Chapter – I

Introduction and Justification
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INTRODUCTION AND JUSTIFICATION

Globalization is a process of increasing economic integration and growing economic interdependence between countries in the world. The fundamental attribute of globalization is the increasing degree of openness in most of the countries.

The 21\textsuperscript{st} century has been witnessing stupendous changes and challenges in the field of economics, culture, society, religion, intelligence, politics, environment etc because of liberalization, privatization and globalization. Management of men, materials, machines, money and methods has become more global and strategic. Global financial management has become a concept of common parlance. It means financial management in an international business environment. Global financial management involves with different currency of different countries, dissimilar political situations, imperfect markets and diversified opportunity sets.

Global Financial Management came into being when the countries of the world started opening their doors for each other. This phenomenon is well known with the name “liberalization”. Due to the open market environment and freedom to conduct business in any corner of the world, business houses started looking for opportunities even outside their country’s boundary.

Global Finance has become an important wing for all Multi National Companies. Global financial management includes the management of funds transacted and generated in the global financial markets. Global financial markets have a different shape and analytics compared to the domestic financial markets.

The global financial market has experienced tremendous growth in terms of primary issues and trades on secondary market. The liberalization policies initiated in India in the early 1990s brought about radical changes in the conduct of stock market operations. Globalization, deregulation, and foreign portfolio investments made the Indian stock exchanges competitive and efficient in their functioning. Government of India has embarked on a liberalization and economic reform programme with a view to bringing about a rapid and substantial economic growth.
The role of capital market is to allocate the capital from less productive to more productive uses. In the international context, the emerging economies have more investment opportunities than the developed economies, which have already attained the full calibre of their economic growth. On the other hand, the developed economies have the capability to generate more investable funds. The emerging economies seeking higher economic growth look towards developed economies for international capital to supplement their low level of internal capital formation; and investors in developed markets look towards emerging economies for better returns on their investments.

Before 1990s, the emerging markets including India were not opened for foreign private investors. Most of the capital flow from developed markets to emerging markets was in the form of multilateral or bilateral aids. During 1990s, under the influence of the policies adopted by World Bank, IMF and other multilateral economic organizations, the emerging economies started opening their capital markets for foreign private investment. Today the private investment flow in the form of foreign direct investment and foreign portfolio investment is the prominent role in international capital flow.

Despite scepticism in many quarters, India opened its stock market to foreign investors in September 1992 and has received portfolio investments from foreigners in the form of Foreign Institutional Investment (FII) in equities and in other marketed securities including derivatives. FIIs have emerged as one of the most influential groups to play a critical role in the overall performance of the stock market, especially the Indian equity market. For a developing country like India, opening up of the stock market to foreign institutional investors act as a catalyst in improving efficiency of the market.

Indian capital market, since liberalizations, has undergone tremendous changes and has evolved as a vibrant system of investment flows. A dynamic capital market is an important segment of the financial system of any country as it plays a significant role in mobilizing savings and channelling them for productive purposes. The efficient fund allocation depends on the stock market’s efficiency in pricing the different securities traded in it. Macroeconomic variables are the element of a factor
(variable) which is independent of the level of income. (e.g. the level of consumption that people need to survive even when they have no income)

Stock markets are said to reflect the health of the country’s economy. On the other hand, major economic indicators determine stock market movements to a large extent. From a thorough analysis of the various economic indicators and its implications on the stock markets, it is observed that stock market movements are largely influenced by broad money supply, inflation, interest rate, exchange rate, credit / deposit ratio and fiscal deficit apart from political instability.

**NEED OF THE STUDY**

Since Indian capital market is vast it attracts the investors as their investment destination. The Indian market is steadily growing and had allured domestic investor’s community and foreign investment group in the past. The major part of investment in Indian capital market is attributed by institutional investors among whom foreign institutional investors (FIIs) are of primary importance. Foreign institutional investment flow supplements and augments domestic savings and domestic investment without increasing the foreign debt of our country. Capital inflows to the equity market increase, stock prices lower the cost of equity capital and encourage the investment by Indian firms. In view of recent global financial crisis, there is a need to relook at the role of FII-flow in Indian capital market.

**SIGNIFICANCE OF THE STUDY**

Indian economy is growing at a very fast pace. Most of the FIIs are investing in India due to its significant growth. These FIIs though they are investing in the country, they not only invest for profit they also are affecting the movement of stocks in the stock markets. Hence they have an impact on the stock market in a large way which is an important parameter of the Indian economy as it contributes to the growth of the Indian Economy. So it is significant to study the impact of economic variables on Indian stock market through the monthly inflow of foreign institutional investments (FIIs)
Stock market is an important part of the economy of a nation. The stock market plays a pivotal role in the growth of the industry and commerce of the country that eventually affects its economy to a great extent. Stock market is seen as a very significant component of the financial sector of any economy. Furthermore it plays a vital role in the mobilization of capital in many of the emerging economies.

The study gains importance of the following reasons:

a) This study was designed to explore the influences of Call Money Rate (CMR), Consumer Price Index (CPI), and Dollar Price (DP) on stock market prices in BSE and NSE.

b) The study will be useful for the investors to make suitable investment decisions by identifying and focusing on the important economic variables.

c) This study will be of great assistance to Individual investors, Institutional investors, foreign investors, Portfolio managers and Corporates who depend on the stock market for Initial Public Offerings (IPOs).

**RESEARCH GAP/STATEMENT OF THE PROBLEM**

The foreign investment market was not so developed in the past. But once the globalization took the whole world in its grip, the diversified global market became united. Because of this, the investment sector became very strong and at the same time allowed the foreigners to enter the national financial market. At the same time, the developing countries understood the value of foreign investment and allowed the foreign direct investment and foreign institutional investment in their financial markets. Although FIIs are the long-term investments for foreigners, they are seemed to be unpredictable due to the influence of economic variables such as Interest rate, Inflation rate and Exchange rate etc. Such unpredictable conditions handicap the stock market as well as the Government in formulating policies for the national development. Foreign capital inflows through FIIs, in India, are important from the policy perspective, especially when the country has emerged as one of the most attractive investment destinations in Asia.
Macroeconomic Variables Integration of global financial markets Stock Market (BSE, NSE)

Stock market volatility has been a major cause of concern for policy makers, investors and academia throughout the world, especially for the last two decades. Rapid financial innovations, regulatory and non-regulatory reforms, interventions of SEBI, globalization of Indian capital market, new classes of investors, etc have all shown a great impact on the behaviour of share prices in India. Together, the new participants and the new market environment have impacted the market structure which in return resulted in high volatility.

The market volatility has been impacted by various factors like the macroeconomic variables, operations of Foreign and Domestic Institutional Investors, derivatives market operations as well as the international stock market operations.

India is one of the fast growing markets in the world and is an appropriate case for conducting such a study, as portfolio investment has become the dominant path of foreign investment in the Indian economy. India liberalized its financial market and allowed FIIs to participate in their domestic markets in 1992. The opening up of the market resulted in a number of positive effects.

First, the stock exchanges had to improve the quality of their trading and settlement procedures in line with the best practices of the world.

Second, the transparency and information flows improved on account of the entry of FIIs in India. However, people are also sensing negative effects in the form of potential destabilization because of the bulk buying and selling activity of FIIs.

Presently, the fluctuations in the Indian market are attributed heavily to cross border capital flows in the form of FDI, FII and to reaction of Indian market to global market cues. In this context, understanding the relationship and influence of various exchanges/factors on each other is very important. In order to formulate policy regarding FIIs, it is essential to determine their relation with economic variables and the resultant impact on the stock market, with FII as an intervening variable.
Hence, there arises a need for the research to study the impact of economic variables on Indian stock market volatility through foreign institutional investors under the title, “The influence of macroeconomic variables on Indian stock market with foreign institutional investments as an intervening variable”.

OBJECTIVES OF THE STUDY

The following are the objectives of the study;

Overall Objective

The main objective of this study is to investigate the, “The influence of macroeconomic variables on Indian stock market with foreign institutional investments as an intervening variable”.

Specific Objectives

1. To test the stationarity of CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal after finding the normality.

2. To study the long-run relationship between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal using Co-integration.

3. To analyse the short-run/causality relationship between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal using Granger causality test.

4. To examine the existence of relationship between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal by using Correlation matrix.

5. To model the relationship between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal using simple regression.

6. To test the mediating effect of FII as the intervening variable using Sobel test.
HYPOTHESES OF THE STUDY

Keeping in view the objectives of the study, it was intended to test the following null hypotheses:

$H_{01}$: There is no stationarity between the monthly inflow of FII, CMR, CPI, DP, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal.

$H_{02}$: There is no co-integration between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal.

$H_{03}$: There is no causality between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal.

$H_{04}$: There is no correlation between CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal.

$H_{05}$: The impact of CMR, CPI, DP, FII, BSE Sensex, BSE Auto, BSE FMCG, BSE IT, BSE Metal, NSE, NSE Auto, NSE FMCG, NSE IT and NSE Metal is not significant.

$H_{06}$: There is no mediating effect of FII as the intervening variable between macroeconomic variables and the Indian stock market.

SCOPE OF THE STUDY

The present study has been carried out with the focus of studying the influence of macroeconomic variables on BSE and NSE of the Indian stock market with foreign institutional investments as an intervening variable. The Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) are the two leading stock exchanges of India. The foreign institutional investors are investing in these markets. So, both of these markets have been taken to study the intervening of foreign institutional investment in India.

Prices of monthly inflows of FII under National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) and the macroeconomic variables like Call Money
Rate (CMR), Consumer Price Index (CPI) and Dollar Price (DP) of 12 years from 1st January 2005 to 30th September 2016 have been used for analyzing and testing the impact of macroeconomic variables on Indian stock market through the monthly inflow of Foreign Institutional Investments (FIIs).

This study is useful for the SEBI, the Government, the Advisory agents and the investors to manage the price fluctuation that prevails in the market. Moreover it is helpful for the investors in the stock markets in India to hedge their profits using the investments of foreign institutional investors.

LIMITATIONS OF THE STUDY

This study has researchers, is subjected to some inherent limitations.

1. This study is based on the analysis of the published data that have been collected by the researcher from RBI, SEBI, bseindia and nseindia and hence all the limitations of the sources in terms of reliability and accuracy may apply to this study also.

2. A time span of only 12 years has been considered for examining the relation between macroeconomic variables and the indices of the Indian stock market of this study be relevant for any period other than the study period.

3. This study mainly focuses on selected three independent economic variables which may not completely represent the macroeconomic scenario.

4. At stage - VI, in the process of analysis, only the presence of impact has been studied and not the quantum of impact.

5. The result of the study may not be applicable for any other period other than the period of the study.

6. All the limitations of statistical tools are applicable to this study.

CONCLUSION

In Chapter - I the researcher has specified the statement of the problem, the Objectives framed, the Research Hypotheses, the Scope and the Limitations of the study. With the help of this, the researcher has framed the materials and methodology in the forthcoming chapter (chapter-II).