REASONS FOR FII FLUCTUATIONS IN INDIA: A LITERATURE REVIEW

Mr. Omer Fareed Mohammed* | Dr. S C Behl**

**PhD Scholar, Himalayan University, Itanagar, Arunachal Pradesh, India.*

***Research Supervisor, Himalayan University, Itanagar, Arunachal Pradesh, India.*

ABSTRACT

FIIs or Foreign Institutional Investments are popularly considered the driving forces of the Indian market. They have grown to become synonymous to the economy's growth and so it is imperative to understand the determinants that impact them. There is already a barrage of literature review in this regard, which is why we investigate these studies to draft a clear understanding of FII determinants that are in play and intend to discover the gaps in the research. The review of some of the existing research revealed that even though the national stock market behavior majorly impacts the FII investment flow, the macroeconomic policies of the country along with the foreign or external factors also play a role in FII fluctuations. The research also concluded that FIIs and national equity performance are also impacted with a change in FII.

Keywords: Uni- dimensional, causality, equity returns, predicament, instrumental, securities

ABOUT AUTHORS:

Author Mr. Omer Fareed Mohammed is working at Al Buraimi University College in Oman; He is pursuing Ph.D. from Himalayan University, Arunachal Pradesh, India. He has more than 18 years of teaching experience. He has attended various Seminars and conferences. His area of expertise covers the Corporate Finance, Stock Market Analysis, Forensic Accounting. Environmental Accounting, Personal Financial Planning, Auditing and Use of Information Technology in Accounting.

Author Dr. S C Behl is an active researcher with many publications in his name. He has 46 years' experience in Accounts, Finance, Audit, Personnel Management & Admin in lower, Middle and HOD in Government and Private Sector He has attended and organised various National and International conferences and has given extensive lectures.

INTRODUCTION

Capital limitations and internal economic challenges are increasingly crippling the growth of developing economies. Foreign investments came into play here to propel the emerging economies. Foreign investments scarcity was a crippling reality for India during the 1990s. Initially during the early 1980s, the governments were keen to develop the economy from within through inward initiatives and foreign investments were controlled. They focused more on reducing the dependency on imports to control giving up more foreign reserves. However, in 1990s, the economic predicament steered the foreign investments as a method of growth. The control on foreign investments was removed to a certain extent and FIIs were encouraged to invest in Indian financial markets.

SEBI defines "Foreign Institutional Investor" as an institution that is incorporated or established beyond the confines of India and which makes investments in the Indian securities. SEBI registered a drastic increase in the number of FIIs even though the initial foreign investments were low in the nascent years. The bulk of the Indian market is dominated by the FIIs excluding the financial period of 1998 and 2008. Foreign investments have grown in India by leaps and bounds since 1993 when it registered a humble Rs. 2595 crores to an impressive and staggering investment of Rs. 163350 crores in 2012. Similarly, the number of foreign institutes augmented from a mere 3 during 1994 to an overwhelming 1757 in the year 2013. (SEBI)

Gradually FIIs became instrumental in the growth aspect and driving force of the Indian economy. We have already established the importance of foreign investments to an economical development. Therefore it is impertinent to scrutinize the factors that propel the flow of these investments. A barrage of literature is available analyzing these foreign investment determinants and so we are examining the scope of these determinants that define the flow of foreign investments in India.

The research is self-explanatory and used review of existing information to collaborate on its stance. The present research is segmented into 4 criteria. Initial segment highlights the introduction of FIIs. The following segment illustrates the hypothetical structure of FIIs. Third segment of the research focuses on the review of existing determinants and information on foreign institutional investments and the final segment provides a conclusive summary of the FII research.

Indian FIIs

FIIs or Foreign Institutional Investment are institutions that are incorporated or established beyond the confines of India and which makes investments in the Indian securities under the guidance of SEBI. A typical FII comprises of charitable societies, Nominee Company, asset management company, power of attorney holder or a trustee, university funds, mutual funds, foreign pension funds, institutional portfolio manager, charitable trusts or investment trusts originating outside India but making broad based fund investments or proprietary investments. FIIs are eligible to invest their own funds or their international clients that are recognized by SEBI. The accounts maintained by FII on behalf of their clientele are known as sub accounts that are not only increasing in number but also in capacity.

Trend changes in funds flow of Foreign Institutional investors

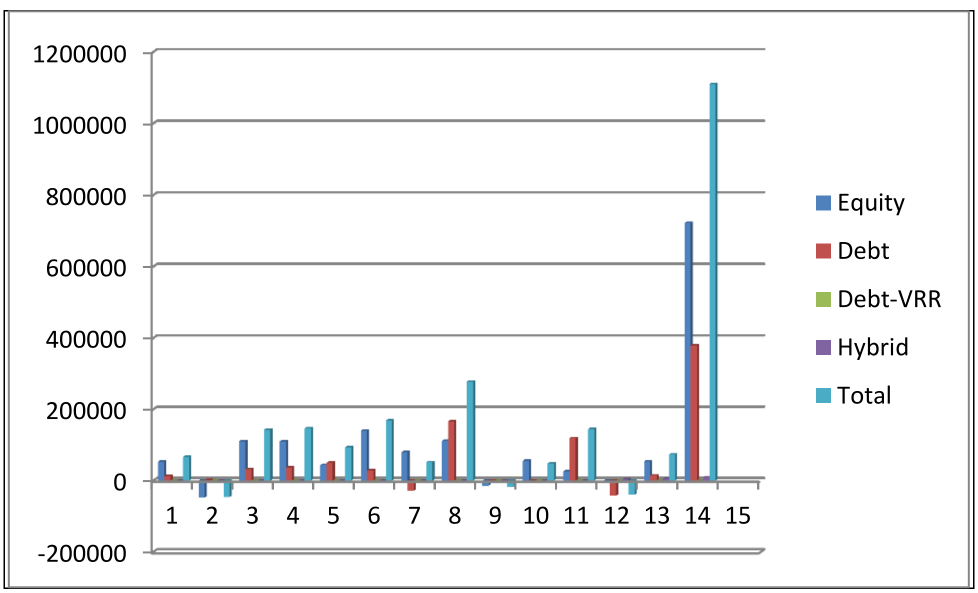
It is evident that the equity investment from the year 2007-08 to 2008-09 year funds were decreased, and from the year 2008-09 to 2009-10 year funds flow were increased, from the year 2009-10 to 2010-11 year funds flow were decreased, from the year 2010-11 to 2011-12 year funds flow were decreased, from the year 2011-12 to 2012-13 year funds flow were increased, from the year 2012-13 to 2013-14 year funds flow were decreases, from the year 2013-14 to 2014-15 year funds flow were increased, from the year 2014-15 to 2015-16 year funds flow were decreases, from the year 2015-16 to 2016-17 year funds flow were increased, from the year 2016-17 to 2017-18 year funds flow were decreased, from the year 2017-18 to 2018-19 year funds flow were decreased, from the year 2018-19 to 2019-2020 year funds flow were increased.

Table 1: Gross FII Investment in India
FII Investment

Financial Year	Equity	Debt	Debt-VRR	Hybrid	Total
2007-08	53404	12775	0	0	66179
2008-09	-47706	1895	0	0	-45811
2009-10	110221	32438	0	0	142658
2010-11	110121	36317	0	0	146438
2011-12	43738	49988	0	0	93726
2012-13	140033	28334	0	0	168367
2013-14	79709	-28060	0	0	51649
2014-15	111333	166127	0	0	277461
2015-16	-14172	-4004	0	0	-18176
2016-17	55703	-7292	0	0	48411
2017-18	25635	119036	0	11	144682
2018-19	-88	-42357	0	3515	-38930
2019-20	53983	14110	-392	5340	73433
Total	721914	379307	-392	8866	1110087

Table 1 shows FII investments over the past decade. The foreign investments have increased dramatically since 2003. In 1992, FIIs were allowed to invest in India with required limitations on the primary and secondary market securities. After that, the FII investment continued to grow steadfastly and played a key role in growth and development of the economy.

GRAPH



It is observed that the Debt investment from the year 2007-08 to 2008-09 year funds were decreased, and from the year 2008-09 to 2009-10 year funds flow were increased, from the year 2009-10 to 2010-11 year funds flow were increased, from the year 2010-11 to 2011-12 year funds flow were increased, from the year 2011-12 to 2012-13 year funds flow were decreased, from the year 2012-13 to 2013-14 year funds flow were decreased, from the year 2013-14 to 2014-15 year funds flow were increased, from the year 2014-15 to 2015-16 year funds flow were decreased, from the year 2015-16 to 2016-17 year funds flow were decreased, from the year 2016-17 to 2017-18 year funds flow were increased, from the year 2017-18 to 2018-19 year funds flow were decreased, from the year 2018-19 to 2019-2020 year funds flow were increased

FOREIGN INSTITUTIONAL INVESTMENTS IN INDIAN MARKET

Foreign investments in India are regulated by FEMA Section 5(2) and SEBI (FII). Foreign investors are guided to receive consent from RBI as per the FEMA (Foreign Exchange Management Act) and get registered with SEBI. FII are allowed to invest in India only under the following circumstances:

a. Investments in the form of securities, shares and debentures for listed and unlisted companies through a registered Indian stock exchange.
b. National mutual fund schemes like UTI (Unit Trust of India), collective Investment Schemes (despite not being listed on a registered stock exchange)
c. National and regional securities floated by the governments.
d. Stock exchange derivatives
e. Security receipts
f. Commercial papers
g. Depository bills in India

Institutions that are qualified to invest using FII regulations include

a. A multilateral or foreign agency or organization that includes an international government establishment, a foreign apex bank, sovereign wealth fund companies.
b. Any institution that was incorporated or established beyond the confines of India in the form of mutual fund, reinsurance organization, a pension fund, insurance or an investment trust agency.
c. An investment management, asset management or a bank, an advisor or an institutional portfolio company that was incorporated outside the country and intends to invest in the Indian market for proprietary funds and broad based funds;
d. A trust operating outside India that intends to invest in India in the capacity of a trustee towards proprietary funds or its brad based funds.
e. Foundations, endowments, charitable trusts or societies or university funds.

Sub- account is a resident who lives outside the country and proposes to make investments in India in foreign institutional investor capacity and is also recognized as a sub- account by the SEBI (FII) guidelines, 1995. A NRI or a non resident Indian is not qualified as a sub –account investor. The following sub- account applicants are eligible to be deemed as foreign investors:

a. Portfolio funds or broad- based funds which are drawn, incorporated or originate outside India.
b. Recognized FIIs holding proprietary funds.
c. Foreign nationals with a net value of over US $ 50 million, who has a good standing certificate, a valid passport of a foreign country for the past 5 years and is an FII client for no less than 3 years.
d. An organization which is listed on a foreign stock exchange holding an asset value of no less than US$ 2 bn and an average annual profits of at least US$50 mn in the previous three years from the application date.

RBI plays the role of a watchdog to supervise investment market.

Caution list of Indian companies: FII investors are regulated by RBI when they make investments in the Indian companies. The RBI limits the sale of shares in AD category 1 banks and its branches when the FII investments in the Indian company are close to 2 percent under the sector limit. Any further sale requires a mandatory approval from the central bank, which is RBI who approves the limit to which the FII can invest in the caution list Indian companies.

Ban List: When FII investments in the Indian company are up to the agreed ceiling, statutory limit or sectoral cap as specified by the RBI, then the company is added to the ban list. When this happens, NRIs or FIIs cannot further cite portfolio investments schemes to invest or purchase shares in the companies that are included in the ban list.

Review of Literature

FIIs are influenced by stock market behavior, ex-ante risk and national and international inflation rates **(Agarwal, 1997).** Risks and stock market behavior are considered the major influencers of FII inflows. Another researcher (Chakrabarti 2001) analyzed month wise data from May 1993 till June 2001 and deduced that FII inflows in India are directly correlated with market equity income. But instead of being the cause of equity income, the FIIs are treated to be the effect of equity returns. He also drew attention to the FII inflow after post- Asian crisis where FIIs were influenced by the equity returns but the Indian market beta behavior was not influencing the FIIs.

Mukherjee (2002) cited the periodical data between January 1999 and May 2002 to propose that FII investments in India were influenced by the existing equity returns but these investments were particularly a single dimensional causality. The Indian market performance did not influence the FIIs even though sale and purchase of FIIs were considerably influenced by market equity returns. He also construed that impact of economical fundamentals and exchange rate fluctuation returns even though present were minimal.

Gupta and Gordon in 2003 cited the periodic data between 1993-2001 to assume that FIIs are positively influenced by budding market stock behavior and negatively impacted by external interest rates. FIIs in India were sometimes cautious due to internal factors like low stock market performance, downgrading of credit rates and exchange rate depreciations.

Bhanumurthy and Rai (2004) used the month wise data between Jan 1994 – Nov 2002 to reveal that FII inflows were instigated by Indian equity returns. The results also recorded that FII inflows were negatively impacted by ex-ante risk at BSE, return and ex-ante risk at S&P 500 and domestic inflation and the FIIs were positively influenced by market equity return.

Khan (2005) found FIIs to have a positive correlation with existing results and prospective equity behavior. **Panda (2005)** said BSE SENSEX was not affected by the FII inflows but the FII investments are influenced by the BSE SENSEX performance.

Nair and Trivedi (2006) proposed that FII investments were chiefly influenced by volatility and Indian market returns. They stated that FIIs are looking at the Indian market but not as a diversified portfolio risk. **Chakraborty (2007)** used month wise inflows from April 1997- March 2005 to establish that Indian stock market performance influences FII inflows and not the other way round. A small causality was detected in market returns due to FII inflows when the prospect of inflows built up on present crisis in the stock market.

Sarogi (2008) used periodic data of January 2001- December 2007 to explain that a affirmative connection exists between FII inflows and SENSEX in India a negative impact due to nominal exchange rate depreciation, domestic equity market risks, international equity market risks, inflation rate and S&P 500.

Prasanna (2008) proposes a depressing impact of promoters' holdings on FIIs and a positive impact of earnings per share and share returns on FIII inflows. **Mishra (2009)** analyzed the May 1993- August 2009 data to conclude a long standing influence of stock exchange status on net FII investments in India. He proposed that there existed a single directional causal influence of stock returns on FII inflows and not vice versa.

Dhillon and Kaur (2010) cited the FII information between April 1995- December 2006 to illustrate the positive relationship between FII investments and national factors like liberalization, stock market performance and market capitalization in India and Inflation status in the US. The Foreign investments are also negatively impacted by deviations in stock market index and S&P 500 index of the Indian markets.

Roy and Mukherjee (2011) used mutual fund performance as criteria to study the variations in FII inflow and concluded that FIIs are influenced by mutual fund status when the foreign investors are looking to diversify to equity returns, at the same time keeping a track of interest rates in the international market.

Rajendran & Anuradha (2012) professed that uni-dimensional causality existed between IIP, FII equity, FII equity against stock market returns and exchange rates of the domestic market and concluded that FII were influenced by them and not the other way round.

Garg & Dua (2013) used the data from Oct 1995- Oct 2011 to support their claim that FII are significantly influenced by domestic exchange rates, stock market returns and output growth apart from budding market equity status, volatile interest rates and interest rate differential though international output growth does not have a significant impact on the inflow of FIIs to India.

Singh (2014) based his arguments on the data collected from the period April 2007- October 2013 and professed that a FII inflows and domestic stock market returns were mutually influential in the causality.

CONCLUSIONS

The research intended to determine the basis that influenced FII inflows to India. For this intent, the research cited the secondary sources available supporting the information. It is therefore concluded that a series of factors influence FII inflow to India both domestic and international with varying degrees of impact. The primary determinant of FII investments is stock market status. Earlier research studies concluded that causality was uni-directional and originating from stock market returns thereby impacting FII inflows. However, **Singh (2014) and Rajendran & Anuradha (2012)** have brought to light an underlying shift in causality that is originating in FII inflows and influencing the stock market returns.

Other key determinants of Foreign Institutional Investments include domestic interest rates and index (risks), exchange variables, inflation and economic growth rate (IIP). International conditions like inflation in USA, stock market risks in the international markets, interest rates and stock market returns in budding and developing economies also play a role in influencing FIIs.

The present research paper (based on supporting analysis of the given data) concludes that FIIs in India are influenced not just by the Indian stock market but also by other macroeconomic variables and external factors. The currently cited secondary data supports the affect of FII to equity markets but no credible information is available to support FII flow determinant effect on the Indian debt market. The studies investigated FII investment impact at the macro level but micro level (firm based) analysis were ignored. These conclusions are opening prospects for researcher, policymakers and regulators to view the FII investment at micro level and analyze macroeconomic determinants to propel FII inflows to India.

REFRENCES

1. **Chakraborty T (2007),** "Foreign Institutional Investment Flows and Indian Stock Market Returns: A Cause and Effect Relationship Study", Indian Accounting Review, Vol. 11, No. 1, pp. 35-48.
2. **Dua P and Garg R, (2013),** "Foreign Portfolio Investment Flows to India: Determinants and Analysis", Centre for Development Economics Department of Economics, Delhi School of Economics, February,Working Paper No. 225
3. **Panda C (2005) ,** "An Empirical Analysis of the Impact of FII's Investment on Indian Stock Market", The ICFAI Journal of Applied Finance, January, pp. 53-61.
4. **Prasanna P.K (2008),** "Foreign Institutional Investors: Investment Preferences In India",JOAAG, Vol. 3, No. 2, pp. 40-51.
5. **Rai K and Bhanumurthy N. R (2004),** "Determinants of Foreign Institutional Investment in India: The Role of Return, Risk and Inflation", The Developing Economics, XLII (4), pp. 479-93.
6. **Saraogi R (2008),** "Determinants of FII Inflows: India", MPRA working paper No. 22850, available at http://ideas.repec.org/p/pra/mprapa/22850.html.
7. **Gordon J and Gupta P (2003),** "Portfolio Flows into India: Do Domestic Fundamentals Indian Securities Market Review (ISMR), National Stock Exchange
8. **Kaur M and Dhillon S.S (2010),** "Determinants of Foreign Institutional Investors Investment in India", Eurasian Journal of Business and Economics, Vol. 3, Issue 6, pp. 57-70.
9. **Khan A, Ashraf S and Ahmed S (2005),** "Foreign Institutional Investment Flows and Equity Returns in India", The ICFAI Journal of Applied Finance, Vol. 11, pp. 16-30. Matters?", IMF Working Paper Number WP/03/02.
10. **Mishra P.K., Das K.B. and Pradhan B.B. (2009),** "Foreign Institutional investment and Stock Returns in India: A causality Test", Global Journal of Pure and Applied Mathematics, Vol. 5, No. 2, pp. 153-162.
11. **Mukherjee P, Bose S and Coondoo D (2002),** "Foreign Institutional Investment in the Equity Market: An Analysis of Daily Flows during January 1999-2000", Money and Finance, ICRA Bulletin, April-September 2002, pp. 21-51.
12. **Mukherjee P. and Roy M. (2011),** "The Nature and Determinants of Investments by Institutional Investors in the Indian Stock Market", Journal of Emerging Market Finance, Vol. 10, No. 3, pp.253-283.
13. **Agarwal R. N. (1997),** "Foreign Portfolio Investment in Some Developing Countries: A Study of Determinants and Macroeconomic Impact", Indian Economic Review, Vol. 32, No. 2, pp. 217- 229.
14. **Anuradha N and Rajendran G (2012),** "Macroeconomic Variables on Foreign Institutional Investment during the Economy Crisis and Recovery Period in an Emerging Market: India", European Journal of Economics, Finance & Administrative Sciences, August, Issue 51, pp. 134.
15. **Chakrabarti R (2001),** "FII Flows To India: Nature and Causes", Money and Finance, Vol 2, No.7, pp. 61-81.
16. **Singh S, Tripathi L.K. and Pardes A (2014),** "FII Flow and Indian Stock Market: A Causal Study", Asian Journal of Research in Business Economics and Management, Vol. 4, No. 1,
17. January 2014, pp. 202-209.
18. **Trivedi P and Nair A (2006),** "Determinants of FII Investment Inflows in India", The ICFAI Journal of Applied Finance, Vol. 12, No. 3, pp. 5-20.