AN OVERVIEW OF FOREIGN INSTITUTIONAL INVESTMENT IN INDIA

Ravi Akula,

Assistant Professor,
Dept. Of Commerce & Business Management,
Mahatma Gandhi University, Nalgonda,
Andhra Pradesh, India

ABSTRACT

Most of the under developed countries suffer from low level of income and capital accumulation. Though, despite this shortage of investment, these countries have developed a strong urge for industrialization and economic development. As we know the need for Foreign capital arises due to shortage from domestic side and other reasons. 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. The present paper is a modest attempt to study the trends in Foreign Institutional Investment into India. It is observed that the FIIs investment has shown significant improvement in the liquidity of stock prices of both BSE and NSE. However, there is a high degree of positive co-efficient of correlation between FIIs investment and market capitalization, FIIs investment and BSE & NSE indices, revealing that the liquidity and volatility was highly influenced by FIIs flows. Further, it is also proved that FIIs investment was a significant factor for high liquidity and volatility in the capital market prices. The present study is a modest attempt to know the status of FIIs in Indian capital market.

Keywords : Infrastructure, Industrialization, Globalization, Comparative advantage, BSE and NSE, Regulatory Framework.

PRELUDE

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.

Gurucharan Singh (2004) highlighted that the securities market in India has come a long way in terms of infrastructure, adoption of best international practices and introduction of competition. Today, there is a need to review stock exchanges and improve the liquidity position of various scrips listed on them.

A study conducted by the World Bank (1997) reports that stock market liquidity improved in those emerging economies that received higher foreign investments.

Calvo, et al., (1999) suggest that foreign investors purse irrational trading strategies such as herding and quick changes in sentiments that make the emerging stock markets volatile. They argue that information disadvantage and diversified international portfolio investment create incentives for rational herd behavior causing stock markets in emerging economies to be volatile.

Fitz Gerald (1999) observed that the large and sudden reversals of foreign equity investments make them extremely volatile in character. The securities markets in developing countries are typically narrow and shallow, and therefore, participation of foreign portfolio investors may, a priori, induce considerable instability in these markets..

OBJECTIVES

The main objective of this paper is to through light on the trend of FIIs into Indian economy in the recent past. The other objectives are:

a. To examine the need for foreign capital.

b. To study the growth of registered number of Foreign Institutional Investors in India.

c. To study the activities such as investments and sales by the FIIs in the recent past.

DATA SOURCES

FII transactions i.e. purchases, sales and investment data have been taken from PROWESS, the online database maintained by the Centre for Monitoring of Indian Economy (CMIE), Handbook of Statistics of the Reserve Bank of India (RBI), SEBI Handbook, SEBI Monthly Bulletin and SEBI Annual Reports. The relevant information is also gathered from the business line, the economic times, NSE, BSE and SEBI Websites.

NEED OF THE FOREIGN CAPITAL

The need of foreign investment/ foreign capital arises due to the following reasons:

1. **Development of basic 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 able to raise necessary investments. To fill the gap foreign capital is highly suitable.

2. **Rapid industrialization:** 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. **To undertake the initial risk:** many 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 imperatives:** 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 resulting 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%, where as 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 posses 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.

REGISTERED FIIS IN INDIA

The Indian capital market opened its doors to foreign investors in 1991. The new industrial policy of the government has initiated many measures to attract foreign capital. The following table highlights the registered FIIs in India during the period from 2006 to 2010.

Table – 1: No of Registered FIIs in India

Year	No. of Registered FIIs
January 2006	833
January 2007	1059
January 2008	1279
January 2009	1609
January 2010	1697

Source: www.bseindia.com

From the above table it is clear that there is constant growth in the number of registered FIIs in India. In the year 2006(January, 2006), the number of registered FIIs were 833 only. The same number has been increased to 1697 by the year 2010 (January 2010). The number has been increased by more than 100 per cent. In spite of the global financial crisis the number of registered FIIs has shown a significant increase. Irrespective of the situation in Indian stock markets these FIIs has earmarked their presence. But the investment made by FIIs has experienced drastic decline in the recent past. This is mainly because of the global economic meltdown. Though the number of registered FIIs increased the net investments were not increased proportionately. Many research studies found that

Table – 2: FIIs Purchases in Secondary Market (Rs. in Crores)

Year	FIIs purchases in BSE	FIIs purchases in India
January 2006	11384	35200
January 2007	13148	45052
January 2008	17927	103678
January 2009	4140.86	27874
January 2010	7194.81	58130

Source: www.bseindia.com

The above explains the purchases made by the FIIs during the period January, 2006 to January, 2010. The purchases in January, 2006 were Rs. 35200 Crores in India in which Rs. 11384 Crores purchases in Bombay Stock Exchange. The FIIs purchases experienced growth for the period 2006, 2007, and 2008. The impact of global economic meltdown has started from the year second half of the year 2008. The last two years period is showing negative growth. Many foreign institutional investors have started to revert their investments to their home countries. This has resulted in the negative growth. Only small amount of purchases were made by the FIIs in January, 2009 and January, 2010.

Table – 3: FIIs Sales in secondary market (Rs. in Crores)

Year	FIIs sales in BSE	FIIs sales in India
January 2006	10266	31522
January 2007	13312	44560
January 2008	24196	116714
January 2009	5885.9	32119
January 2010	8529.17	58631

Source: www.bseindia.com

The sales in the secondary market by FIIs can be seen in the above table (Table: 3) it is found that the sales have overtaken the purchases in the last four years. In January, 2006 the sales made by FIIs are Rs. 10266 Crores in BSE and Rs. 31522 Crores in India. In the next year i.e. January, 2007 the sales made by FIIs were Rs. 13312 Crores in BSE and Rs. 44560 Crores in Indian secondary market. In January, 2008 the sales were Rs. 24196 Crores in BSE and Rs. 116714 Crores in India.

Table – 4: Net investment by FIIs (Rs. In Crores)

Year	FIIs net investment in BSE	FIIs net investment in India
January 2006	1118	3678
January 2007	-164	492
January 2008	-6269	-13036
January 2009	-1745	-4245
January 2010	-1334	-500

Source: www.bseindia.com

From the above table, the net investments made by the FIIs were Rs. 1118 Crores in January, 2006. Later, year after year there was negative net investment recorded from January, 2007 to January, 2010. This may be due to the global financial crisis and other changes in the global business environment.

From the above tables (table Nos. 1, 2, 3, and 4) it is found that:

- The FIIs investment in Indian securities market has shown fluctuating trend year after year. This may be due to changes in the global financial system. The global financial crisis has resulted in negative inflow of FIIs.
- The number of FIIs has also steeply increased from 158 in 1993-94 to 540 in 2003-04 registering an increase at 242 percent and it was further, steeply gone up to 733 as on July 14^{th}, 2005. This may be on account of liberal policies of the government towards foreign capital.
- The reasons for enormous enthusiasm of FIIs in Indian capital market may be on account of well structured, regulated and matured capital market, low risk, and evidence of basic fundamental in the Indian capital market. The Capital market in India could able to face financial crisis effectively with the help of regulatory authorities. The regulatory authorities such as Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) have succeeded in protecting the interest of stakeholders. The financial system of India has once again proved its strength.

CONCLUSION

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 10^{th} among the largest economies in the world (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. 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.

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