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FIIS IMPACT ON INDIAN STOCK MARKET-A STUDY FOCUSED ON BSE SENSEX AND NSE NIFTY INDEX

V. Krishna Mohan* and K. V. Siva Prasad**

Abstract: *Capital is considered to be very important growth in any economy. In case of emerging economies like India, Domestic capital is not sufficient to fulfill the requirement of economy boost up. In that case foreign capital plays a very important role. Foreign institutional investors' inflows and outflows directly create impact on stock market. FII's have gained a significant role in Indian stock markets. The present globalization context has shown the real dynamism of Indian stock market and the various benchmarking of both BSE SENSEX and NSE NIFTY in terms of its highest peaks and sudden falls. In this context present paper focusing on the contribution of foreign institutional investment in both Sensex and Nifty FII flow during the period of 1993 to 2014 and examine the volatility of BSE Sensex and NSE Nifty due to foreign institutional investors. The data for the study uses the information obtained from the secondary resources. The present study has an aim to examine the impact of foreign institutional investment on Indian stock market and economy. Its focus is on relationship between FII and BSE Sensex and NSE Nifty to find out trend and pattern of FII flow in Indian stock markets and also to examine the relationship between FII and Sensex and Nifty.*

Keywords: Foreign Institutional Investors Sensex, Nifty, volatility, capital flows

JEL Classification: G10, G 14

INTRODUCTION

The remarkable economic growth during the past two decades in most of the emerging countries had been stimulated by foreign capital inflows from developed countries. It has witnessed sharp increase in flows of foreign private capital result in net capital inflows. In India, Foreign Institutional Investors (FIIs) was first allowed in September 1992 as part of the liberalization process that followed balance of payment crisis in 1990-1991. FIIs facilitate in decreasing the fiscal deficit, increase in cash flows, and increase the domestic savings and thereby availability of capital reserve apart from keeping the foreign exchange management under control. There were many terms and conditions which restricted many FIIs to invest in India but in the course of time, in order to attract more investors SEBI has simplified many terms such as the ceiling for overall investments of FIIs. India, which is the second fastest growing economy after China, has lately been a major recipient of Foreign

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* Post-Doctoral Fellow, Department of Commerce and Management Studies, Andhra University Visakhapatnam.

** Professor, Department of Commerce and Management Studies, Andhra University Visakhapatnam.

Institutional Investor (FII) funds driven by the strong fundamentals and growth opportunities. FIIs are the most successful investors in India and their inflows and outflows also determine the direction of Indian stock market.

In this context, the paper has the focus on the contribution of foreign institutional investment in both SENSEX and NIFTY; FIIs flow during the period of 1993 to 2014 and examine the volatility of BSE SENSEX and NSE NIFTY due to foreign institutional investors' investment pattern.

LITERATURE REVIEW

In view of the importance of FIIs role in Indian capital markets, there are many research studies in the area as detailed here in the chronological order.

Chakrabarti (2001) has examined in his research that the FIIs net inflows were more likely to affect than the cause of equity market returns, with the FIIs not having informational disadvantages compared to domestic investors. **Morgan Stanley (2002)** has reported that 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 sluggish domestic sentiment. FII strongly influence short-term market movements during bear markets. The correlation between foreign inflows and market returns is high during bear phase and weakens with strengthening equity prices due to increased participation by other players. **Mukherjee Paramita, Bose Suchismita Bose and Coondoo Dipankor (2002)**, found that the FII activities had a strong demonstration effect and was driving the domestic market suggesting that the FII flows tend to be caused by return in the domestic market. **Sivakumar S (2003)**the study focused on the net flows of FII's over the years. It also briefly analyses the nature of FII flows based on research, explores some determinants of FII flows and examines if the overall experience has been stabilizing or destabilizing for the Indian capital market. **Rai Kulwant *et al.* (2003)** held that the present study tries to examine the determinants of Foreign Institutional Investments in India, which have crossed almost US$ 12 billion by the end of 2002. In this study, by using monthly data, we found that FII inflow depends on stock market returns, inflation rate (both domestic and foreign) and ex-ante risk. **Agarwal, Chakrabarti *et al.* (2003)** has found in their research that the equity return has a significant and positive impact on the FII. But given the huge volume of investments, foreign investors could play a role of market makers and book their profits. Hence, there is a possibility of bi-directional relationship between FII and the equity returns. **Sundhya Ananthanarayanan (2004)** this study focused on impact of FIIs on the major stocks of India.The study resulted that unexpected flows have a greater impact than expected flows on stock indices,it is also find strong evidence consistent with the base broadening hypothesis, contrarian strategies being employed by foreign institutional investors. And support the price pressure hypothesis. Finally, we do not find any substantiation to the claim that foreigners' destabilize the market.**Griffin (2004)**, found that contemporaneous flows are significant predictors of returns for Korea, Taiwan, Thailand and India, indicating that contemporaneous flows are positive and highly significant in India. FIIs Inflows and stock index movement show positive correlation, but fail to predict the future value. The unexpected flows have a greater impact than expected flows on stock indices and no evidence have been found that foreigners destabilize the market. **David A. Carpenter *el al.* (2005)** has examined that the Indian government has established a regulatory framework for three separate investment avenues: foreign direct investment (FDI), investment by foreign institutional investors (FII) and investment by foreign venture capital investors. While these investment alternatives have created clear avenues for foreign investment in India, they remain subject to many conditions and restrictions which continue to hamper foreign investment in India. **Dhamija Nidhi (2007)**revels that in recent years the foreign institutional investment (FII) inflowsincreases because of this concerns regarding the volatility of these flows, threat of capital flight, its impact on the stock markets and influence of changes in regulatory regimes. The present study aims to the role of various factors relating to individual firm-level characteristics and macroeconomic-level conditions influencing FII investment. The regulatory environment of the host country has an important impact on FII inflows. As the pace of foreign investment began to accelerate, regulatory policies have changed to keep up with changed domestic scenarios. **P. Krishna Prasanna (2008)**observed that foreign investors invested more in companies with a higher volume of shares owned by the general public. The promoters holding and the foreign investments are inversely related. Foreign investors choose the companies where family shareholding of promoters is not substantial. Among the financial performance variables the share returns and earnings per share are significant factors influencing their investment decision.

NEED FOR THE STUDY

The research works so far, in the area of Foreign Intuitional Investors are limited to certain categories. Integrated studies on different kinds of indices are very limited. The present study is to provide research analysis on the trends and patterns of foreign capital flow into stock market in the form of FII and also relationship of FII's and BSE Sensex and NSE Nifty. Yet another need for the present study is derived from the view point of FII's impact on BSE Sensex and NSE Nifty. This paper outlines the foreign capital flow into stock market in the form of foreign intuitional investors and the market as a whole with the following specific objectives and hypotheses.

OBJECTIVES OF STUDY

- To study the trends and patterns of foreign capital flow into India in the form of FII

- To study the relation and impact of Foreign Institutional Investment (FII) on BSE Sensex
- To study the relation and impact of Foreign Institutional Investment on CNX Nifty

HYPOTHESIS

- $H_0 1$: There is no significant relation between FII on BSE Sensex and CNX Nifty
- $H_0 2$: There is no significant impact of FII on BSE Sensex and CNX Nifty

RESEARCH METHODOLOGY

This study has been conducted purely based on the secondary data which has been collected mainly from websites of BSE, NSE SEBI, RBI and NSDL etc. Keeping in view theobjectives; the study has taken up a time period of 21 years (1993 to 2014) of FII, Sensex and Nifty. The statistical tools such as correlation and regression are used in the analysis of data. With a view to study the linear relationship between variables such as FII, Sensex and Nifty, an attempt is made to study the relationship and impact of FII on BSE Sensex and NSENifty.

RESULTS AND DISCUSSION

FIIs flow on Indian Stock Markets

As the Indian equity market is growing the trend and future prospects in foreign institutional investments had become a great concern have made India an attractive destination for foreign institutional investors (FIIs). Indian corporate sector's securities major portions are held by FII's. These investors are often viewed as sophisticated investors as these institutional investors are better informed and better equipped to process information than individual investors.As the share of foreign investors in emerging markets has risen considerably, it has influenced the asset prices considerably. Consequently, policy makers have become increasingly concerned about the factors determining international investment, the performance of foreign capital investments and the impact of foreign investment on local turnover and on the volatility of stock prices. The Table 1 revels that except 1998 and 2008 remaining 19 years (1993 to 2014) are positive with high inflows and year on year with increased net worth. It has been observed that the share indices on various Indian stock markets are highly dependent on the net inflow from Foreign Institutional Investors. Due to net flow of Foreign Institutional Investment being outward during 2011, there was a decline of around 25% in Nifty.

Why is Indian stock market so much dependent on FIIs? We can easily observe that FIIs has been much more than Direct Institutional Investment in India. During the last one year there was net outflow of Rs. 57,932.74 in DII while there has been inflow of Rs. 76,123.15 (Figures from May 2013 to April 2014). Thus Indian stock market and the Indian industries are more dependent on the FII for their growth. When FIIs stop investing or the investors go for profit booking, it is observed that there is a sharp fall in the share prices.

Table 1
Flow of FII, BSE Sensex and CNX Nifty Dataduring 1993 - 2014

Year	*Equity*	*Debt*	*Total*	*BSE SENSEX*	*NSE NIFTY*
1993			2,595.10	3,346.06	1042.59
1994			6,791.20	3,926.90	1182.14
1995			3,853.80	3,110.49	908.53
1996			10,803.60	3,085.20	899.10
1997	5,760.20	447.00	6,207.30	3,658.98	1079.40
1998	-739.80	-740.10	-1,479.90	3,055.41	884.25
1999	6,578.40	118.90	6,697.30	5,005.82	1592.20
2000	6,369.90	141.00	6,510.90	3,972.12	1254.30
2001	11,970.40	524.40	12,494.80	3,262.33	1059.05
2002	3,629.60	48.30	3,677.90	3,377.28	1093.50
2003	30,459.40	4,694.40	35,153.80	5,838.96	1879.75
2004	38,965.80	3,083.30	42,049.10	6,602.69	2080.50
2005	47,181.90	-5,518.40	41,663.50	9,397.93	2835.95
2006	36,540.20	4,049.00	40,589.20	13,786.91	4007.40
2007	71,486.30	9,428.50	80,914.80	20,286.99	6138.60
2008	-52,987.40	11,771.90	-41,215.50	9,647.31	2959.15
2009	83,424.20	4,563.40	87,987.60	17,464.81	2959.15
2010	133,266.30	46,408.30	179,674.60	20,509.09	6134.50
2011	-2,714.20	42,067.00	39,352.80	15,454.92	4624.30
2012	1,28,360.50	34989.40	1,63,350.00	19,426.71	5905.10
2013	1,13,136.00	-50,848.00	62288.00	21,170.68	6304.00
2014	97,054.00	1,59,156.00	2,56,213.00	27,499.42	8282.70

Source: NSDL, BSE and NSE Web site

Correlation between FII and BSE Sensex

Table 2
FII and BSE Sensex Descriptive Statistics

	Mean	*Std. Deviation*	*N*
FII	47553.31	70084.222	22
BSE	10131.23	7808.210	22

Table 3
Correlations

		FII	*BSE*
FII	Pearson Correlation	1	.840**
	Sig. (2-tailed)		.000
	N	22	22
BSE	Pearson Correlation	.840**	1
	Sig. (2-tailed)	.000	
	N	22	22

**. Correlation is significant at the 0.01 level (2-tailed)
Source: Authors Calculations

Based on above results the mean value of FIIs is 47553.31, Standard deviation is 70084.222 for BSE mean value is 10131.23 and standard deviation is 7808.210. It can be concluded that the Correlation value 0.840. It is highly significant at 0.01 level of significant.Hence the null hypothesis ($H0_1$) has been rejected therefore there is a relationship between FII and BSE Sensex.

Correlation between FII and NSE Nifty

Table 4
FII and NSE Nifty Descriptive Statistics

	Mean	*Std. Deviation*	*N*
FII	47553.31	70084.222	22
NSE	2959.37	2280.424	22

Table 5
Correlations

		FII	*NSE*
FII	Pearson Correlation	1	.835**
	Sig. (2-tailed)		.000
	N	22	22
NSE	Pearson Correlation	.835**	1
	Sig. (2-tailed)	.000	
	N	22	22

**. Correlation is significant at the 0.01 level (2-tailed)
Source: Authors Calculations

Based on above results the mean value of FIIs is 47553.31, Standard deviation is 70084.222 for NSE Nifty mean value is 2959.37 and standard deviation is 2280.424. It can be concluded that the Correlation value 0.835. It is highly significant at 0.01 level of significant. Hence the null hypothesis ($H0_1$) has been rejected therefore there is a relationship between FII and NSE Nifty.

Regression analysis between FII and BSE Sensex

Regression has been used to determine the strength of relationship between FII and Sensex. R-square value is 0.706 which means model explains the 70.6% variation. In other words independent variable FII is able to explain 70.6% variation of the dependent variable BSE Sensex. The table reveals that the F-Statistics (48.096) is very moderate and the corresponding P value is highly significant P value is highly significant 0.000 which is less than the significant value 0.01. This indicates that relationship between FII's and the movement of BSE Sensex.Which means null hypothesis ($H0_2$) is rejected and there is significant impact of FII on BSE Sensex.

Table 6
Model Summary

Model	*R*	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*	*Change Statistics*				
					R Square Change	*F Change*	*df1*	*df2*	*Sig. F Change*
1	.840[a]	.706	.692	4336.105	.706	48.096	1	20	.000

a. Predictors: (Constant), FII b. Dependent Variable: BSE
Source: Authors Calculations

Regression analysis between FII and NSE Nifty

Regression has been used to determine the strength of relationship between FII and Nifty. R-square value is 0.697 which means model explains the 69.70% variation. In other words independent variable FII is able to explain 69.70% variation of the dependent variable NSE Nifty. The table reveals that the F-Statistics (46.057) is very moderate and the corresponding P value is highly significant 0.000 which is less than the significant value 0.01. This indicates that relationship between FII's and the movement of NSE Nifty. Which means null hypothesis ($H0_2$) is rejected and there is significant impact of FII on NSE Nifty.

FII's to NSE Nifty

Model Summary

Model	*R*	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*	*Change Statistics*				
					R Square Change	*F Change*	*df1*	*df2*	*Sig. F Change*
1	.835[a]	.697	.682	1285.778	.697	46.057	1	20	.000

a. Predictors: (Constant), FIIb. Dependent Variable: NSE
Source: Authors Calculations

CONCLUSION

The majority FIIs are entering into Indian markets because of thelarge size of the market, increasing number of investors who are investing in capital market, liberalized trade policy by Indian government and the stable political scenario besides technology and infrastructure which have created conducive environment for entry of FIIs and the growth of Indian capital market. It can be seen that the Flow of FIIs has advanced significantly during the last 22 years, i.e., from the year 1993 to 2014.

The FIIs investment in Indian markets as reported by Moneycontrol.com is Rs. 11,44,659Crore in June 2015. The correlation between FIIs to BSE Sensex and NSE Nifty is found to be high positive and strong. As R-square is also found to be high (FIIs to Sensex 0.706 and FIIs to Nifty 0.697) FIIs would affect Sensex0.706% and Nifty 0.697% for each percent of FII rise. There is a relationship between such FII flows and changes in stock market indices like Sensex and Nifty indicating rejection of both hypotheses set for the study.

In view of this, it can be concluded that FIIs are not the cause of volatility in Indian stock marketsbut there may be various other reasons which can be investigated in detail.

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