CHAPTER 8
SUMMARY, CONCLUSION AND SUGGESTIONS

8.1 INTRODUCTION

Indian companies have been significantly influenced by foreign investors for their economic growth until 1947. After independence the Indian government came out with the policies that primarily promoted self reliance. According to Foreign Exchange Regulation Act (FERA), 1973, foreign owners were allowed to hold up to 40 percent of shareholdings in Indian companies or to accept non-Indian company status with comparatively tighter regulations and tax burden. However, the balance of payment crisis in 1991 made the Government to be more trade-liberal and to revise its regulations relating to foreign investment. Consequently, financial assistance from the foreign sources was availed for setting up new along with promotion of existing entrepreneurial ventures in India (Alam, 2011).

Foreign institutional investment (FII) registered a noteworthy improvement in the liquidity of BSE and NSE security prices. There has been a high degree of positive correlation of FII with market capitalization, BSE and NSE indices. Further, it has also been proved that FII contributed to the high liquidity and fluctuations in the capital market prices (Kulshrestha, 2014). FIIs were permitted investment in Indian debt and equity markets since September 1992, under regulation by the Indian government and thereafter by SEBI in 1995 under the SEBI (Foreign Institutional Investors) Regulations, 1995. The FIIs are thus regulated by both the SEBI and the RBI in India.

Working Group on FII (WGFII) set up by Indian Government in its report dated July 30th, 2010 recommended dissolution of various categories of foreign investors into QFI- a single window for portfolio investment in India. Consequently, SEBI constituted a Committee in December, 2012 which proposed establishment of rules for FPI. As a result draft SEBI (Foreign Portfolio Investors) Regulations, 2013 were released in October 2013 which later on notified as SEBI (Foreign Portfolio Investors) Regulations, 2014 (FPI Regulations) and applicable in place of SEBI (Foreign Institutional Investor) Regulations, 1995 and Qualified Foreign Investors.
Stock market development has become a prime focus of many countries including India. There is a high demand for capital by companies from global markets in the form of FDI or FII. Foreign investment is greatly influenced by country’s economic development (Sharma, 2014). Significant contribution of foreign investment in accelerating the growth and development of Indian economy makes it imperative to investigate the factors or determinants influencing such investment. In emerging economies like India, foreign capital adds to the foreign exchange reserves that enable the country to face its current account scarcity during emergent situations. The increasing importance of new market engines, i.e., FIIs makes it valuable to investigate the factors that push such investments. It is required to empirically identify the factors that motivate the FII to pump in more money into the Indian market and also the factors that make them withdraw their funds, i.e., have a negative impact on FII. Moreover, FIIs are likely to face more information asymmetry in developing markets, like India as compared to domestic investors. In India, the majority of foreign investment studies have given attention to FDI which is perceived to be an important facet for economic growth as FDI invests comparatively for a longer period and more comprehensive data is readily available in respect of FDI than FII. In international context, most of the studies related to FDI and FII have been conducted in developed countries such as USA and Swedish listed firms than developing countries. However, the Indian studies on FII have mainly focused on stock market. There have been very few Indian studies based on analyzing the impact of firm performance and corporate governance on FII. Hence, present study covers these research gaps by analyzing firm performance and corporate governance as determinants of FII for better understanding the variations in their investments, in the Indian context. Present study attempts to examine the investment pattern of FIIs by considering three main determinants, viz., macro-economic variables, firm performance and corporate governance. Further, it has been evident that the liberal trade policies, globalization, and amendments in FII regulations have made India as...
one of the attractive destination for FII. Hence, present study also shows the trend and pattern of FII in recent years.

The study covers financial years 2005-06 to 2015-16 for assessing the impact of macro-economic, firm performance and corporate governance on FII, while the trend of FII in India has been assessed for 2005-06 to 2017-18. The S&P BSE listed companies as on March 31st, 2015, have been considered for analyzing the impact of firm performance and corporate governance on FII. After applying multiple screens, a sample of 3201 company observations for determining the impact of firm performance and corporate governance, and 132 observations for assessing the impact of macro-economic variables on FII in India, has been perused. The required data has been taken up from the corporate database (PROWESS) maintained by CMIE (Centre for Monitoring Indian Economy), companies’ annual reports, SEBI publications and the websites of NSDL, BSE, RBI, and SEBI. FII has been used as the dependent variable in present study. Macro-economic variables, viz., Index of industrial production (IIP) representing country economic growth, Indian stock market return (RN), market capitalisation (MCAP), stock market turnover (TO), foreign exchange reserves (FR), inflation of US (PPI), Exchange rate of Indian rupee in US dollars (ER), WPI representing host country inflation, S&P 500, and US T-BILL representing interest rate prevailing in US, have been taken up. With respect to firm performance characteristics, firm size (SIZE), book-to-market ratio (BM), turnover (TURN), dividend yield (DY), return on equity (ROE), leverage (LEV), cash (CASH), and export rate (EXP) have been taken as independent variables. Corporate governance constitutes the third primary independent variables that explain variations in FII. In present study, corporate governance has been characterised by board independence (BIND), board size (BS), chairman/CEO duality (CEOD), audit committee size (ACS), its independence (AIND), and promoters’ shareholdings (PSH).

Present study primarily aims to identify the impact of macro-economic variables, firm performance, and corporate governance on FII in India. Trend and pattern of FII in India during the period of study has also been analyzed. For achieving research objectives, study has been organized into eight chapters. Chapter 1 provides an overview of research topic and various theories governing investment decision of foreign investors. A snapshot of specific provisions regarding FII
regulations and profile of FII in India has also been discussed. The concluding section presents organisation of the study. Literature review on trend and pattern of FII in India, and relationship of FII with macro-economic, firm performance, and corporate governance has been presented in Chapter 2. The chapter concludes with the methodological observations, and identification of research gaps from previous studies. Chapter 3 of the study discusses the need, objectives and hypotheses of the study, the population and sample selection procedure, sources of data, period of study, and operationalization of dependant and independent variables. It also puts forth the framework of analysis adopted in the study and further elaborates the methodology adopted for testing the hypotheses. Analysis of trend and investment pattern of FII in India during the period of study has been given in Chapter 4. It also provides the preference of FIIs in diverse sectors of the Indian economy by way of the asset under custody (AUC). In addition, analysis of FII in India from different countries all over the world and category-wise pattern of FII has also been presented. Analysis results of the impact of macro-economic variables on FII during the period of study have been presented in Chapter 5. It also shows the univariate analysis consisting of descriptive statistics, correlation analysis and ADF unit root test for checking the stationarity of data. Chapter 6 presents the results of multivariate analysis including yearly and panel results for assessing the impact of firm performance on FII in India. Chapter also shows the univariate analysis consisting of descriptive statistics, correlation analysis for the sample and RE Tobit model for checking the robustness of panel results. Chapter 7 shows the multivariate analysis which includes yearly, panel results, and RE Tobit model for assessing the impact of corporate governance variable on FII in India. Further, the results of descriptive statistics and correlation analysis, being a part of univariate analysis have also been given. Chapter 8 puts forth the suggestive measures for enhancing FII in India, along with summary of the research findings, limitations of the study, and scope for future research.

Present chapter has been divided into six sections where research findings, conclusion, and implications are discussed in Sections 8.2 and 8.3 respectively. Section 8.4 shows the study limitations. Suggestions for enhancing FII in India have been presented in Section 8.5 while Section 8.6 discusses the scope for future research.
8.2 RESEARCH FINDINGS AND CONCLUSION

This section of the chapter shows objective-wise significant research findings for better understanding the role of FII in India. This section has been divided into four parts, wherein, sub-section 8.2.1 shows the research findings on the trend and pattern of FII in India. Research findings based on the impact of macro-economic variables on FII have been given in sub-section 8.2.2. Sub-sections 8.2.3 and 8.2.4 show the research findings related to the impact of firm performance and corporate governance on FII in India during the period of study.

8.2.1 Trend and Pattern of Foreign Institutional Investment in India

This section presents the results of trend and pattern of FII in India during the financial years 2005-06 to 2017-18. Overall, total FII have shown an increasing trend. Total FII increased from the financial year 2005-06 to 2007-08, thereafter, it showed the negative trend in 2008-09. Possible reason for this could be the global recession which made the FII withdrew their investments from India. The FII in equity shows a steep trend and comparatively more fluctuations than the total FII for the financial years 2005-06 to 2017-18. There has been a growing trend of FII in debt securities as compared to equity securities. Possible reason for this could be that FII are usually short-term investors who want returns which are ensured by Indian company’s stable performance and fixed interest bearing debts. In financial year 2013-14, FII reached to its lowest which may be due to the announcement of SEBI to amend FII regulations, but it recovered back in 2014-15 and reached to its maximum, due to SEBI new amendments for simplifying norms that acted as a catalyst for investments. Total number of registered FIIs was 527 which increased to 1,710 in the financial year 2013-14. Total and average AUC held by FIIs has been increasing year-by-year. FIIs hold the maximum AUC of 36 % in financial services sector, followed by a percentage of 12% in miscellaneous sector (others) and 11% in software and services sector. These results support the previous research findings (e.g., Shrikanth & Kishore, 2012) which stated that FIIs believe in exploiting the market expertise to the fullest and proper fund management by pooling of little investments from the retail investors. Further, they prefer to invest in diverse sectors and securities with the purpose of increasing their returns and reducing their risk to the minimum while
maintaining the liquidity of the investments intact. Research findings also show that financial services sector has emerged as the preferred area of investment by FIIs as this sector is strongly regulated and has lesser governance issues. Further, sectors like software & services, automobiles, capital goods gained momentum due to ‘Make in India’ programme (Sarkar & Dhanjal, 2015; Singh, 2015; Pathak et al., 2016).

Analysis of AUC held by FIIs of top eleven countries in India revealed that USA holds the highest position followed by Mauritius at the second place, Miscellaneous Countries (Others) at the third place with Singapore having a slightly less AUC, and Luxembourg at the fifth place. Similarly, as far as AUC in equity, FII from the USA holds the highest position followed by Mauritius, Miscellaneous (other) countries’ and Luxembourg. In case of AUC in debt, Singapore has the highest value of AUC followed by Mauritius. Australia and Japan holds the least amount of AUC in debt. One of the reasons for highest position regarding AUC held by USA firms is due to the fact that the developing nations like India, are expected to grow two to three times faster as compared to developed ones like the USA (Leeds & Sunderland, 2003). Similarly, bilateral trade agreements between countries like Mauritius and Singapore with India and tax benefits has attracted more and more AUC (Dua & Garg, 2013). Analysis of category-wise pattern of AUC held by FIIs in India has witnessed the maximum amount of AUC by Mutual Funds in all the given financial years. The other most favored categories for FII have been Broad based Funds/Portfolio; Investment Manager/Advisor; Bank; Investment Trust; Sovereign Wealth Fund; Pension Fund; Asset Management Company; Broad Based Fund; Institutional Portfolio Manager; Insurance/Re-insurance Company; and Central bank. From the financial year 2014-15, foreign investment has been divided into three broad categories, viz., Category I-III, wherein Foreign Portfolio Investment (FPI) includes FII, its Sub-Accounts and Qualified Foreign Investors (QFIs). During the financial years 2014-15 to 2017-18, Sovereign Wealth Fund in Category-I hold the maximum AUC followed by AUC in Central Bank in the financial year 2014-15, while from 2015-16 onwards Governmental Agency holds the second place. In Category-II, for all the financial years, Mutual Funds hold the first place with maximum AUC followed by Broad Based Fund. In Category-III, in the financial years 2014-15, 2016-17 and 2017-18, maximum AUC is registered by other sector (miscellaneous) with
amount while in the financial year 2015-16, Corporate Bodies have shown the highest amount of AUC. Overall, these results support the fact that India hosts the largest number of listed companies after USA and foreign investors consider it as the preferred investment destination.

### 8.2.2 Impact of Macro Economic Variables on FII in India

The findings of the present section provide evidence that macro-economic variables played an important role in FII by influencing their investment decisions for the financial years 2005-06 to 2015-16. Correlation analysis has shown a significantly negative association of exchange rate, and wholesale price index while a significantly positive association of index of industrial production representing host (India) countries economic growth, stock market return, foreign exchange reserves, and market capitalization with FII ($FII_{ni}$).

Findings of ARDL Model for assessing the long-run impact of macro-economic variables revealed a significantly positive influence of index of industrial production, producer price index representing inflation of home country (USA), stock market return, and market capitalization on FII ($FII_{ni}$) during the study period. Macro-economic variables, viz., exchange rate, wholesale price index representing inflation in India, and US T-bill have shown a significantly negative impact on FII ($FII_{ni}$). Results also showed a significantly negative impact of $D_{8}$ crisis-dummy variable thereby indicating that the crisis had a negative impact on FII inflows. $D_{9}$ (seasonal monthly dummy variable) has been found to be significant because of the festive season having a positive impact on stock market returns (Dash et al., 2011) thereby, leading to positive FII inflows. Short-run regression results using ARDL approach revealed a significantly positive impact of index of industrial production, stock market turnover, and market capitalization on FII ($FII_{ni}$). Variables, namely, exchange rate, stock market return, and US T-bill have shown a considerably negative influence on FII ($FII_{ni}$). Table 8.1 provides the summary of the acceptance or rejection of research hypotheses based on findings of ARDL for assessing the long-run impact of macro-economic variables on FII in India.
Table 8.1: Summary of the Acceptance or Rejection of Research Hypotheses

<table>
<thead>
<tr>
<th>Research Hypotheses</th>
<th>Relationship</th>
<th>ARDL Model 2 (Long-run)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$H_{1a}$: There is a significant relationship between FII and Exchange rate</td>
<td>Negative</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_{1b}$: There is a significant relationship between FII and index of industrial production</td>
<td>Positive</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_{1c}$: There is a significant relationship between FII and wholesale price index</td>
<td>Negative</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_{1d}$: There is a significant relationship between FII and producer price index representing (USA) Home country inflation</td>
<td>Positive</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_{1e}$: There is a significant relationship between FII and BSE stock market return</td>
<td>Positive</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_{1f}$: There is a significant relationship between FII and S&amp;P 500 representing foreign stock market return</td>
<td>Negative</td>
<td>Rejected</td>
</tr>
<tr>
<td>$H_{1g}$: There is a significant relationship between FII and BSE market turnover</td>
<td>Positive</td>
<td>Rejected</td>
</tr>
<tr>
<td>$H_{1h}$: There is a significant relationship between FII and foreign exchange reserves</td>
<td>Positive</td>
<td>Rejected</td>
</tr>
<tr>
<td>$H_{1i}$: There is a significant relationship between FII and BSE market capitalization</td>
<td>Positive</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_{1j}$: There is a significant relationship between FII and US T-bill representing foreign interest rates</td>
<td>Negative</td>
<td>Accepted</td>
</tr>
</tbody>
</table>
8.2.3 Impact of Firm Performance on FII

The correlation analysis shows a strong positive association of FII with firm size, turnover, ROE, cash flows and export rate. It indicates that big-sized firms with large turnover, high ROE, sound liquidity position as indicated by cash flows, and high export rates, attract more foreign investment. A significantly negative association has been found between FII and BM, thereby confirming that foreign investors tend to be more attracted towards the growth firms as indicated by low BM. Correlation matrix has also shown a significantly negative association of FII with dividend yield which also confirms the fact that foreign investors prefer to hold few stocks with higher dividend yield stocks so as to reduce the negative impact of disharmonious taxation (Dahlquist & Robertsson, 2001; Liljeblom et al., 2001).

Panel results show that all firm performance variables explain 31.70 percent of the cross-sectional deviation in FII. Firm size, market turnover, ROE, cash flows, and firm export rate have shown a considerably positive influence on FII and are consistent with previous research (Falkenstein, 1996; Huberman, 1999; Dahlquist & Robertsson, 2001; Liljeblom et al., 2001; Benett et al., 2003; Aggarwal et al., 2005; Almazan et al., 2005; Lakshmi, 2010). Book-to-market ratio, dividend yield, leverage have shown a significantly negative influence on FII and confirm these findings with previous research (e.g., Lakonishok et al., 1994; Dahlquist & Robertsson, 2001). These results, thus, verify the fact that FII tends to be attracted more towards the big-sized companies, with high turnover, high ROE, sound liquidity position and high export rate. Similarly, results also support the conjecture that FII perceive more book-to-market ratio, excessive leverage and dividend yield as risk enhancing factors, thereby causing them to withdraw their investments from such risky projects. These findings provide evidence that firm performance variables for the BSE-listed companies played an important role in FII by influencing their investment decisions for the financial years 2005-06 to 2015-16.

Results of the RE Tobit Model have shown that a company size, its turnover, ROE, sufficient cash flows and export rate, have a considerably positive influence on FII. Further, high BM ratio of a company, high dividend yield, and excessive leverage, have been found to be negatively influencing the FII preference for such companies, in a significant manner. Thus, the findings based on the RE Tobit Model
have also been found to be consistent with the panel results as well as the past research, thus, confirming their impact on FII.

These results are also consistent with the findings obtained from the developed markets (e.g., Dalhquist & Robertsson, 2001; Ferreira & Matos, 2006). Comparable results of present study with those of similar studies in developed countries suggested that BSE-listed companies have well defined firm performance variables that display properties similar and rather better than to those in developed markets in the context of foreign investments. In addition, consistent results have been obtained while comparing results of present study with those of developing nations (e.g., Liu et al., 2011). Results of present study are also found to be consistent and comparable with those of previous Indian studies (e.g., Patnaik & Shah, 2008; Lakshmi, 2010; Deb et al., 2013). Table 8.2 provides the summary of the acceptance or rejection of research hypotheses based on analysis of the impact of firm performance on FII in India.

**Table 8.2: Summary of the Acceptance or Rejection of Research Hypotheses**

<table>
<thead>
<tr>
<th>Research Hypotheses</th>
<th>Relationship</th>
<th>Results GLS RE Model</th>
<th>RE Tobit Model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>H2a</strong>: There is a significant relationship between FII and firm size</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2b</strong>: There is a significant relationship between FII and book-to-market ratio</td>
<td>Negative</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2c</strong>: There is a significant relationship between FII and firm market turnover</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2d</strong>: There is a significant relationship between FII and dividend yield</td>
<td>Negative</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2e</strong>: There is a significant relationship between FII and return on equity</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2f</strong>: There is a significant relationship between FII and Leverage</td>
<td>Negative</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2g</strong>: There is a significant relationship between FII and cash</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td><strong>H2h</strong>: There is a significant relationship between FII and export rate</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
</tbody>
</table>
8.2.4 Impact of Corporate Governance on FII

The finding of the present section provide evidence that corporate governance variables for the BSE-listed companies played an important role in FII by influencing their investment decisions for the financial years 2005-06 to 2015-16. Results of correlation matrix showed a significantly positive association of FII with board independence, audit committee size, audit committee independence and board size while a significantly negative association with CEO duality and promoter shareholding. These results indicate that FIIs prefer to invest more in companies which have strong and effective boards with majority of independent outside directors, appropriate structure of audit committee with large number of independent auditors by which shareholders’ interest is ensured. Significantly negative association of FII with CEO duality and promoter shareholding has been observed as these are considered to be a hindrance in transparency mechanisms of a company.

Panel results show that all corporate governance variables explain 16.53 percent of the cross-sectional deviation in FII. Board independence showed a considerably affirmative influence on FII and is consistent with previous research (Cai & Warnock, 2005; Dahya et al., 2006; Aggarwal et al., 2007). Board size showed a considerably affirmative influence on FII. This may be due to the fact that a larger board creates bigger pool of knowledgeable experts from diverse areas, who are also capable of managing the big organisations and curbing the internal manipulations in time which thereby enhances foreign investors’ interest (Pfeffer, 1972; Das, 2014; Kumari & Pattanayak, 2014) thus, panel results showed a significantly affirmative influence of board size on FII. CEO duality showed a considerably negative influence on FII and further confirms these findings with previous research (Aggarwal et al., 2007). As foreign investors consider appropriate structure of audit committee with large number of independent auditors to be playing key role in improving the quality of financial reporting by a company, hence, audit committee independence showed a significantly affirmative influence on FII. Panel results showed a significantly negative influence of promoters’ shareholding on FII.

Overall, panel results of most of the CG variables are found to be consistent with past research, thus, confirming their impact on FII. These results also verify the fact that FII tends to be attracted more towards companies with larger board size, audit committees and boards working independently, with separation of CEO and
chairman positions and less number of promoter’s shareholdings. The findings of the panel data empirically proved the impact of CG variables on FII for the BSE-listed companies. Results of the individual explanatory CG variables were consistent with those obtained in developed markets as well as previous Indian studies (e.g., Bowman & Min, 2012; Das, 2014; Khan & Banerji, 2016). The findings based on the RE Tobit Model have also been found to be consistent with the panel results as well as the past research, thus, confirming their impact on FII.

Firm performance and corporate governance variables, together explain 34.58 percent of the cross-sectional deviation in FII. With respect to firm performance variables, it is evident that the coefficient estimates of firm size, turnover, ROE, cash flows, export rate revealed a significantly positive influence on FII. Book-to-market ratio, dividend yield and leverage have revealed a significantly negative influence on FII. Analysis of corporate governance variables shows that board independence and audit committee independence have an appreciably positive influence on FII. Significantly negatively results are shown by CEO duality and promoter shareholding on FII. Table 8.3 provides the summary of the acceptance or rejection of research hypotheses based on analysis of the impact of corporate governance variables on FII in India.

Table 8.3: Summary of the Acceptance or Rejection of Research Hypotheses

<table>
<thead>
<tr>
<th>Research Hypotheses</th>
<th>Relationship</th>
<th>GLS RE Model</th>
<th>RE Tobit Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>H3a: There is a significant relationship between FII and board independence</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td>H3b: There is a significant relationship between FII and board size</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td>H3c: There is a significant relationship between FII and CEO duality</td>
<td>Negative</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td>H3d: There is a significant relationship between FII and audit committee</td>
<td>Positive</td>
<td>Rejected</td>
<td>Rejected</td>
</tr>
<tr>
<td>H3e: There is a significant relationship between FII and audit committee independence</td>
<td>Positive</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
<tr>
<td>H3f: There is a significant relationship between FII and promoter shareholding</td>
<td>Negative</td>
<td>Accepted</td>
<td>Accepted</td>
</tr>
</tbody>
</table>
8.3 RESEARCH IMPLICATIONS

Present study primarily aims to identify the key determinants of FII in India for BSE-listed companies. Based on research findings, this section provides theory and policy implications.

8.3.1 Theory Implications

In India, the majority of foreign investment studies have paid attention on FDI (e.g., Sethi et al., 2003; Kamath, 2011; Kumar, 2011; Sahni, 2012) which is perceived to be an important facet for economic growth as FDI invests comparatively for a longer period. On international context, most of the studies related to FDI and FII have been conducted in developed countries such as US and Swedish listed firms (e.g., Ferreira & Matos, 2006; Kim & Rhe, 2009; McCahery et al., 2010; Abdioglu et al., 2011; Mijiyawa, 2012; Gumus et al., 2013; Azam et al., 2014) than developing countries. However, the Indian studies on FII have mainly focused on stock market (e.g., Johri et al., 2012; Saravanakrishnan, 2012; Kulshrestha, 2014; Sharma, 2014). There have been very few Indian studies based on analyzing the impact of macro-economic, firm performance and corporate governance on FII (e.g., Bhattacharya & Rao, 2005; Aggarwal et al., 2007; Patnaik & Shah, 2008; Aggarwal et al., 2010; Lakshmi, 2010; Deb et al., 2013; Bhasin & Khandelwal, 2014; Mohanasundaram et al., 2015; Dhingra et al., 2016; Khan & Banerji, 2016). Hence, present study covers these research gaps by analyzing the impact of these factors as determinants of FII for better understanding the variations in their investments, in the Indian context.

Consistent with expectations, research findings provide evidence of the significant contribution made by macro-economic variables as determinants of FII ($FII_{ni}$) by explaining 55 percent of the variations in it in long-run. Macro-economic variables namely exchange rate, index of industrial production, wholesale price index, stock market returns and market capitalization highlighted their significant contribution to FII in present study. These results will thereby guide the policy makers and regulators to further take initiatives for promoting economic growth and development of the country for attracting more foreign investment.

In addition to macro-economic variables, an effort has been made to examine the key firm performance and corporate governance determinants that may induce foreign investment. Panel results showed that all firm performance variables namely
firm size, turnover, ROE, cash flows, export rate, book-to-market ratio, dividend yield and leverage explained 31.70 percent of the cross-sectional deviations in FII while all CG variables (board size, audit committees and boards working independently, with separation of CEO and chairman positions and promoter’s shareholdings) explained 16.53 percent of the deviation in FII. Panel and RE Tobit Model results are in agreement with those derived from the developed markets. In addition, consistent results have been obtained while comparing results of present study with developing nations. Results of present study are also found to be consistent and comparable with those of previous Indian studies. These results will help shareholders, academicians, and policy makers in recognising the key firm performance and corporate governance variables that have a direct bearing on foreign investment.

In present study, firm performance and corporate governance as determinants of FII have been analysed individually as well as their combined impact on FII is also presented. In this way, present study shows a comprehensive analysis by covering the research gap of previous studies wherein all these factors have been analysed individually. There was hardly any study which has taken together all these factors. Consistent with expectations, panel results shows that all firm performance and corporate governance variables, together explain 34.58 percent of the cross-sectional deviation in FII. Combined results are also consistent with the findings obtained from the developed markets (e.g., Bowman & Min, 2012). In addition, consistent results have been obtained while comparing results of present study with those of developing nations (e.g., Suwaidan et al., 2013). Results of the RE Tobit model verifies the robustness of results. Further, it has been evident that the liberal trade policies, globalization, and amendments in FII regulations have made India as one of the attractive destination for FII. Hence, present study also shows the trend and pattern of FII in recent years.

8.3.2 POLICY IMPLICATIONS

Research results of present study have empirically proved the significant contribution of country’s macro-economic conditions, firm performance and corporate governance in explaining variations in FII in India. Based on research findings, present section suggests some policy implications for future:
Based on study results, it has been empirically proved that FIIs being the short-term speculators can withdraw their funds any time that may lead to instability in Indian stock market. The institutional investment funds like New Pension Fund scheme of Government of India should be aggressively promoted to have domestic institutional investment share in the stock market. The FIIs like Sovereign Funds and Pension Funds are different from other short-term profit expectation funds such as Hedge funds, the policies can be framed in such a way to motivate FIIs having objectives of making profit through long-term commitment of funds in Indian stock market.

The research findings provide evidence that macro-economic variables like BSE returns represented by RN and MCAP showing strength of Indian stock market, played an important role in FII by influencing their investment decisions both in long-run and in short-run. Similarly IIP representing host (India) country economic growth has shown a considerably positive influence on FII indicating that FIIs invest in developing countries with promising returns as evident by their level of IIP. Analysis of firm performance and corporate governance as determinants of FII has proved their significant contributions in accounting for variations therein. Hence, adequate measures should be adopted accordingly for raising the governance quality and corporate performance and also for ensuring stable economic environment that ultimately enhances FII in India.

FIIs hold the maximum AUC of 36% in financial services sector, and 11% in software and services sector. As of now FIIs focus is more on financial service sector. Balanced development in all sectors is required for overall growth so Govt. can encourage foreign investment in more sectors by providing incentives and subsidies. Even banks and other financial service providers should be efficient in supporting FIIs, as they are the vehicle in promoting long term financial investments from FIIs.

Foreign institutional shareholding with multiple investors has got the maximum investment ceiling of 24% of paid-up capital and any investment in excess of this limit could be made only with a special permission. Investment limit for a single FII has been fixed at 10% of company’s paid-up capital. However, these ceilings could be raised by passing of special resolution (Kulshrestha, 2014). Government has set minimum and maximum limit, within which FIIs are permitted to invest in India base on sectoral caps, however these limits do not stand at par with
what has been set for FDI. Keeping in view the role of FII as one of the crucial sources of finance to Indian stock market as evident by research findings of present study, FII investment limits should be raised to justify their contribution to Indian economy.

SEBI (FPI), 2014 categorised FPIs into Category I, II and III FIIs on risk associated with them. Trend analysis in present study has shown significant contribution by foreign investors category-wise, viz., total AUC, AUC in equity, and debt held. Based on these results, it is imperative to simplify the procedural requirements and relaxing entry barriers for Category I and II foreign investors which at present are very cumbersome and not so investor friendly.

Research findings of present study have made it clear that overall, total FII, FII in equity and debt have shown an increasing trend over the period of study, i.e., 2005-06 to 2017-18. Similarly, there have been short-term fluctuations that accounts for changes in amount of investments in total FII, FII in equity and debt. These results are in conformity with the previous research findings (e.g., Parsanna, 2008; Singh, 2009; Shukla et al., 2011; Saravankrishnan, 2012; Kulshrestha, 2014; Sharma, 2014) which have also witnessed the volatile nature of foreign investments and supported the fact that FII is one of the crucial sources of investment which strongly influences the total inflows into the Indian economy. These results will suggest policy makers to come out with foreign investors’ friendly so as to further enhance investment by them in future.

It is imperative to track the record of Sub-Accounts individually; amount withdrawn and invested by them into the Indian stock market. Another policy implication for regulators is to make sure not to encourage FII at the cost of domestic institutional investment (DII).

India has tax treaty with Mauritius and Singapore, exempting their residents from Capital Gains Tax payable on the sale of Indian equity or convertible debt. However, this treaty as per Govt. discussion will be removed from April 1st, 2019 due to which the transactions covered under these will attract tax liability ranges from 10%-40% making India unfavourable destination for investment. Hence, policy makers should take adequate steps for finding a mid-way to it as the trend analysis of FII in India in present study has shown that FIIs from the USA holds the highest
position followed by Mauritius, Miscellaneous (other) countries’ and Luxembourg. In case of AUC in debt, Singapore holds the highest value followed by Mauritius.

8.4 LIMITATIONS OF THE STUDY

The study is subject to several limitations which must be acknowledged while interpreting the results.

- The data has been collected from Prowess database, websites of NSDL, SEBI, and BSE. The validity of the findings is based on the nature of the database. Another limitation concerning data is the study period. The study covers financial years 2005-06 to 2015-16 for assessing the impact of macro-economic conditions, firm performance characteristics and corporate governance on FII. A longitudinal research design would have allowed for more rigorous analysis. But required data on key variables for the financial years 2016-17 and 2017-18 was not available till date. However, depending on data availability, the pattern of FII in India in the form of asset under custody held by FII in different sectors of the Indian economy has been assessed for the financial years 2011-12 to 2017-18.

- In present study, firm performance and corporate governance variables whose data has been collected on annual basis as determinants of FII, have been analysed individually as well as their combined impact on FII. However, macro-economic factors (whose data was collected on monthly basis) could not be analyzed together with above mentioned factors. This was due to the fact that the requirements of analysis of macro-economic variables were completely different from that of firm performance and corporate governance variables.

- The pooling of company-year observations for the firm performance and corporate governance variables, may have led to biasness in t-statistics due to lack of independence of observations. This issue has been addressed by reporting the results on annual basis as well as for the panel data. However, only panel results have been shown in respect of macro-economic variables as it is a time series monthly data with completely different properties.
8.5 SUGGESTIONS FOR ENHANCING FII IN INDIA

One of the objectives of the study has been to suggest measures for attracting more foreign investment in India. Consequently, present section of this chapter suggests following measures that may contribute to foreign capital in home country:

- SEBI FPI, 2014 regulation has divided FPI into 3 categories based on KYC risk norms, however, there has been lack of clarity regarding key issues like the rollover process from the FII to the FPI regime, chiefly from a registration perspective and its tax implications. Like the FPI Regulations so far have not clarified that whether all categories of FPIs would be treated as FIIs for the purpose of the Income Tax Act or not. Hence, these issues need immediate clarification to remove the doubts of existing and prospective foreign investors (Vimaladevi, 2014).

- There has to be adequate and updated investor friendly infrastructure at stock exchanges that can add on to the marketability of securities. For e.g., India follows a T+2 settlement policy for exchange traded transactions and T+1 for Govt. securities Since April, 2003 as compared to China and Singapore following T+1 for all traded transactions. Although SEBI in 2013 tried to reduce its trade cycle to T+1 by issuing a symposium paper ‘Risk Management- Safer Markets for Investors’, that called for suggestions by different stakeholders. However, no further action was taken thereafter (Alam, 2011; FPI Survey, 2016).

- The attestation requirement for obtaining the whole set of authenticated documents for FPIs is cumbersome. There should be a single window for FPI license and PAN with more encouragement to self-attestation. A residuary class of legal standing in PAN forms should be introduced and they should be allowed to amend it, pursuant to streamlining in their domicile nation (FPI Survey, 2016).

- Income tax return form for FPI is very extensive with many redundant options mentioned in it, like income from house property, profits and gains from business and profession. Although, CBDT has provided an option to tax payers of submitting returns through email, which reduces the interface with
the Indian Revenue Department, but still there is a need to bring more simplicity in return procedure. The short-term capital gain tax on derivatives should be made at par with that on equities (FPI Survey, 2016).

- Subsequent to FPI regime in 2014 depositories like NSDL and CDSL need to maintain the data relating to FPIs including FIIs. As the provisional trade data reported by NSE/BSE on respective websites is limited only to secondary market transactions, so there should be a completed data and information to all pioneer authorities (FPI Survey, 2016).

- Regulatory measures for foreign investors should be made at par with those of domestic ones. So that serious participants will enter and develop the market on a long-term basis and that too into the debt market which so far has not been properly explored (Vimaladevi, 2014).

- SEBI has been continuously working on simplifying KYC norms, registration and settlement procedure, and share transfer system. Further, relaxation on entry/exit routes and uniformity in economic policies will contribute to foreign investment (Alam, 2011).

- It has come to the knowledge that foreign investors use participatory notes (PNs) as for tax avoidance by transferring their liability to lower tax jurisdictions. A ban on PNs will help in vanishing off the tax bias in favor of equity inflows. There has to be certain number of permissible withdrawals fixed up for foreign investors who are investing money through PNs (Vimaladevi, 2014).

- Foreign investment should be encouraged in diverse areas, industries and through different alternatives like futures, options, etc.

- Players like speculators and gamblers etc bring volatility in the stock market. Hence, their activities should be regularly monitored for building the confidence of real investors.

- Foreign investors are susceptible to corrupt and mal-practices prevailing in a country. To boost up their confidence on law and order of the country, strict actions should be ensured to control such ill practices.
There are persistent deficits in the current account in India with high amount of imports. Policy maker should carefully monitor the activities of FIIs causing such deficits (Alam, 2011).

Strengthening the macro-economic fundamentals, improving the supervision mechanism and transparent policies to reduce procedural and bureaucratic hurdles will help India in attracting foreign capital. The debt market also should be simultaneously improved. Taxes on capital /gains are at lower levels for foreigners and hence they can even get way without paying taxes in case of double taxation treaties between two countries. Hence, SEBI has to closely watch these investments and ensure inflows are through authorized sources only. Unauthorized sources results in money laundering (Alam, 2011).

Banking, foreign exchange reserves, exchange rate and functioning of stock markets should be regulated. Encouragement of long-term investment and discouragement of short-term capital flows can also help to improve the stability. Preventive measures like hedging should be undertaken to ensure sufficient funds accumulation for protecting the country from any in future financial crisis which may arise due to excessive withdrawals (Alam, 2011).

In India, trading cost includes brokerage, service tax, stamp duty, SEBI turnover fees, exchange transaction and custody fees. Further after inclusion of tax administrative, compliance and hedging costs, there occurs increase in total cost. Govt. should provide all possible relaxation in above mentioned cost (FPI Survey, 2016).

8.6 SCOPE FOR FUTURE RESEARCH

Present study analyzes the trend of FII in India over a period of eleven years. Further, role of various determinants that account for variations in FII, viz., macro-economic variables, firm performance and corporate governance has also been analyzed. With respect to future research in similar field, study can be extended by including additional variables like proxies that represent stock market fluctuations, market returns, director’s remuneration, MSCI membership, and ADR, etc. Also a comparative analysis of FII vis-à-vis Domestic institutional investors based on macro-economic conditions, firm performance and corporate governance will provide fruitful
insights to study similarities and differences into their investment behaviour. Depending upon data availability, a comparative study of foreign investment in India vis-à-vis in other developing countries may also be conducted. Most importantly from the financial year 2014-15, there has been change in the categories of FII. Foreign investment has been divided into three broad categories, viz., Category I-III, wherein Foreign Portfolio Investment (FPI) includes FII, its Sub-Accounts and Qualified Foreign Investors (QFI). Consequently, category-wise analysis of FPI can provide useful insights in identifying the most and the least preferred category by foreign investors. Comparative analysis can be made on foreign investment in equity and debt. Depending on data availability country wise analysis can be done.
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