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**IMPACT OF FPIS/FIIS ON INDIAN STOCK MARKET**

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An FII means an entity established or incorporated outside India, which proposes to undertake investment in India; while an FII sub-account includes those foreign corporate, foreign individuals, institutions, funds or portfolios established or incorporated outside India on whose behalf investments are proposed to be made in India by an FII. Since the beginning of the liberalization FII inflows in India steadily grown in importance. Paper covers the flow of FII in India and their relationship with other economic variable. The aim of the paper is to cover the relationship between FII and stock market and role of FIIs in the Indian capital market. It covers the investment trend of FII and the various issues related to the FII investment in the domestic market. Flls frequently move investments, and those swings can be expected to bring price fluctuations resulting in increasing volatility. Increased investment from overseas may shift control of domestic firms to foreign hands. Which showed us how the Indian market is interdependent on global markets like U.S., Europe and other Asian markets? This was the same as happen in current scenario, U.S. and other market meltdown slotted in direct impact on Indian market. The FII are taking out the money and the impact is shown on current Indian markets. **T**he growth of institutional investors in the market is having its own advantages as well as its own share of problems on the brighter side almost always purchase stocks on the basis of fundamentals. And this means that it is essential to have information to evaluate, so research becomes important and this leads to increasing demands on companies to become more transparent and more disclosures. During the Euro-zone crisis and other global economic developments, FIIs started withdrawing significant amount of investments from Indian stock market . To cope up with the challenge maintaining the foreign investment in the Indian market, government came up the scheme of Qualified Foreign Investor (QFI). The only difference was QFIs need not to register with SEBI to trade in the Indian market. when the introduction of QFI failed to boost the growth of inflow of funds in Indian market, government brought rationalized policy to bring together the FIIs and QFIs and introduced Foreign Portfolio Investment (FPI) as a single, uniform route for foreign investment with significant reduction in the procedures for trading in the Indian stock market by foreign individuals, firms and funds.

**Key words:** FIIs, FPIs, Market Volatility, Capital market

## Background

The national common minimum programmed of the present UPA government envisages policies, which encourage foreign institution investors (FIIs), but reduce exposure to the Indian financial system to speculative capital flows. An FII means an entity established or incorporated outside India, which proposes to undertake investment in India; while an FII sub-account includes those foreign corporate, foreign individuals, institutions, funds or portfolios established or incorporated outside India on whose behalf investments are proposed to be made in India by an FII. FII inflow to India grew manifold from 13 Cr (net, monthly) in January 1993 to 5127 Cr within a year's time. Given the volatile nature of capital flows to emerging markets seen in the early 1990s and the nature and growth of such flows to India, FII investment in India, obviously called for special regulatory attention. Investment by FIIs in India is jointly regulated by Securities and Exchange Board of India (SEBI) through the SEBI (Foreign Institutional Investors) Regulations, 1995 and by the Reserve Bank of India through Regulation 5(2) of the Foreign Exchange Management Act (FEMA), 1999. The promulgation of legislation pertaining to foreign investment by SEBI in 1995 marked a watershed for FII flows to India, this led to a significant increase in the level of FII equity inflows in the pre-Asian crisis period. The SEBI FII Regulations and RBI policies are amended and modified from time to time in response to the gradual maturing of the Indian financial market and changes taking place in the global economic scenario.

## Objectives of the study

- To know the proportion of FPIs/FIIs in stock market.
- To find out the relationship between the FPIs/FIIs investment and stock market.
- To know the volatility of Sensex due to FPIs/FIIs.
- To study the behavioral pattern of foreign investments after the modification of FIIs and QFIs into FPIs in India during 2000 to 2016

**Categories** The categories of investors such as Pension Fund, Mutual Fund, Investment Trust, Asset Management Company, Bank, Nominee Company and Incorporated /

Institutional Portfolio Manager or their Power of Attorney holder (providing discretionary and non-discretionary portfolio management services), university funds, endowments, foundations and charitable institutions. They have been allowed to invest in the domestic financial market since 1992; the decision to open up the Indian financial market to FII portfolio flows was influenced by several factors such as the disarray in India's external finances in 1991 and a disorder in the country's capital market. Aimed primarily at ensuring non-debt creating capital inflows at a time of an extreme balance of payment crisis and at developing and disciplining the emerging capital market, foreign investment funds were welcomed to the country.

**Review of Literature**

**K Lakshmi (2003)** found that the FIIs investment in the 49 companies that comprise the S&P CNX NIFTY is only about 12 per cent of the total outstanding shares. National stock exchange reports that FIIs hold only a meager 4.26 per cent of the total outstanding shares of the companies listed on NSE as at the end of March 2003. An sectoral study of the data reveals that FIIs hold less than 10 per cent all the sectors barring just two namely FMCG and Media and Entertainment.

**Prof. Lakshmi Sharma (2005)** found that The FIIs investments, though shown an increasing trend over time, are still far below the permissible limits. This means, the convergence of the sectoral cap for FIIs and FDI investments alone may not really help bring in more funds unless some specific measures are taken up.

**Kalpit Rajkumar Lodha (2008)** Due to the increased effects of globalization, last couple of years the Indian Financial Market being increasingly exposed to global market factors and are faced by rising levels of complexity of risks. To mitigate the effect of those underlying risks, Indian markets are increasingly using highly complex hedging strategies with the help of exotic derivative instruments. The sheer explosive growth in volume of total derivative contracts outstanding validates the heightened interest of Indian markets for such products.

**Anand Bansal and J.S. Pasricha (2009)** studied the impact of market opening to FIIs on Indian stock market behavior. They empirically analyze the change of market return and volatility after the entry of FIIs to Indian capital market and found that while there is no significant change in the Indian stock market average returns; volatility is significantly reduced after India unlocked its stock market to foreign investors. In the next section we are discussing the data sources and methodology of the study.

**Anandadeep Mandal, Sailabala Debi, and Smruti R. Tripathy( 2011)** Author examines the effect of FIIs on Indian stock market volatility by using time series ARIMA approach. the empirical findings suggest that, FIIs are not the only and influencial cause of volatility in Indian equity markets. The primary reason for this finding is that the data series used for the study is a monthly data series. According to the researcher the market volatility caused by FIIs is generally on a daily basis. On the basis of monthly data series, the volatility sputters out. Another reason that can be attributed to this is the varied categories of foreign portfolio flows that come to Indian equity markets.

**Chopada Pranjal Basant(2012)** Proved there is significant effect of FIIs on the movement of sensex. Researcher also mention mentioned about influence of FIIs not only stock market but domestic market is also growing with the increased inflow of FIIs. The finding of the study also shows that FIIs are the most dominant player in the market.

**Mr.Vineeth V.Poliyath (2012)** Author studied trend analysis of net investment and found that the performance of Sensex is fluctuating. Also examines that the fluctuation is increasing in recent years. Correlation study between Sensex movement and FII inflow shows that the fluctuation in not related to FII investment

**Rahul Pandey (2016)** examines the influence of the inflow of FIIs on sensex movement. Sensex improves with the inflow of FIIs and decreases with the outfow of FIIs. Author used Pearson correlation to find out the correlation between FIIs to sensex movement and finds positive correlation between two.

**Contribution by FIIs**

Foreign capital flows are essential to growth of emerging market economies to finance the capital needed for excess of investment over the domestic savings. They help in developing emerging financial markets and overall financial development of the economy. Following table shows the inflows and outflows of FIIs from the period of 1992-2016

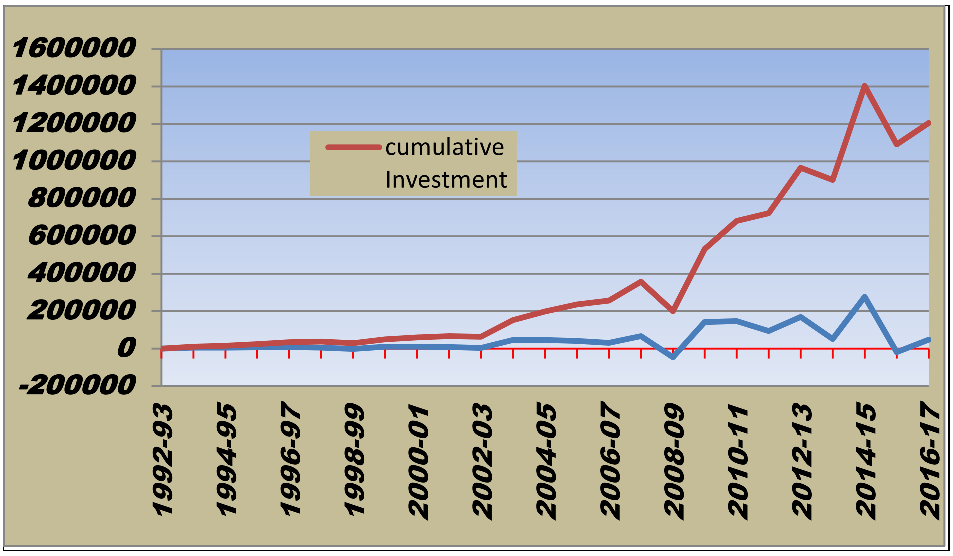
**Investment by Foreign Institutional Investors (SEBI)**

| Financial Year | Equity | Debt | Total |
|---|---|---|---|
| 1992-93 | 13 | 0 | 13 |
| 1993-94 | 5127 | 0 | 5127 |
| 1994-95 | 4796 | 0 | 4796 |
| 1995-96 | 6942 | 0 | 6942 |
| 1996-97 | 8546 | 29 | 8575 |
| 1997-98 | 5267 | 691 | 5958 |
| 1998-99 | -717 | -867 | -1584 |
| 1999-00 | 9670 | 453 | 10122 |
| 2000-01 | 10207 | -273 | 9933 |
| 2001-02 | 8072 | 690 | 8763 |
| 2002-03 | 2527 | 162 | 2689 |
| 2003-04 | 39960 | 5805 | 45765 |
| 2004-05 | 44123 | 1759 | 45881 |
| 2005-06 | 48801 | -7334 | 41467 |
| 2006-07 | 25236 | 5605 | 30840 |
| 2007-08 | 53404 | 12775 | 66179 |
| 2008-09 | -47706 | 1895 | -45811 |
| 2009-10 | 110221 | 32438 | 142658 |
| 2010-11 | 110121 | 36317 | 146438 |
| 2011-12 | 43738 | 49988 | 93726 |
| 2012-13 | 140033 | 28334 | 168367 |
| 2013-14 | 79709 | -28060 | 51649 |
| 2014-15 | 111333 | 166127 | 277461 |
| 2015-16 | -14172 | -4004 | -18176 |
| 2016-17 | 55703 | -7292 | 48411 |
| 2017-18 ** | 16820 | 94490 | 111310 |
| Total | 877774 | 389728 | 1267499 |

Source: SEBI

Foreign Institutional Investment/Foreign Portfolio Investment is an important constituent in the capital flows available to a country to trail its economic growth. As on Aug 2017, 111310 FIIs are registered. Foreign Institutional investment brings in a flow of non debt creating foreign inflows into any market. Since 1992 when FIIs were allowed to invest in the country, FII flows into India has increased manifold. Net investment by FII increased from December 2013-14 and reached the highest in February 2015(2777461).

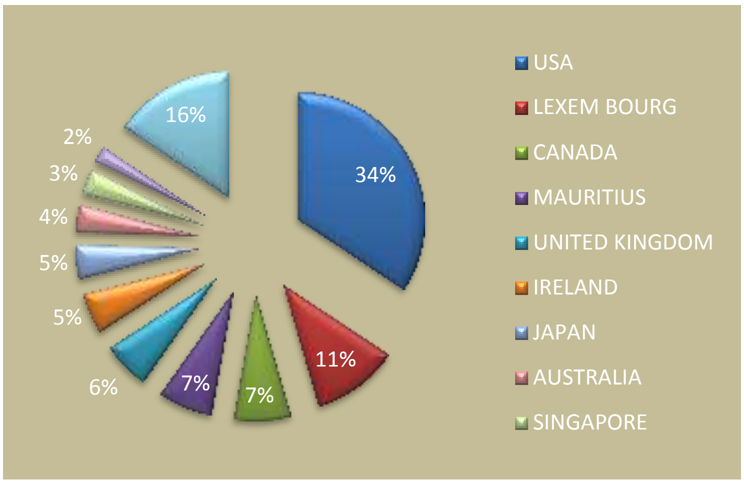
**Trends in Foreign Institutional Investment**




**Source: SEBI**

FIIs have played a very important role in building up India's forex reserves, which have enabled a host of economic reforms. Secondly, FIIs are now important investors in the country's economic growth despite slow domestic outlook. FII strongly influence short-term market movements during bear markets. However, the correlation between market returns and FII inflows reduces during bull markets as other market participants raise their involvement reducing the influence of FIIs. Research by Morgan Stanley shows that there is correlation between foreign inflows and market returns. Market return is high during bear and weakens with strengthening equity prices due to increased participation by other players. Other than above reason of influence is exchange rate. Exchange rate is also has a significant impact on index volatility.

**Country-wise number of registered FIIs/FPIs**

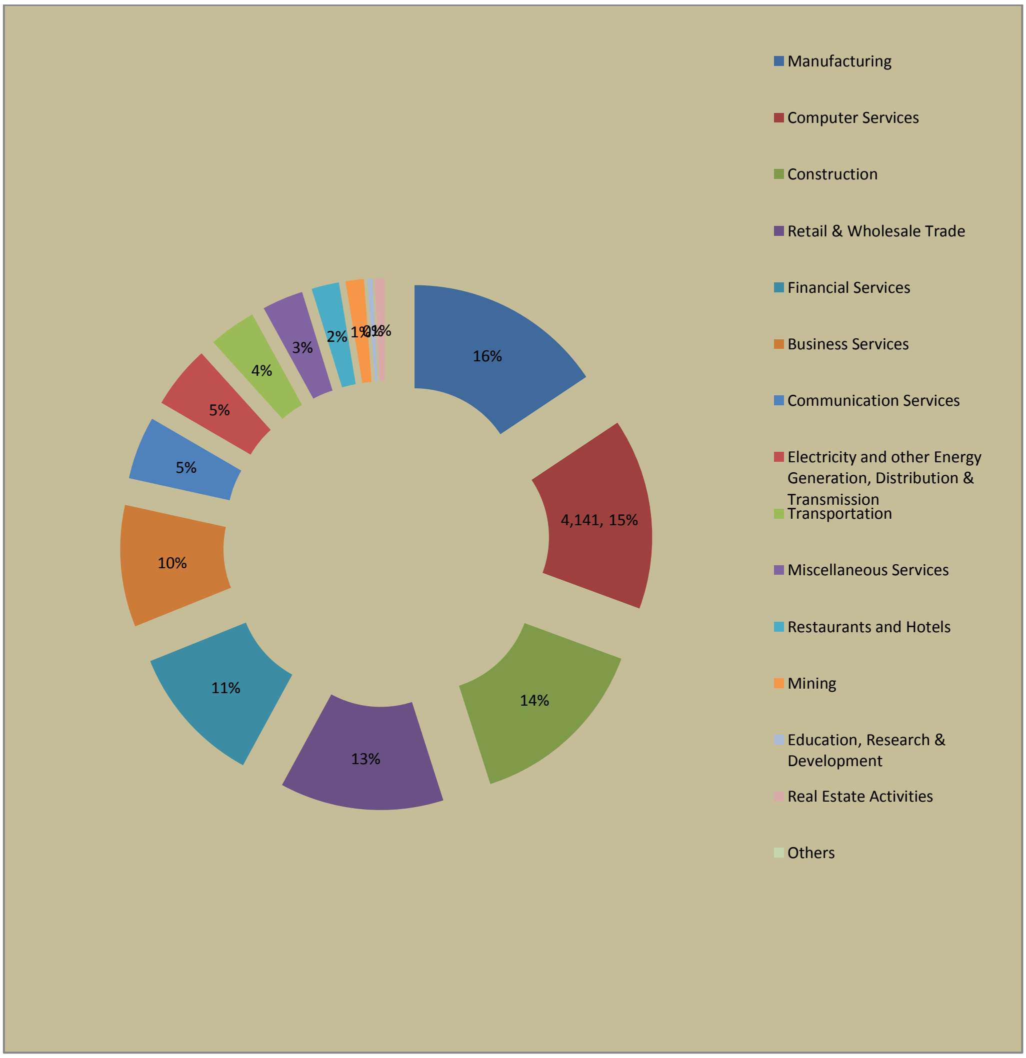



**Source: SEBI**

As on March 31, 2016 , the number of FPIs registered were the highest from USA 34%, followed by Luxembourg 11%, Canada 7% and Mauritius 7%. The Countries like Philippines, Bahamans, Israel and Brazil each had only one registered FPI.

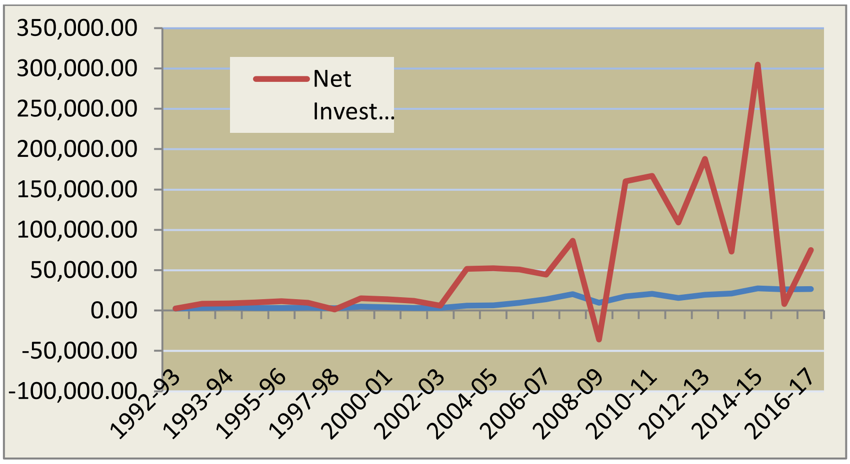
**Registration of Foreign Portfolio Investors And Custodians**

SEBI notified the SEBI (Foreign Portfolio Investors) Regulations, 2014 on January 7, 2014. Accordingly, the foreign portfolio investor regime commenced from June 1, 2014, revamping the existing FII and sub-account structure. As per the new regime, all existing FIIs, sub-accounts and qualified foreign investors (QFIs) have been merged into new single category, 'foreign portfolio investors' (FPIs). To invest in Indian capital market foreign investors need to qualify eligible criteria prescribed under regulations 4 of FPI Regulations, 2014. Total 8,717 FPIs registered with SEBI in 2016 as compared to 8214 including deemed FIIs.




**Source: RBI**

**BSE SENSEX and NET INVESTMENT of FPIs/FPIs**




**Source: SEBI**

**BSE Sensex and FIIs Investment Correlation**

In India statutory agencies like SEBI have prescribed norms to register FPIs/FIIs and also to regulate such Investments flowing in through FIIs. It is very clear from the above chart that Sensex and FIIs are positively correlated. FIIs are playing important role in moving the Sensex The relation between BSE Sensex and FPIs is quite predictive from the above graph as it shows there is optimistic movement between two. Crash in the trend of net investment brings down the sensex. The investment pattern of 1998, 2008, 2011 shows crash in sensex because of outflows of FIIs investment.

**Correlation between Net Investment and Closing BSE Index**

Below table shows the correlation between Net investment and Closing BSE Index from 1992 -2016. Correlation comes out 0.623 which shows strong positive correlation between Sensex and Net investment of FIIs/FPIs. Which states that the Sensex moves with the inflow of FIIs nvestment and decline when investors pull out their money from the market.

**Charts shows Sensex movement and net Investment**

| YEAR | SENSEX | Net Investment |
|---|---|---|
| 1992 | 2,615.37 | 13 |
| 1993 | 3,346.06 | 5127 |
| 1994 | 3,926.90 | 4796 |
| 1995 | 3,110.49 | 6942 |
| 1996 | 3,085.20 | 8575 |

| | | |
|---|---|---|
| 1997 | 3,658.98 | 5958 |
| 1998 | 3,055.41 | -1584 |
| 1999 | 5,005.82 | 10122 |
| 2000 | 3,972.12 | 9933 |
| 2001 | 3,262.33 | 8763 |
| 2002 | 3,377.28 | 2689 |
| 2003 | 5,838.96 | 45765 |
| 2004 | 6,602.69 | 45881 |
| 2005 | 9,397.93 | 41467 |
| 2006 | 13,786.91 | 30840 |
| 2007 | 20,286.99 | 66179 |
| 2008 | 9,647.31 | -45811 |
| 2009 | 17,464.81 | 142658 |
| 2010 | 20,509.09 | 146438 |
| 2011 | 15,454.92 | 93726 |
| 2012 | 19,426.71 | 168367 |
| 2013 | 21,170.68 | 51649 |
| 2014 | 27,499.42 | 277461 |
| 2015 | 26,117.54 | -18176 |
| 2016 | 26,626.46 | 48411 |

**Correlation between Sensex and Net Investment 0.62**

**Volatility of Sensex and Nifty**

Volatility of an asset is measured by the variability in the price over time measured as the variance or the standard deviation of the returns on the asset. The more the standard deviation the more volatile the asset is. This is also a measure of the riskiness of the asset since the more variation it has the more unpredictability associated with its returns. There are a lot of Market Models that measure the residual variances to measure volatility. A volatile market experiences unpredictable price fluctuations. Following table shows the volatility of Sensex and Nifty from 1997-2010.Stock markets volatility is not only affected by FIIs trading, there are many other factors which affect the volatility for e.g. Derivative market and dematerialization of trading accounts, volume of trade etc.

**Annualized Volatility of Nifty & Sensex**

| Year | S&P CNX Nifty | BSE Sensex |
|---|---|---|
| 1997-98 | 2 | 2.3 |
| 1998-99 | 1.5 | 1.8 |
| 1999-00 | 1.8 | 1.7 |
| 2000-01 | 2 | 2.2 |
| 2001-02 | 1.4 | 1.5 |
| 2002-03 | 1 | 1 |
| 2003-04 | 1.4 | 1.4 |
| 2004-05 | 1.6 | 1.5 |
| 2005-06 | 1 | 1 |
| 2006-07 | 1.8 | 1.8 |
| 2007-08 | 2 | 1.9 |
| 2008-09 | 2.7 | 2.8 |
| 2009-10 | 1.9 | 1.9 |
| 2010-11 | 1.1 | 1.1 |
| 2011-12 | 1.3 | 1.3 |
| 2012-13 | 0.9 | 0.9 |
| 2013-14 | 1 | 1.1 |
| 2015-16 | 1.1 | 0.9 |
| 2016-17 | 0.09 | 0.9 |

**Source: SEBI**

**Volatility of Stock Market as per Traditional Measures**

| | Time Period | Return | Volatility |
|---|---|---|---|
| **Pre-Liberalization period** | **1961-80** | **.0155** | **.0521** |
| **Real Sector Reforms** | **1981-90** | **.065** | **1.001** |
| **Financial Sector Reforms** | **1991-00** | **.073** | **1.83** |
| **Second generation Reforms** | **2001-07** | **.103** | **1.32** |
| **Global crisis period & later** | **2008-16** | **.152** | **1.83** |

Above table shows the Standard deviaton values of the stock market and percentage of return.Pre-liberlization period shows the minimum percentage of return and volatility. During real sector reforms and financial sector reforms returns improved with the rise in volatility. As market exposed to globalization the returns as well as volatility increased. During the period of 2001-07 return improved but volatility reduced due to structured foreign investment policies.

**Effect of FIIs on Indian Economy**

**Better pour of capital**

FIIs invest more in equity than debts Because of this preference for equities over bonds, FIIs can help in compressing the yield differential between equity and bonds and improve corporate capital structure.

**Managing uncertainty and controlling risks**

FIIs promote financial modernization and expansion of hedging instruments. FIIs as professional bodies of asset managers and financial analysts, not only enhance competition in the financial markets, but also improve the alignment of asset prices to fundamentals.

**civilizing capital markets**

FIIs enhance healthy competition and effectiveness in the markets. Equity development aids economic development. By the viability of riskier long term capital for projects and increasing firm's incentives to supply more information about themselves, the FIIs can help in the process of economic development.

**Improved corporate governance**

AS FIIs are foreign investor ,need full disclosure from the organization where they already invested .This way all organization will provide full disclosureabot their financial position in order to attract capital

**Knowledge flows**

The activities of FIIs help strengthen Indian finance .FIIs advocate modern ideas in market design, promote innovation, development of sophisticated products such as financial derivatives, and enhance competition in financial intermediation.

**Costs Herding and positive feedback trading**

There are concern that foreign investors are chronically ill-informed about India, and this lack of sound information may generate herding and positive feedback trading (buying after positive return and selling after negative returns this kind of behavior can aggravate volatility, and pushes price away from fair values

**Possibilities of taking over companies**

While FIIs are seen as pure portfolio investors, without interest in control, portfolio investor can occasionally behave like FDI investors, and seek control of companies.

**Complexities of monetary management**

The problem showed up in terms of very large foreign exchange reserve inflows requiring considerable sterilization operations by RBI to maintain stability.

**Conclusions**

A number of studies in the past have observed that investments by FIIs and the movements of Sensex are quite closely correlated in India and FIIs wield significant influence on the movement of sensex. There is little doubt that FII inflows have significantly grown in importance over the last few years. In the absence of any other substantial form of capital inflows, the potential ill effects of a reduction in the FII flows into the Indian economy can be severe. From the point of attracting foreign capital, the initial expectations have not been realized. Investment by FIIs directly in the Indian stock market did not bring significantly large amount compared to the GDR issues. GDR issues, unlike FII investments, have the additional advantage of being project specific and thus can contribute directly to productive investments.FII investments, seem to have influenced the Indian stock market to a considerable extent. Results of this study show that not only the FIIs are the major players in the domestic stock market in India, but their influence on the domestic markets is also growing. Data on trading activity of FIIs and domestic stock market turnover suggest that FII's are becoming more important at the margin as an increasingly higher share of stock market turnover is accounted for by FII trading. Moreover, the findings of this study also indicate that Foreign Institutional Investors have emerged as the most dominant investor group in the domestic stock market in India. Particularly, in the companies that constitute the Bombay Stock Market Sensitivity Index (Sensex), their level of control is very high. Data on shareholding pattern show that the FIIs are currently the most dominant non-promoter shareholder in most of the Sensex companies and they also control more tradable shares of Sensex companies than any other investor groups.

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