Chapter 2: Role Of FIIs In Indian Stock Market

“Huge investments are being done by FIIs (Foreign Institutional Investors) in Indian companies. But the question is – If India is a developing country, why do they rely on our services and invest in India. Do they lack the knowledge about poverty and social issues in India? Does India has a false image in International market?”

2.1 Introduction
Reason of above denotation lines, the truth is that they do not be short of acquaintance about the poverty of India neither there is any false image in the International market. The main reason why Foreign Institutional Investors put their money in India is because we have the ability to produce goods and provide services at a lower cost. The scarcity employment opportunities in India has created a situation where industries can easily hire a well qualified or even an over qualified professional at a lower cost, usually at a fraction of international wage standards. In developed countries getting good service from the well qualified professionals can be a significant burden on their budget. So, it staffing costs affect the profitability and the survival of these foreign companies. If a company does not control their cost then they will probably not survive, especially because their competitors might already be outsourcing in India to save costs.

In India, there are so many qualified people, competing for good jobs. Pay scales provided by foreign companies may be much lower than their domestic rate, but that lower salary will be an excellent one for people in India due to lower living costs and currency exchange rate. If you post a single job, it is common to get a list of 100 candidates, each of them almost equally well qualified. As such the scarcity of employment opportunities brings good competition in the labour force and automatically improves the the quality and productivity which is highly favorable for foreign corporations.

Labour costs in India rise each year and in some fields like software, people feel that we will no longer experience a double digit salary increases anymore. This is important to protect the cost benefits and continue to attract Foreign Institutional Investors to India.
This is the reason that industries like BPO, IT and Manufacturing are steadily rising in India.

There is hardly any big company in the entire world that does not have their presence in India in one way or the other. Some companies outsource their accounting and others outsource IT and BPO operations. Regardless of the domestic issues, they get an excellent service for their money.

Before liberalization in 1991, India was a self-reliant economy with markets depending on Domestic institutions and investors. FIIs & OCBs were permitted to invest in Indian financial instruments in September 1992 with restrictions.

India opened its stock markets to foreign investors in September 1992 and since then; considerable amount of portfolio investment from foreigners in the form of Foreign Institutional Investor’s (FII) investment in equities is coming in India. This has become one of the main channels of international portfolio investment in India for foreigners. In order to trade in Indian equity markets, foreign corporations need to register with the Security Exchange Board of India (SEBI) as Foreign Institutional Investors (FII). FII’s have been allowed to invest in the Indian securities market since September 1992 when the Guidelines for Foreign Institutional Investment were issued by the Government. The SEBI Regulations were enforced in November 1995, largely based on these Guidelines. The regulations require FII’s to register with SEBI and to obtain approval from the Reserve Bank of India under the Foreign Exchange Regulation Act to buy and sell securities, open foreign currency and rupee bank accounts, and to remit and repatriate funds. Once SEBI registration has been obtained, an FII’s does not require any further permission to buy or sell securities or to transfer funds in and out of the country, subject to payment of applicable tax. Foreign investors, whether registered as FII’s or not, may also invest in Indian securities outside the country.

2.2 Meaning & Definitions of FII
The term is used most commonly in India to refer to outside companies investing in the financial markets of India. International institutional investors must register with the Securities and Exchange Board of India to participate in the market. One of the major
market regulations pertaining to FIIs involves placing limits on FII ownership in Indian companies.

FIIs can be said to include investors or investment funds that are from or registered in a country outside of the one in which they are currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds. In other words, Foreign Institutional Investor means an entity established or incorporated outside India that proposes to make investment in India. Positive tidings about the Indian economy combined with a fast-growing market have made India an attractive destination for foreign institutional investors. FII investment is usually referred to as Hot Money because it can leave the country at the same speed at which it comes in.

**SEBI’s definition of FIIs** presently includes foreign pension funds, mutual funds, charitable /endowment /university funds etc. as well as asset management companies and other money managers operating on their behalf.

According to Michael Frenkel and Lukas Menkhoff, “FIIs are beneficial for an economy under specific institutional conditions. It is defining characteristic of an emerging market that these conditions are often not met”.

Foreign institutional investors ‘investments are volatile in nature, and they mostly invest in the emerging markets. They usually keep in mind the potential of a particular market to grow.

Foreign institutional investment is a short-term investment, mostly in the financial markets. FII, given its short-term nature, can have bidirectional causation with the returns of other domestic financial markets such as money markets, stock markets, and foreign exchange markets. Hence, understanding the determinants of FII is very important for any emerging economy as FII exerts a larger impact on the domestic financial markets in the short run and a real impact in the long run.

### 2.3 FIIs Investment Avenues

Foreign Institutional Investor invests in different avenue which are as follow: One who propose to invest their proprietary funds or on behalf of "broad based" funds or of foreign corporate and individuals and belong to any of the under given categories can be registered for FIIs.
1. Pension Funds
2. Mutual Funds
3. Investment Trust
4. Insurance or reinsurance companies
5. Endowment Funds
6. University Funds
7. Foundations or Charitable Trusts or Charitable Societies
8. Asset Management Companies
9. Nominee Companies
10. Trustees
11. Bank

Currently entities eligible to invest under FII course are as follows

1. **Designated bank.**
   
   "Designated bank" means any bank in India, which has been authorized by the Reserve Bank of India to act as a banker to Foreign Institutional Investors.

2. **Domestic custodian**
   
   "Domestic custodian" includes any person carrying on the activity of providing custodial services in respect of securities.

3. **Sub-accounts**
   
   "Sub-account" includes those institutions, established or incorporated outside India and those funds, or portfolios, established outside India, whether incorporated or not, on whose behalf investments are proposed to be made in India by a FIIs.

4. **Domestic Entity:**
   
   A domestic portfolio manager or a domestic asset management company shall also be eligible to be registered as FII to manage the funds of sub-accounts. FII’s registered with SEBI fall under the following categories:
   
   (a) Regular FII’s – Those who are required to invest not less than 70 per cent of their investment in equity-related instruments and up to 30 per cent in non-equity instruments.
   
   (b) 100 per cent debt-fund FII’s – those who are permitted to invest only in debt instruments.
5. Prohibitions on Investments:

Foreign Institutional Investors are not permitted to invest in equity issued by an Asset Reconstruction Company. They are also not allowed to invest in any company which is engaged or proposes to engage in the following activities:

a) Business of chit fund

b) Nidhi Company

c) Agricultural or plantation activities

d) Real estate business or construction of farm houses (real estate business does not include development of townships, construction of residential or commercial premises, roads or bridges).

e) Trading in Transferable Development Rights (TDRs).

2.4 The eligibility criteria for FII registration:

As per Regulation 6 of SEBI (FII) Regulations, 1995, Foreign Institutional Investors are required to fulfill the following conditions to qualify for grant of registration:

1. Applicant should have track record, professional competence, financial soundness, experience, general reputation of fairness and integrity;

2. The applicant should be regulated by an appropriate foreign regulatory authority in the same capacity/category where registration is sought from SEBI. Registration with authorities, which are responsible for incorporation, is not adequate to qualify as Foreign Institutional Investor.

3. The applicant is required to have the permission under the provisions of the Foreign Exchange Management Act, 1999 from the Reserve Bank of India.

4. Applicant must be legally permitted to invest in securities outside the country or its in-corporation / establishment.

5. The applicant must be a "fit and proper" person.

6. The applicant has to appoint a local custodian and enter into an agreement with the custodian. Besides it also has to appoint a designated bank to route its transactions.

7. Payment of registration fee of US $ 5,000.00
2.5 Supporting Documents Requirement:

1. Application in Form A duly signed by the authorised signatory of the applicant.
2. Certified copy of the relevant clauses or articles of the Memorandum and Articles of Association or the agreement authorizing the applicant to invest on behalf of its clients.
3. Audited financial statements and annual reports for the last one year, provided that the period covered shall not be less than twelve months.
4. A declaration by the applicant with registration number and other particulars in support of its registration or regulation by a Securities Commission or Self Regulatory Organisation or any other appropriate regulatory authority with whom the applicant is registered in its home country.
5. A declaration by the applicant that it has entered into a custodian agreement with a domestic custodian together with particulars of the domestic custodian.
6. A signed declaration statement that appears at the end of the Form.
7. Declaration regarding fit & proper entity.

2.6 Procedure And Grant Of Certificate

1. Where an application is made for grant of certificate under these regulations, the Board shall, as soon as possible but not later than three months after information called for by it is furnished, if satisfied that the application is complete in all respects, all particulars sought have been furnished and the applicant is found to be eligible for the grant of certificate, grant a certificate in form B, subject to payment of fees in accordance with the Second Schedule.

2. Provided that the Board may exempt from the payment of fees, an applicant such as the World Bank and other institutions established outside India for providing aid, and which have been granted privileges and immunities from the payment of tax and duties by the Central Government.

3. A foreign institutional investor holding a certificate shall, at all times, abide by the Code of Conduct as specified in Third Schedule.
Chart 2.1 Process of Foreign Institutional Investors Investments
2.7 Requirements of the Foreign Capital

The requirements of foreign investment/ foreign capital arise due to the following reasons:

1. **Country Infrastructure:**
   The development of any economy depends on the available infrastructure in that country. The infrastructure facilities such as Roads, Railways, sea ports, warehouses, banking services, and insurance services are the prominent players. Due to long gestation period naturally, individuals will not come forward to invest in infrastructure industries. Government of India could not raise necessary investments. To fill the gap, foreign capital is highly suitable.

2. **Industrilisaion:**
   The need for foreign capital arises due to the policy initiatives of the government to intensify the process of industrialization. For instance, the government of India is gradually opening the sectors to foreign capital to expand the industrial sector.

3. **Risk averse:**
   Any developing countries suffer from severe scarcity of private investors. The risk problem can be diverted to the foreign capitalists by allowing them to invest. As we know the Indians are comparatively risk averse. The same risk can be transferred to foreign investors by allowing their investment where risk is more.

4. **Global imperative:**
   Globalization is the order of the day. The international agreements between countries are also the reason for the foreign capital. The multinational companies are expanding their presence to many countries; while they are entering into the foreign countries they will bring their capital. The principles of WTO and other regional associations are binding the member countries to allow foreign capital.

5. **Comparative advantage:**
   The variations in the cost of capital like interest rate are also one of the important factors which result in approaching foreign capital. For example; Interest rates are high in
India compared with developed economies. To reduce the cost of capital, companies/organizations are now looking for foreign capital. In several countries the interest rates are very low as 1% to 3%, whereas in some countries the interest rates are very high as 8% to 10% per annum.

6. To remove the technological gap:
The developing countries have very low level of technology compared to the developed countries. However, these developing countries possess a strong urge for industrialization to develop their economies and to wriggle out of the low level equilibrium trap in which they are caught. This raises the necessity for importing technology from the advanced countries. That technology usually comes with foreign capital when it assumes the form of private foreign investment or foreign collaboration.

2.8 Advantages of FII Investments

The advantages of having FII investments can be broadly classified under the following categories.

1. Enhanced flows of Equity Capital:
FII’s are well known for a greater appetite for equity than debt in their asset structure. For example pension funds in the United Kingdom and United States had 68 per cent and 64 per cent respectively of their portfolios in equity in 1998. Thus opening up the economy to FII’s is in line with the accepted preference for non-debt creating foreign inflows over foreign Debt. Furthermore because of these preferences for equities over bonds, FII’s can help in compressing the yield differential between equity and bonds and improve corporate capital structures. Further, given the existing savings investment gap of around 1.6 per cent, FII inflows can also contribute in bridging the investment gap so that sustained high GDP growth rate of around 8 per cent targeted under the 10th Five year Plan can materialize.

2. Managing Uncertainty and Controlling Risks:
Institutional investors support financial innovation and development of hedging instruments. Institutions for example, because of their interest in hedging risks are known
to have contributed to the development of Zero coupon bonds and index futures. FII’s, as professional bodies of asset managers and financial analysts just not only enhance competition in financial markets but also improve the alignment of asset prices to fundamentals. Institutions in general and FII’s in particular are known to have good information and low transaction costs. By aligning asset prices closer to fundamentals, they stabilize markets. Fundamentals are known to be sluggish in their movements. Thus, if prices are aligned to fundamentals, they should be as stable as the fundamentals themselves. Furthermore a variety of FII’s with a variety of risk-return references also help in dampening volatility.

3. Improving Capital Markets:
FII’s as professional bodies of asset managers and financial analysis, enhance competition and efficiency of financial markets. Equity market development aids economic development by increasing the availability of riskier long term capital for projects and increasing firm incentives to supply more information about themselves, FII’s can help in the process of economic development.

4. Improved Corporate Governance:
Good Corporate Governance is essential to overcome the principal agent problem between Shareholder and Management. Information asymmetries and incomplete contracts between share holders and management are at the root of the agency costs. Dividend payment, for example is discretionary. Bad corporate governance makes equity finance a costly option. The large shareholders with leverage to complement their legal rights and overcome the free rider problems but shareholding beyond say 5 per cent also lead to exploitation of minority Shareholders. FII’s constitute professional bodies of asset managers and financial analysts, who by contributing to better understanding of firms operations improve corporate governance. Among the four models of corporate control - takeover or market control via equity, leveraged control or market control via debt, direct control via equity and direct control via debt or relationship banking. The third model which is known as corporate governance movement has institutional investors at its core. In this third model, Board Representation is supplemented by direct contacts by institutional investors.
Institutions are known for challenging excessive executive compensation and remove under performing managers. There is more evidence that institutionalization increases dividend payouts and enhances productivity growth.

2.9 Disadvantages of FII Investments:
The two common apprehensions about FII inflows are the fear of management takeover and potential capital outflows.

1. Management Control:
There are domestic laws that effectively prohibit institutional investors form taking management control. For example, US Law prevents mutual funds from owning more than 5 per cent of a Company’s stock. According to the International Monetary Fund’s Balance of Payments Manual 5, FDI is that category of international investment that reflects the objective of obtaining a lasting interest by a resident of other economy. The lasting interest implies the existence of a long term relationship between the direct investor and the enterprise.

2. Potential Capital Outflows:
FII inflows are popularly described as ‘hot money’ because of the herding behavior and potential for large capital outflows. All the FII’s tries to either only buying or only selling at the same time particularly at times of market stress. Value at Risk models followed by FII’s may destabilize markets by leading to simultaneous sale by various FII’s as observed in Russia and Long Term Capital Management 1998 (LTCM) crisis. Extrapolative expectations or trend chasing rather than focusing on fundamentals can lead to destabilization. Movements in the weight age attached to a country by indices such as Morgan Stanley Country Index (MSCI) or International Finance Corporation (IFC) also leads to mass shift in FII portfolios.

2.10 Facilitation to Foreign Investment in India
Foreign investment can be done through automatic route up to 100 per cent without need for any approvals in certain sectors which are open for Foreign investment. The investor has to keep the Reserve Bank of India informed. The sectors not open to foreign investments are retail trade, housing and real estate, agriculture, lottery and gambling. In certain sectors, there is a maximum prescribed limit on foreign investment. Some of
these are being increased. Prior approval of the government is needed for those cases which need industrial license and those involving investment beyond the maximum limits. Such cases are cleared by the Foreign Investment Promotion Board in a transparent, efficient, time-bound and predictable manner. The department of industrial policy and promotion is the nodal agency for information and assistance for foreign investors. Their website www.dipp.nic.in has comprehensive information for foreign investors and gives weekly update on proposals for foreign investment under consideration. It also gives information on projects available for foreign investors and contains online applications for clearances.

2.11 FIIs Investments trends in Indian Stock Markets

1. The total number of FIIs and sub-accounts registered with the SEBI as on year 2010 were 1713 and 5378 respectively. Table shows the net investments by FIIs in the Indian stock markets.

2. There was a substantial increase in the FIIs investments during the year 1995—96 and 1996-1997. However, the FIIs investment declined in the year 1997-98 due to the selling pressure in the later part of the years, following the south east Asian Crisis. Brief spells of net outflows occurred as a result of the pokhran nuclear bomb blast and political instability, but they were made up.

3. The overall investment during 1997-98 remained positive. Through it declined in percentage terms -20.6%. The net investment by FIIs turned negative for the first time during 1998-99 due to the imposition of economic sanctions and downgrading by international rating agencies. This negative investment affected the share prices of Indian business.


5. A large number of FIIs arrived with emerging market funds in 2000-01 wherein the FII net inflow touched a high of Rs.12,189 crores in 2000-01. FIIs were permitted to trade in the derivatives market in Feb 2002.

6. The Net FII inflow touched a record Rs. 30,893 crores in 2003 and Rs, 37,183 crores in 2004, with most of the investment in promising mid-cap stocks. The third wave which came in 2003 brought in new FIIs such as hedge funds, university funds and developed market funds to encash India’s growth trend.
7. FII Investments in India grew by 1602% in 2003-04. Moreover, an increasing trend in the growth rate was witnessed since June 2004. In November 2001 alone, FIIs investments crossed the US$ 1-billion mark. This trend revealed a growing global interest in the Indian stocks. A stream of good public issues, strong economy compared to other emerging markets, attractive valuations of well-managed companies and the resilience of the domestic economy even in times of rough global economic and financial cycle, contributed to the huge inflows. Moreover, introduction of the STT which removed the tax related ambiguities like as the double taxation treaty with Mauritius that had existed earlier and abolition of long terms, capital gain tax which lowered the cost equity for FIIs made the Indian stock market more attractive.

8. FIIs pumped in US$ 16bn in the equity market during 2007-08 which was a historic high. Investments by FIIs in the equity segment and the debt segment rose by 111.6% to Rs. 53,404 crores and by 128% to Rs. 12,775 crores, in 2007-08, respectively.

9. These FII inflows pushed up the price of stocks and P/E ration of good companies beyond sustainable levels. This increased investment was on account of strong macroeconomic fundamentals, abolition of long-term, capital-gain tax, encouraging corporate results and attractive valuations. A large portion of this FII investment is concentrated in top-ties stocks.

10. FIIs were net sellers during 2008-09 on account of the global financial. During April to July of 2008, FIIs liquidated Rs. 15,114 crores in the market, on account of the global liquidity crunch. When global liquidated scenario improved, a large number of them turned to be net purchasers during the period April to November of 2009, reflecting a high level of confidence in Indian companies and economic growth prospects. The cumulative FII investment at acquisition cost was US$89.3 billion at the end of March 2010.

11. India stock markets are an attractive investment avenue as Indian markets are not dependent on the world economy and have a large domestic case. Moreover, Indian markets offer a wide variety in terms of sectors and companies.

12. The only factor that determines the behaviour of the FIIs is the opportunity for profit. If they feel that a market has the potential for profit, they will invest. It is company specific success stories that have retained FIIs in the India market.
### Table 2.1 Trends of FIIs Investments In Indian Stock Market During :1993-2010  Round Figures in Cr.

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<th>Years</th>
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(Source: [www.sebi.com](http://www.sebi.com))
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(Source: [www.bseindia.com](http://www.bseindia.com) and [www.nseindia.com](http://www.nseindia.com))
Chart 2.2 Trends of FII Investments In Indian Stock Market

Chart 2.2 Trends of BSE SENSEX AND NIFTY50
2.12 Impact Of FIIs On Indian Stock Market Performance

India opened doors to foreign institutional investors in September, 1992. This event represents a landmark event since it resulted in effectively globalizing its financial services industry. Initially, pension funds, mutual finds, investment trusts, Asset Management Companies, nominee companies and incorporated/institutional portfolio managers were permitted to invest directly in the Indian stock markets. Beginning 1996-97, the group was expanded to include registered university funds, endowment, foundations, charitable trusts and charitable. Since then, FII flows which form a part of foreign portfolio investments have been steadily growing in importance in India.

The FIIs are major institutional investors in Indian capital market. Movement in the SENSEX has clearly been driven by the behavior of foreign institution investors. The presence of foreign institution investor in the SENSEX companies and their active trading behaviours, their role in determining the share price movements must be considerable. Indian stock markets are known to be known narrow and shallow in the sense that there are few companies whose shares are actively traded. Although there are 4700 companies listed with stock exchange.

The BSE SENSEX incorporates only 30 companies, trading on whose shares are seen as indicative of market activity. This shallowness also means that the FIIs can also affect the behavior of other retail investors, who tend to follow the FIIs when making their investment decision.

The Indian stock markets are both shallow and narrow and the movement of stocks depends on limited number of stocks. As FIIs purchases and sells these stocks there is a high degree of volatility in the stock markets. If any set of development encourages outflow of capital that will increase the vulnerability of the situation. The high degree of volatility can be attributed to the following reasons:

**First**, increase in investment by FIIs cause sharp price increase. It would provide additional incentives for FII investment and this encourages further investment so that
there is a tendency for any correction of price unwaited by price earnings ratios to be delayed. And when the correction begins it would have to lead by an FII pullout and can take the form of extremely sharp decline in the share prices.

**Second**, as and when FIIs are attracted to the market by expectations of a price increase that tend to be automatically realized, the inflow of foreign capital can result in an appreciation of the rupee. This increases the return earned in foreign exchange, when rupee assets are sold and the revenue converted into dollars. As a result, the investments turn even more attractive triggering an investment twisting that would imply a sharper fall when any correction begins.

**Third**, the growing realization by the FIIs of the power they wield in what are shallow markets, encourages speculative investment aimed at pushing the market up and choosing an appropriate moment to exit. This implicit manipulation of the market if resorted to often enough would obviously imply a substantial increase in volatility.

**Finally**, in volatile markets, domestic speculators too attempt to manipulate markets in periods of unusually high prices.

The stock market has also witnessed a growing trend of ‘Institutionalization’ that may be considered as a consequence of globalization. The number of the institutional investor entities, whose primary purpose is to invest their own assets or those entrusted to them by others and the most common among them are the mutual funds and portfolio investors has been growing. Today, large institutions command a control on the Stock market because they have large funds available with them and they move continuously from one market to another. In European and Japanese markets, institutions virtually dominate total trading of stocks there. However, in US, retail investors still remain active participants.

An important feature of the development of stock market in India in the last 17 years has been the growing participation of Institutional Investors, both Foreign Institutional Investors and the Indian Mutual Funds since the pension funds are still restricted to fully participate in the stock market otherwise pension funds are big investors all world over. With the acceleration of reforms in India, the stock market
India opened its stock markets to foreign investors in September 1992 and since then; considerable amount of portfolio investment from foreigners in the form of Foreign Institutional Investor’s (FIIs) investment in equities is coming in India. This has become one of the main channels of international portfolio investment in India for foreigners. In order to trade in Indian equity markets, foreign corporations need to register with the Security Exchange Board of India (SEBI) as Foreign Institutional Investors (FIIs). As a part of the reform process, the Government of India opened up the Indian capital market to global competition and took measures to initiate structural reforms by putting in place the requisite regulatory and supervisory structure in the form of SEBI. In a move towards current account convertibility and to increase foreign exchange inflows, Foreign Institutional Investors (FIIs) were permitted to invest in the tradable Indian securities such as shares, debentures, bonds, mutual fund units etc. through primary and secondary markets as per guidelines issued by Government of India in September 1992.

The FII flows to India began in January 1993. The number of foreign institutional investors (FII's) registered with the Securities and Exchange Board of India (SEBI) has now increased to 1,042 in June 2007 which was 813 in the beginning of calendar year 2006. The gross FII investments in the country till June from the time they were allowed to invest in the India equity markets stands at US$ 53.06 billion. FII’s have raised their holding in 540 companies out of top 1,000 companies on the Bombay Stock Exchange (BSE) during September-March (2006-07) period. Companies that have gained favor with foreign investors are mostly from construction, banking and second-line IT companies among others. CLSA, HSBC, Citigroup and Merrill Lynch have been the most active foreign investors during January 2006 to April 2007. Together they were involved in US$ 4.73 billion worth of trading in shares. Apart from the four FII’s, many others, including Crown Capital, Fidelity, Goldman Sachs, Morgan Stanley, UBS, T Rowe Price International, Capital International, have taken a significant exposure to Indian equities Given that India is one of the fastest growing economies in South Asia, promising a growth of over 6 percent, second only to China, it would not be a surprise to see increased FII flows to India in the future. FIIs are now looking at the economy as a whole, with the macro-economic factors also playing their role in attracting foreign investors. Factors like a strong currency, key reforms in the
banking, power and telecommunications sector, increased consumer spending and stable policies are expected to play a major role in attracting FIIs to India.

2.13 FIIs Recent Trend

1. Fast GDP growth has made India a preferred destination for foreign investors post the 2008 financial crisis. In 2010 itself, India attracted nearly US$ 30 billion of net foreign inflows, which was just under 50 per cent of all inflows into emerging Asian markets, excluding China.

2. FII Trading Activity - Rising Investments in equity and debt markets – Foreign investors have invested Rs 6,460 crore (US$1.45 billion) in Indian stock markets in just five trading sessions of July 2011 and the trend is expected to continue, according to analysts.

3. In the first six months of 2011, overseas investors infused around Rs 17,000 crore (US$3.82 billion) into the Indian market, including stocks and bonds. In the same period, FIIs made investments of Rs 9,948 crore (US$2.23 billion) in the debt market, with investments in stocks being Rs 2,670 crore (US$ 599.79 million).

4. FIIs bought equities and debt securities worth Rs 26,004 crore (US$ 5.84 billion) till July 10, 2011, according to the data available with market regulator Securities and Exchange Board of India (SEBI).

5. The number of FIIs registered with SEBI increased from 1,718 as of December 31, 2010, to 1,730 as of July, 2011. Moreover, the number of registered sub-accounts has risen from 5,503 in December 31, 2010 to 5,898 currently.

6. International investors increased their stakes in most companies last quarter. FII’s holding was higher in 26 companies while it remained the same in 50 per cent of the 108 companies for which shareholding details were available with stock exchanges as on July 13, 2011.

7. FII-supported out performers include Talwalkars Better Value Fitness (TBVF), Lupin, Petronet LNG, GlenmarkPharma, ING Vysya Bank, MRPL and Castrol India. There is a growing trend of FIIs increasing their exposure towards consumer staple companies. FIIs have raised holdings in companies such as Sintex, Cadila Healthcare, Asian Paints, Lupin and Ranbaxy Labs in the quarter ended June, 2011.

8. FIIs have raised stakes in private sector lenders such as Kotak Mahindra Bank (0.60 per cent) and Development Credit Bank (3.39 per cent).
9. For broking companies, FII stake has gone up in India Infoline, from 29.5 per cent to 35.71 per cent. FIIs raised their stake in Gujarat Pipavav Port to 23.09 per cent from 15.74 per cent in the previous quarter.

10. FIIs have raised their ownership in India by 170 basis points to 20.4 per cent in 2010-11, through the purchase of depository receipts and through market operations. Overall, FIIs hold 25 per cent of market value of private sector companies and 7.7 per cent in government-owned companies.

11. FIIs purchased a high Rs 110,100 crore (US$ 24.73 billion) worth of shares in 2010-11. Of the shares purchased, Rs 61,300 crore (US$ 13.77 billion) was through primary sources and Rs 48,800 crore (US$ 10.96 billion) from the trading platform of the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).

12. In 2010, FIIs had increased their holdings by 150 bps to 18.7 per cent.

13. The Indian stock market has gained from the flow of FII money so far in July 2011. With lower inflation numbers reported, and concerns over Greece debt sliding, the risk desire of global investors has been in favour of emerging markets. Foreign investors infused more money in July in Indian equities than for the period between January and June.

14. On the back of significant FII inflows, the Indian rupee has resumed its rise against the US dollar. On July 6, 2011, the rupee closed at 44.48/49 after being as high as 44.3350. This was the highest since May 3, 2011.

2.14 Government Initiatives

1. FIIs are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS). Under this scheme, FIIs can acquire shares/debentures of Indian companies through the stock exchanges in India.

2. The ceiling for overall investment for FIIs is 24 per cent of the paid-up capital of the Indian company, and limit is 20 per cent of the paid-up capital in the case of public sector banks. The ceiling of 24 per cent for FII investment can be raised up to sectoral cap/statutory ceiling, subject to the approval of the board and the general body of the company passing a special resolution to that effect.

3. To further increase FII participation in the Indian market, the government and SEBI have taken several measures:
4. Allowed foreign individuals, corporate and other investors such as hedge funds to register directly as foreign institutional investors.

5. SEBI has FII investment limit in government securities being increased to US$ 5 billion from US$ 3.2 billion.

6. Institutional investors--including FIIs and their sub-accounts--have been allowed to undertake short-selling, lending and borrowing of Indian securities from February 1, 2008.

7. SEBI has simplified the registration norms for FIIs and sub-accounts.

8. Significantly, it has allowed investment managers, advisors or institutional portfolio managers in the NRI category to be registered as FIIs.

9. Consequent to the liberalisation of registration norms, the number of foreign institutional investors (FIIs) registered with the Securities and Exchange Board of India (SEBI) has increased to 1403 as on June 27, 2008 as compared with just 1051 FIIs a year back.

10. Simultaneously, the up gradation of India's sovereign ratings combined with the improvement in the macro-economic situation and growth fundamentals has led to a near tripling of FII investments in the debt market. Total investment in the country's debt market till November amounted to US$ 1.59 billion as against US$ 487 million in the corresponding period in 2006.

11. Also, with the government raising the investment limit for the FIIs in the Government Securities, the FIIs are rushing in to buy Government paper. As of 27 June, 2008 FIIs have already invested US$ 3.87 billion in the debt market, as against US$ 2.29 billion in debt at the close of 2007.

12. Earlier in May 2008, SEBI had hiked the investment allocations to FIIs in both government and corporate debt collectively by US$ 3.5 billion, taking the total investment limit to US$ 8 billion.

13. SEBI has said that it has relaxed the reporting norms for FIIs coming to India. These reporting guidelines pertain to the lending of securities as part of short-selling. Till now, the FIIs were supposed to disclose their information on a daily basis. After the relaxation, they need to do it on a weekly basis.

14. SEBI has allowed FIIs to invest US$25 billion a year in bonds issued by infrastructure companies as against the previous limit of US$5 billion. FIIs can now invest US$40 billion annually in corporate bonds.
15. The Policy Guidelines on phase III expansion of private FM radio services, approved by the Cabinet, have raised the aggregate cap on FII to 26 per cent from the existing 20 per cent. Allowing 26 per cent will encourage foreign investors to invest as it gives them more leeway to participate actively in management, according to TarunKatial, Chief Executive Officer, Reliance Broadcast Network Ltd

2.15 Conclusion

The Foreign Institutional Investors have gained a significant role in Indian Capital Market. Availability of Foreign Capital depends on many firm specific factors other than economic developments of the country. Foreign investment refers to investments made by residents of a country in another country’s financial assets and production processes. After the opening up of the borders for capital movement, foreign investments in India have grown enormously.

It affects the productivity factor of the beneficiary or the receiver country and has the potential to create a ripple effect on the balance of payments of that country. In developing countries like India, foreign capital helps in increasing the productivity of labor and to build up foreign exchange reserves to meet the current account deficit. It provides a channel through which these countries can have access to foreign capital. Foreign institutional investors' investments are volatile in nature, and they mostly invest in the emerging markets. They usually keep in mind the potential of a particular market to grow.

The Indian economy has been one of the fastest growing economies in the world, next only to China. According to the strong growth rate of GDP, India now ranks 10th among the largest economies in the world as per the World Bank Report. Indian economy has experienced the problem of capital in many instances. While planning to start the steel companies under government control, due to shortage of resources it has taken the aid of foreign countries. Likewise we have received aid from Russia, Britain and Germany for establishing Bhiloy, Rourkela and Durgapur steel plants.

In the last decade during 2003-2012, the rises in stock market have been attributed to the FIIS participation in the Indian Stock Market. But still FIIs are looked with a word of
caution and a sense of worry for market regulators. The foreign institutional investment was increased during the years 2006 and 2007. Later on, due to global financial crisis the investments by FIIs were reduced. FIIs investment increased during 2008 to 2011.

This study observed that investments by FIIs and the movements of SENSEX are quite closely correlated in India and FIIs wield significant influence on the movement of SENSEX. There is little doubt that FII inflows have significantly grown in importance over the last few years.

In the absence of any other substantial form of capital inflows, the potential ill effects of a reduction in the FII flows into the Indian economy can be severe. From the point of attracting foreign capital, the initial expectations have not been realised. Investment by FIIs directly in the Indian stock market did not bring significantly large amount compared to the GDR issues. GDR issues, unlike FII investments, have the additional advantage of being project specific and thus can contribute directly to productive investments. FII investments, seem to have influenced the Indian stock market to a considerable extent.

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