A Study On The Determinants And Impact Of
Foreign Institutional Investments
In Indian Stock Market

Abstract

Foreign Institutional Investors (FIIs) or Foreign Portfolio Investors (FPIs) make cross border investments to create internationally diversified portfolio of securities. The broad objective of the study is to examine the influence of foreign institutional flows on Indian equity markets and vice versa. The study is presented in six chapters. Chapter-II depicts the drivers of FPIs – benefits of international diversification, participation in the growth of the foreign markets and abnormal returns arising out of market segmentation. They benefit the host countries through catalysing regulatory and institutional reforms, better functioning of the capital markets, enhanced investor confidence and participation leading to increase in domestic savings and external resources, increase in availability of risk capital and reduced cost of raising capital. An examination of international trend in FPI flows in Chapter-III reveals that, negatively skewed return distributions and low risk of extreme outcomes in the developed countries have helped them accumulate over two thirds of total global FPIs in equity. Chapter-IV discusses the regulatory framework for FIIs in India.

Using econometric tools such as Multivariate Panel Regression, Vector Auto Regression and Granger Causality tests, the empirical Chapter-V investigates the existence or non-existence of a definite relationship between the FII holdings in a sample of listed Indian companies included in the NIFTY, and the stock price liquidity, volatility and informational efficiency. The study finds evidence of absence of any causal linkage between FII holding in a stock and informational efficiency or return volatility of it. Liquidity of a firm’s stock is found to influence FII holding in it with no reverse causality. The results of index level analysis find no causal influence of FII flows to equity on efficiency, liquidity and volatility or vice versa. No causal relationship is found between FII flows and the volatility expectations in the near term. But index return is found to significantly influence the FII flows.

Although FII holdings data of frequencies higher than quarterly intervals, which is unavailable, could make the models more efficient for forecasting purpose, the VAR models explaining FII flows in all the cases show very high R-squared values signifying high explanatory power of the models. However, analysis of behaviour of FII flows in pre and post economic crisis may help forecast possibility of it and open up an area for further research.