be followed to conduct research. Research design is mainly a master plan which covers under its ambit the objectives of the study, selection of variables, data sources, study period, population of the study, sample of the study, various analytical tools & techniques to be used in the study.

Data Base and Sources

To analyse the impact of FII on sector specific stock market returns the study has used the secondary data collected from various sources. The main variables studied are as follows:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Variable Description</th>
<th>Data Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>FII</td>
<td>Monthly and Yearly Purchase, Sale and Net investment by FIIs</td>
<td><a href="http://www.sebi.gov.in">www.sebi.gov.in</a></td>
</tr>
<tr>
<td>NSE Scrip values</td>
<td>For monthly return of selected listed companies in NSE</td>
<td><a href="http://www.nseindia.com">www.nseindia.com</a></td>
</tr>
<tr>
<td>BSE Sensex</td>
<td>Monthly and Yearly closing value of BSE index indicating stock prices of 30 companies in Index</td>
<td><a href="http://www.bseindia.com">www.bseindia.com</a></td>
</tr>
<tr>
<td>NSE Nifty</td>
<td>Monthly and Yearly closing value of BSE index indicating stock prices of 50 companies in Index</td>
<td><a href="http://www.nseindia.com">www.nseindia.com</a></td>
</tr>
<tr>
<td>Market Turnover</td>
<td>Monthly values of market turnover indicating trading volumes at BSE and NSE</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>Market Capitalization</td>
<td>Monthly Market Capitalization of BSE and NSE</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>Exchange Rates</td>
<td>Monthly values of India’s exchange rate against US, Pound Sterling and Euro</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>IIP</td>
<td>Monthly data for Index of Industrial Production indicating production level in India</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>WPI</td>
<td>Monthly data for Wholesale Price Index indicating inflation rate</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>FER</td>
<td>Monthly values of Foreign Exchange Reserve</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>CMR</td>
<td>Monthly values of Call Money Rate. CMR has been used as proxy for interest rate in India.</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
<tr>
<td>Foreign Trade Position</td>
<td>Monthly values of Import, export and trade balance of India.</td>
<td><a href="http://www.rbi.org.in">www.rbi.org.in</a></td>
</tr>
</tbody>
</table>
Study Period

The present study is based on analysis of published data pertaining to FII flows and stock price return. The study period ranges from April 2004 to March 2014. The database used for the study is monthly in nature for the study period.

Population for the study:

The premier indices of both BSE and NSE i.e. Sensex and Nifty represent more than 6500 companies from approximately 23 sectors of the economy. Among these companies, only the companies having continuous FII investment during April 2004 to March 2014 have been considered as population. Details of FII investment in particular companies have been collected through the SEBI website. The numbers of companies across different sectors which have continuous FII flows during the study period have been presented in the table 2.2:

Table: 2.2
Sector-wise Population of the Study

<table>
<thead>
<tr>
<th>Sr. no.</th>
<th>Sector</th>
<th>No. of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Automobile</td>
<td>16</td>
</tr>
<tr>
<td>2.</td>
<td>Banking &amp; Finance</td>
<td>56</td>
</tr>
<tr>
<td>3.</td>
<td>Cement</td>
<td>8</td>
</tr>
<tr>
<td>4.</td>
<td>Chemical</td>
<td>10</td>
</tr>
<tr>
<td>5.</td>
<td>Computer &amp; IT</td>
<td>26</td>
</tr>
<tr>
<td>6.</td>
<td>Consumer Goods (Personal Care)</td>
<td>14</td>
</tr>
<tr>
<td>7.</td>
<td>Diversified (Conglomerate)</td>
<td>15</td>
</tr>
<tr>
<td>8.</td>
<td>Electrical Equipment</td>
<td>9</td>
</tr>
<tr>
<td>9.</td>
<td>Engineering</td>
<td>7</td>
</tr>
<tr>
<td>10.</td>
<td>Fertilisers</td>
<td>9</td>
</tr>
<tr>
<td>11.</td>
<td>Food Processing</td>
<td>6</td>
</tr>
<tr>
<td>12.</td>
<td>Infrastructure</td>
<td>19</td>
</tr>
<tr>
<td>13.</td>
<td>Media &amp; Entertainment</td>
<td>5</td>
</tr>
<tr>
<td>14.</td>
<td>Mining/ Metals/ Minerals</td>
<td>11</td>
</tr>
<tr>
<td>15.</td>
<td>Oil &amp; Gas</td>
<td>20</td>
</tr>
<tr>
<td>16.</td>
<td>Packaging</td>
<td>8</td>
</tr>
<tr>
<td>17.</td>
<td>Pharmaceuticals (Healthcare)</td>
<td>36</td>
</tr>
<tr>
<td>18.</td>
<td>Power</td>
<td>15</td>
</tr>
<tr>
<td>19.</td>
<td>Shipping, Transport &amp; Logistics</td>
<td>11</td>
</tr>
<tr>
<td>20.</td>
<td>Steel</td>
<td>14</td>
</tr>
<tr>
<td>21.</td>
<td>Telecommunications</td>
<td>10</td>
</tr>
<tr>
<td>22.</td>
<td>Textiles</td>
<td>15</td>
</tr>
<tr>
<td>23.</td>
<td>Miscellaneous</td>
<td>61</td>
</tr>
</tbody>
</table>

TOTAL 401
The table 2.2 shows 401 companies have continuous FII flows during the study period. Out of these, 340 companies represent 22 different sectors. Rest 61 companies have been put under miscellaneous option. Banking & Finance sector has maximum representation of 56 companies which have continuous FII flow during the study period followed by Pharmaceutical (36) and computer & IT sector (26). On the other hand, media & entertainment (5), food processing (6) and engineering sectors have least number of companies having continuous FII flows.

**Sample Plan of the Study:**

The study is based on impact of FII on sector specific stock market returns during the period of April 2004 to March 2014. During this period, the stocks of 401 companies from 23 different sectors have continuously been invested in by the FIIs. It is inconvenient to cover these 401 companies due to time involved in calculations. Then, only 12 sectors have been selected for the purpose of the study. This selection is based on contribution of a sector to GDP of the economy. Thereafter, purposive sampling has been used and 130 companies in these sectors have been taken as sample to complete the study. The table 2.3 shows the number of companies across selected sectors which have been selected as sample of the study:

**Table: 2.3**

**Sector-wise Sample of the Study**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Sector</th>
<th>No. of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Automobile</td>
<td>12</td>
</tr>
<tr>
<td>2.</td>
<td>Banking &amp; Finance</td>
<td>17</td>
</tr>
<tr>
<td>3.</td>
<td>Cement</td>
<td>6</td>
</tr>
<tr>
<td>4.</td>
<td>Computer &amp; IT</td>
<td>17</td>
</tr>
<tr>
<td>5.</td>
<td>Engineering</td>
<td>6</td>
</tr>
<tr>
<td>6.</td>
<td>Fertiliser</td>
<td>7</td>
</tr>
<tr>
<td>7.</td>
<td>Infrastructure</td>
<td>15</td>
</tr>
<tr>
<td>8.</td>
<td>Media &amp; Entertainment</td>
<td>4</td>
</tr>
<tr>
<td>9.</td>
<td>Oil &amp; Gas</td>
<td>14</td>
</tr>
<tr>
<td>10.</td>
<td>Pharmaceuticals</td>
<td>18</td>
</tr>
<tr>
<td>11.</td>
<td>Power</td>
<td>8</td>
</tr>
<tr>
<td>12.</td>
<td>Telecommunication</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>130</strong></td>
</tr>
</tbody>
</table>

The table 2.3 shows that out of 130 companies selected as sample, the Pharmaceutical sector has most number of companies (18) which have become the part of sample of the study. The Banking & Finance sector and Computer & IT both have representation of 17
companies among the sample of the study. The main reason behind selecting most companies in Pharmaceutical, Banking & Finance sector and Computer & IT is that these sectors have been the backbone of our economy. The Computer & IT sector even remained immune during the recession of global recession in 2008. On the other hand some sectors i.e. Media & Entertainment (4), Engineering and (6) Telecommunication (6) sectors have least representation of companies in the sample as compared to other selected sectors under the study.

Hypotheses of the Study

Moving upon the problem under consideration, the study has used the following hypotheses:

Table: 2.4

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Null Hypotheses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>There is no significant difference between average monthly return of specific sector companies and average monthly Nifty Return.</td>
</tr>
<tr>
<td>2</td>
<td>The variables have unit root (not stationary).</td>
</tr>
<tr>
<td>3</td>
<td>The Stock Price Return does not Granger causes FIIP.</td>
</tr>
<tr>
<td>4</td>
<td>The FIIP does not Granger Cause Stock Price Return.</td>
</tr>
<tr>
<td>5</td>
<td>The Stock Price Return does not Granger causes FIIS.</td>
</tr>
<tr>
<td>6</td>
<td>The FIIS does not Granger Cause Stock Price Return.</td>
</tr>
<tr>
<td>7</td>
<td>The Stock Price Return does not Granger causes NFII.</td>
</tr>
<tr>
<td>8</td>
<td>The NFII does not Granger Cause Stock Price Return.</td>
</tr>
<tr>
<td>9</td>
<td>There is no volatility for return and FI activities of specific sector companies.</td>
</tr>
</tbody>
</table>

Statistical Tools and Techniques

Keeping in mind the objectives of the study, various statistical and econometric methods have been used in the study. Microsoft Excel 2010, SPSS 17 and EViews 8 are the softwares used for statistical analysis of the data. The brief explanation of the analytical tools applied is as under:

Monthly Returns

To accomplish the objective set out in the study, stock price return has been computed on monthly basis. The averages of daily closing NSE value of a particular scrip value and Nifty index were used to arrive at monthly figures. The Monthly stock price return has been obtained with the following formula:
\[ R_t = P_t - \frac{P_{t-1}}{P_{t-1}} \]

Where:

- \( R_t \) is the return from market in period \( t \);
- \( P_t, P_{t-1} \) represents scrip value or index values at the end of period \( t \) and \( t-1 \) respectively.

**Independent T-Test**

One sample T-Test independent variable has been used to ascertain whether the difference between the means of two variables is zero or not. In the present study this test is used to compare the difference between means of specific sector’s companies return and Nifty Return. Both the returns have been computed on the basis of values from the NSE database. The following hypothesis has been used to compare the means:

**H\(_0\): There is no significant difference between average monthly return of companies and average monthly Nifty Return.**

The null hypothesis assumes no difference between the means of companies return and Nifty Return. On the contrary, the alternative hypotheses will assume the means difference between these is not zero.

**Descriptive Statistics**

Descriptive statistics describes the patterns and general trends of a dataset using measures of central tendency and measures of variability. To show the nature and basic characteristics of the variables used in the analysis measures like skewness, kurtosis and Jarque-Bera tests of normality have also been applied.

**Augmented Dickey Fuller (ADF) Unit Root Test**

The variables used in present study are time series in nature and time series data usually exhibit a trending behaviour in their mean values. Stationarity of time series data is a precondition to extract meaningful conclusion from the analysis. Stationarity of data means the data’s mean and variance are constant (not changing) over time and value of co-variance between two time periods depends only on the distance between the two time periods. The time series analysis begins with the checking of the basic characteristics of the various time series so that it can be checked whether the data is stationary or some corrections are required. Non-stationary behaviours can be trends, cycles, random walks or combinations of the three. Using non-stationary time series data in financial models produces unreliable results and leads to wrong interpretation and forecasting. In order to receive consistent and reliable results, the non-stationary data needs to be transformed into stationary data. The stationarity of time series data or presence of unit root may be checked with Augmented
Dickey Fuller (ADF) test and Phillips- Perron (PP) test. The Augmented Dickey - Fuller (ADF) test has been used in line with the Bhasin and Khandelwal (2014), Kanojia and Rani (2014), Kumar (2012) and Mitra (2010) etc.

The ADF test uses the null hypothesis that variable has unit root (non-stationary). If p-value is found significant (more than 0.05), null hypothesis is accepted and vice-versa. Acceptance of the null hypothesis denotes series is non-stationary. Then series is differenced and checked for stationarity again. The number of time series is differentiated to make it stationary is called the order of integration. If the series is first differenced, it is called series is integrated of order 1. If after first differencing, the series still have unit root, then second differencing is done to make it stationary. Then, the series is called integrated of order 2.

**Granger Causality Test**

Granger causality test is an econometric technique to determine whether one time series is significant in forecasting another. It ascertain that whether the information given by one variable explain the latest value of another variable during a given time period. After estimating the prediction power of a variable, it also ascertains the causality relation between the two variables. It ascertain the causality relation between two variables using null hypothesis (H₀) that X variable does not Granger cause variable Y and variable Y does not Granger cause variable X.

One of the main pre-condition to use Granger Causality test is that time series must be stationary. Thus, the test is performed using the level values of two (or more) variables. If the variables are non-stationary, then the test is done using first (or higher) differences. The number of lags to be included is usually chosen using an information criterion, such as the Akaike Information Criterion or the Schwarz Information Criterion. The present study has used the Schwarz Information Criterion to choose the number of lags in Granger Causality Test.

**Generalized Autoregressive Conditional Heteroskedasticity (GARCH) (1,1) Model**

One of the main objective is the study is to measure the impact of FII flows on volatility in sector’s specific stock price return. So, GARCH (1,1) model has been applied to measure volatility in selected sector’s returns. GARCH (1,1) means that model has one ARCH term and one GARCH term. The ARCH term denotes the impact of past information about volatility on present volatility in returns. While, the GARCH term reveals the persistence of volatility in stock returns meaning thereby impact of past volatility of a
variable on its present volatility. GARCH (1,1) model has two equations: One is mean equation and another one is variance equation.

\[
\text{Dependent Variable} = C(1) + C(2) \times \text{Independent Variable} + e \quad \text{Mean Equation}
\]

- \(C(1)\) is the constant
- \(e\) is residual

One of the preconditions to use GARCH (1,1) model is that residual must have clustering volatility. So, by plotting the residual, it must exhibit some trends over time. If the residual exhibits the instances of clustering volatility GARCH (1,1) model could be used.

\[
H_t = C(3) + C(4) \times H_{t-1} + C(5) \times e_{t-1}^2 + C(6) \times \text{exogenous regressor} \quad \text{Variance Equation}
\]

- \(H_t\) = Variance of residual derived from mean equation. It is also known as current day’s variance or volatility of dependent variable.
- \(C(3)\) = Constant
- \(H_{t-1}\) = Previous day’s residual variance or volatility of dependent variable. It is known as GARCH term.
- \(e_{t-1}^2\) = Previous period’s squared residual derived from mean equation. It is also known as previous day’s dependent variable information about volatility. It is ARCH term.

**Exogenous Regressors** = Outside variables which affect the volatility of dependent variable.

**Simple and Multiple Regression Technique**

One of the main objectives of the study is to identify the determinants of FII in India. So, the Simple Regression Technique and Multiple Regression Techniques have been used to identify the determinants of FII investment in India. The Simple regression technique examines the relationship of a dependent variable with another explanatory variable having a linear relationship. So, the Simple Regression technique has been applied to ascertain the relative effect of selected macro-economic and financial parameters on FII flows taking FIIP, FIIS and NFII as dependent variable one by one. The regression equations used to interpret the effect of macro-economic variables and financial variables are as follows:

\[
\begin{align*}
\text{FIIP/ FIIS/ NFII} &= C(1) \text{ INR/US $} + C(2) \text{ INR/Pound} + C(3) \text{ INR/Euro} + C(4) \text{ IIP} + C(5) \text{ WPI} + C(6) \text{ FER} + C(7) \text{ CMR} + C(8) \text{ Exports} + C(9) \text{ Imports} + C(10) \text{ Trade Balance} \\
\text{FIIP/ FIIS/ NFII} &= C(1) \text{ BMT} + C(2) \text{ NMT} + C(3) \text{ BMC} + C(4) \text{ NMC} + C(5) \text{ SENSEX} + C(6) \text{ NIFTY}
\end{align*}
\]

It is rare that a dependent variable is explained by only one variable. In this case, Multiple Regression technique is usually applied to ascertain the collective impact of explanatory variables on a dependent variable. In the present study, several multiple regression equations have been used to analyse the collective predictability of similar
variables to determine the FII flows. The multiple regression equations have been used as follows:

\[ \text{FII}/\text{FIIS}/\text{NFII} = b_0 + b_1 (\text{Explanatory Variable 1}) + b_2 (\text{Explanatory Variable 2}) \]

Limitations of the study

The main limitation of the study is that it has considered only one constituent of foreign investment in India i.e. FII, the amount of total foreign investment has not been taken up due to diverse nature. The aggregate foreign institutional investment has been considered for increasing the validity of the study. The other limitation of the study is that impact of FII investment on stock market returns has been analysed only in terms of equity returns. The result obtained only on the basis of equity returns may not be the same for other foreign investment instruments. The other shortcoming of the study is that data relating to FII investment in prime sectors of the economy but with passage of time seeing the prospects of the host economy the FIIs could change their investment composition in that particular economy.