

# Foreign Institutional Investors (FIIs) Investment in India: A Trend Analysis of Monthly Flows during January 2004- August 2010

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## Key Words:

1. Foreign Institutional Investors
2. Trend Analysis,
3. Indian Economy

**Abstract :** The ultimate objective of FIIs to invest in any country is return and safety of its funds. Here in this paper researchers have made an attempt to analyze the trend of FIIs investment in India. The information regarding monthly and yearly investment by Foreign Institution Investors (FII's) in India have been collected from the RBI's annual manual. The period covered under the study is from January 2004 to August 2010. The findings of the study indicate that in 2009 FIIs have invested Rs. 912,033 million. While they have withdrawn Rs. 604,266 million in 2008 this is due to the effect of global meltdown and recession in world economy. During the study we found that Market size, Political scenario, Labour cost and productivity, Liberalized Trade Policy, Infrastructure, Incentives and Operating conditions and Disinvestment policy were the causes of FIIs investment in India.

## Introduction:

Investment is the commitment of money or capital to purchase financial instruments or other assets in order to gain profitable returns in the form of interest, income, or appreciation of the value of the instrument. Investment is related to saving or deferring consumption. An investment involves the choice by an individual or an organisation such as a pension fund, after some analysis or thought, to place or lend money in a vehicle, instrument or asset, such as property, commodity, stock, bond, financial derivatives (e.g. futures or options), or the foreign asset denominated in foreign currency, that has certain level of risk and provides use possibility of generating returns over a period of time. When an asset is bought or a given amount of money is invested in the bank, there is anticipation that some return will be received from the investment in the future. Investment comes with the risk of the loss of the principal sum. The investment that has not been thoroughly analysed can be highly risky with respect to the investment owner because the possibility of losing money is not within the owner's control. The difference between speculation and investment can be subtle. It depends on the investment owner's mind whether the purpose is for lending the resource to someone else for economic purpose or not. Investment can be made by a person resident in India and an entity resident out of India or Foreign Institutional Investors (FIIs).

India opened its stock market to foreign investors in September 1992 and in 1993 received portfolio investment from foreigners in the form of foreign institutional investment in equities. This has

become one of the main channels of FII in India for foreigners. Initially, 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.

FII (Foreign Institutional Investors) is used to denote an investor, it is mostly of the form of an institution or entity which invests money in the financial markets of a country. The term FII is most commonly used in India to refer to companies that are established or incorporated outside India, and is investing in the financial markets of India. These investors must register with the Securities & Exchange Board of India (SEBI) to take part in the market.

Entities covered by the term 'FII' include "Overseas pension funds, mutual funds, investment trust, asset management company, nominee company, bank, institutional portfolio manager, university funds, endowments, foundations, charitable trusts, charitable societies, a trustee or power of attorney holder incorporated or established outside India proposing to make proprietary investments or investments on behalf of a broad-based fund .

Foreign Institutional Investors (FIIs) are allowed to invest in the primary and secondary capital markets in India through the Portfolio Investment Scheme (PIS) administered by the Reserve Bank of India (RBI). Under this scheme FIIs can acquire shares/debentures of Indian companies through the stock exchanges in India.

India, which is the second fastest growing economy after China, has lately been a major recipient of Foreign Institutional Investor (FII) funds driven by the strong fundamentals and growth opportunities. According to analysts, the late revival of monsoon, upward revision of economic growth from 5.8 per cent to 6.1 per cent, better-than-expected performance of companies in the

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quarter ended-June 30, the new direct taxes code, leading to savings in the tax payer's money, and the trade policy with an ambitious target of US\$ 200 billion exports for 2010-11 have all revived the confidence of FIIs investing in India. Both consumption and investment-led industries linked to domestic demand, such as auto, banking, capital goods, infrastructure and retail, are likely to continue attracting FII funds.

### Literature Review:

Chakrabarti (2001) has examined in his research that following the Asian crisis and the bust of info-tech bubble internationally in 1998-99 the net FII has declined by US\$ 61 million. But there was not much effect on the equity returns. This negative investment would possibly disturb the long-term relationship between FII and the other variables like equity returns, inflation, etc; He has marked a regime shift in the determinants of FII after Asian crisis. The study found that in the pre-asian crisis period any change in FII found to have a positive impact on the equity returns. But in the post-asian crisis period it was found the reverse relation that change in FII is mainly due to change in equity returns. Stanley Morgan (2002) has examined 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. The Morgan Stanley report notes that FII strongly influence short-term market movements during bear markets. However, the correlation between returns and flows reduces during bull markets as other market participants raise their involvement reducing the influence of FIIs. Research by Morgan Stanley shows that the correlation between foreign inflows and market returns is high during bear and weakens with strengthening equity prices due to increased participation by other players. Mukherjee Paramita, Bose Suchismita Bose and Coondoo Dipankor (2002), found that over the past decade India has gradually emerged as an important destination of global investors' investment in emerging equity markets. In their study they explore the relationship of FIIs flows to the Indian equity market with it possible covariates based on a time series of daily data for the period January, 1999 to May, 2002. Their results show that, though there is a general perception that FII activities exert a strong demonstration effect and thus derive the domestic stock market in India; evidence from causality tests suggests that FII flow to and from the Indian market tends to be caused by return in the domestic equity market and not the other way round. Sivakumar S (2003) has analysed the net flows of foreign institutional investment 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 stabilising or destabilising 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. Given the huge volume of these flows and its impact on the other domestic financial markets understanding the behavior of these flows becomes very important at the time of liberalising capital account. 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. In terms of magnitude, the impact of stock market returns and the ex-ante risk turned out to be major determinants of FII inflow. This study did not find any causation running from FII inflow to stock returns as it was found by some studies. Stabilising the stock market volatility and minimising the ex-ante risk would help in attracting more FII inflow that has positive impact on the real economy. Agarwal, Chakrabarti et.al.(2003) have 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, i.e., they can buy financial assets when the prices are declining thereby jacking-up the asset prices and sell when the asset prices are increasing. Hence, there is a possibility of bi-directional relationship between FII and the equity returns. Sundhya Ananthanarayanan (2004) held that as part of its initiative to liberalise its financial markets, India opened her doors to foreign institutional investors in September, 1992. This event represents a landmark event since it resulted in effectively globalising its financial services industry. We study the impact of trading of Foreign Institutional Investors on the major stock indices of India. Our major findings are as follows. First, we find that unexpected flows have a greater impact than expected flows on stock indices. Second, we find strong evidence consistent with the base broadening hypothesis. Third, we do not detect any evidence regarding momentum or contrarian strategies being employed by foreign institutional investors. Fourth, our findings support the price pressure hypothesis. Finally, we do not find any substantiation to the claim that foreigners' destabilise the market. David A. Carpenter et al (2005) has examined that the Indian government has established a regulatory framework for three separate investment avenues: foreign direct investment; investment by foreign institutional investors; 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) held that the increase in the volume of foreign institutional investment (FII) inflows in recent years has led to 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 determinants and destinations of these flows and how are they influencing economic development in the country have also been debated. This paper examines 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. The paper also provides a review of these changes. P. Krishna Prasanna (2008) has examined the contribution of foreign institutional investment particularly among companies included in sensitivity index (Sensex) of Bombay Stock Exchange. Also examined is the relationship between foreign institutional investment and firm specific characteristics in terms of ownership structure, financial performance and stock performance. It is observed that foreign investors invested more



in companies with a higher volume of shares owned by the general public. The promoters' holdings 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.

### Trend Analysis:

The term "trend analysis" refers to the concept of collecting information and attempting to spot a pattern, or trend, in the information. In some fields of study, the term "trend analysis" has more formally-defined meanings.

In project management trend analysis is a mathematical technique that uses historical results to predict future outcome. This is achieved by tracking variances in cost and schedule performance. In this context, it is a project management quality control tool. The analysis of a variable's past value changes to determine if a trend exists and if so. What the trend indicates? A technical analyst may graph a stock's price throughout a period of time to determine whether a trend has been established. This is a type of technical analysis that is used /or attempt to predict the future movement of a stock or institutional of fund.

### Specific Objectives:

1. To find out the causes for investment by Foreign Institutional Investors (FIIs) in India.
2. To know the trend of investment of Foreign Institutional Investors in India.
3. To study the scope and trading mechanism of Foreign Institutional investors in India.

Exhibit 1: FIIs investment in India in 2004

Month Ended	Amount (Rs M)
Jan-2004	24,356
Feb-2004	31,591
Mar-2004	87,688
Apr-2004	41,730
May-2004	-32,505
Jun-2004	3,106
Jul-2004	11,965
Aug-2004	28,112
Sep-2004	27,843
Oct-2004	40,424
Nov-2004	64,224
Dec-2004	68,538

### Research Methodology:

Our entire study is based on secondary data and relevant secondary data have been collected from various books, journal and web sites. The information regarding monthly and yearly investment by Foreign Institution Investors (FII's) in India have been collected from the RBI's annual manual. The period covered under the study is from January 2004 to August 2010. We have used Trend Analysis Technique by which we would able to know the trend of investment by FII's. Trend analysis is used to predict a trend of investment in future and know the impact of past in present or in future. In trend analysis one can also compute the percentage and know the results about future. Here the purpose of using trend analysis is to determine and find trend of FIIs investment in India.

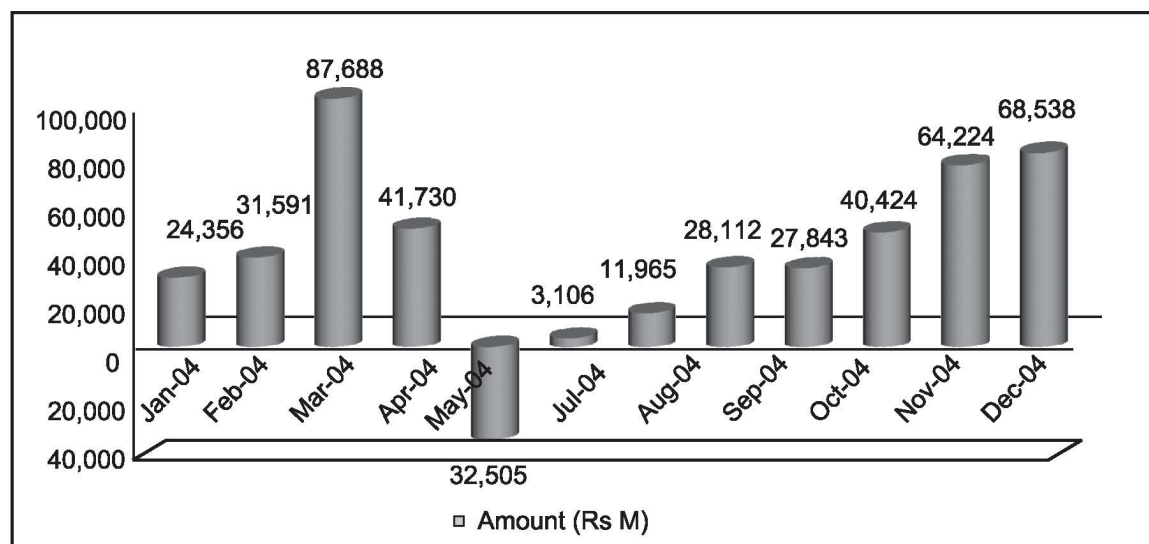
### Trend analysis of FIIs:

Exhibit 1 shows that in the month of March, 2004 FIIs investment was Rs. 87,688 million followed by Rs. 68,538 million in Dec. 2004, while FIIs have withdrawn Rs. 32,505 in May, 2004.

Exhibit 2 shows that FIIs have invested Rs. 87,685 in July, 2005 which was the highest amount invested by FIIs for the year 2005. In May and October, 2005 FIIs have withdrawn Rs. 6,961 million and Rs. 28,526 million respectively.

Exhibit 5 reveals that in the year 2006 FIIs inflow was less than in comparison to outflow i.e. FIIs have withdrawn the highest amount for the year. FIIs withdrew Rs. 82,473 million in May, 2006 followed by Dec. 2006. Inflow of funds by FIIs in India was highest in Nov. 2006 i.e. Rs. 93,142 million followed by Rs. 75,720 in Feb. 2006.

Exhibit 2: FIIs investment in India in 2004



In the year 2007, FIIs average inflows and outflows of funds were very high. FIIs investment was highest Rs. 189,953 million and Rs. 189,485 million in July 2007 and Sep. 2007 respectively, while FIIs have withdrawn three times in the same year i.e. Rs. 41,761 million in Jan., Rs. 41,913 million in Aug., and Rs. 45,974 in Nov. 2007.

Exhibit 9 shows outflow trend throughout the year. In Jan. 2008 FIIs have withdrawn Rs. 172,269 million which was the highest amount withdrawn in 2008. Inflow of funds was quite less. FIIs have invested maximum amount of Rs. 48,827 million in Feb. 2008.

Year 2009 was good from India's point of view because in 2009

FIIs investment has been highest since 2004. In May, 2009 FIIs invested Rs. 206,069 million followed by Rs. 199,395 million in Sep. 2009. FIIs have withdrawn two times i.e. in Jan. and Feb. 2009.

FIIs inflow was quite satisfactory in 2010 as it was in 2009. FIIs investment was Rs. 188,336 million and Rs. 176,576 in March and July respectively. FIIs have withdrawn Rs. 91,745 million in May, 2010.

Exhibit 15 shows total inflow and outflow of funds by FIIs in India. It was found that highest inflow was in 2009 and highest withdrawal was in 2008. Least withdrawal was in 2004 and least investment was in 2008.

Exhibit 3: FIIs investment in India in 2005

Month Ended	Amount (Rs M)
Jan-2005	13,523
Feb-2005	80,796
Mar-2005	74,504
Apr-2005	9,471
May-2005	-6,961
Jun-2005	57,621
Jul-2005	87,685
Aug-2005	44,126
Sep-2005	42,380
Oct-2005	-28,526
Nov-2005	40,641
Dec-2005	40,641

Exhibit 4: FIIs investment in India in 2005

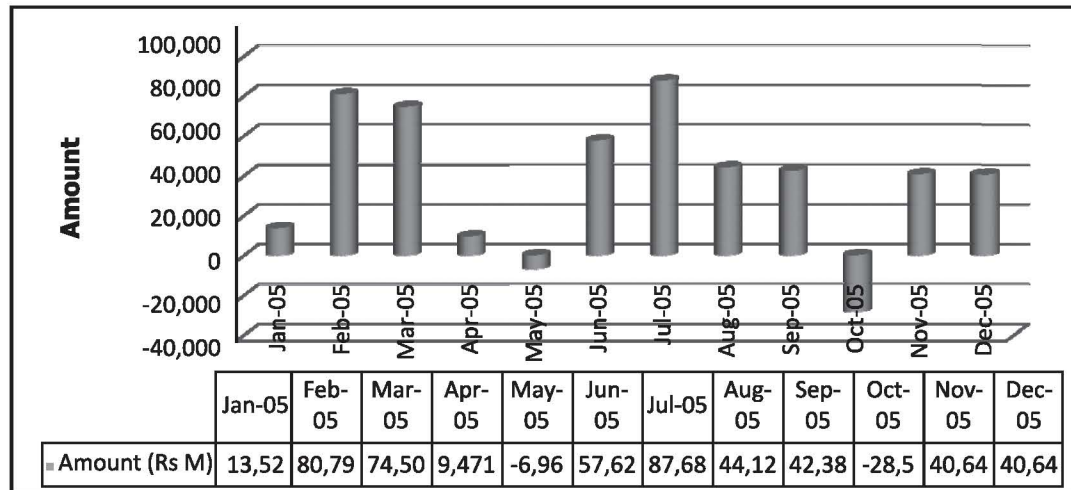


Exhibit 5: FIIs investment in India in 2006

Month Ended	Amount (Rs M)
Jan-2006	37,983
Feb-2006	75,720
Mar-2006	59,778
Apr-2006	39,771
May-2006	-82,473
Jun-2006	9,094
Jul-2006	12,764
Aug-2006	47,739
Sep-2006	59,282
Oct-2006	65,995
Nov-2006	93,142
Dec-2006	-35,936

Exhibit 6: FIIs investment in India in 2006

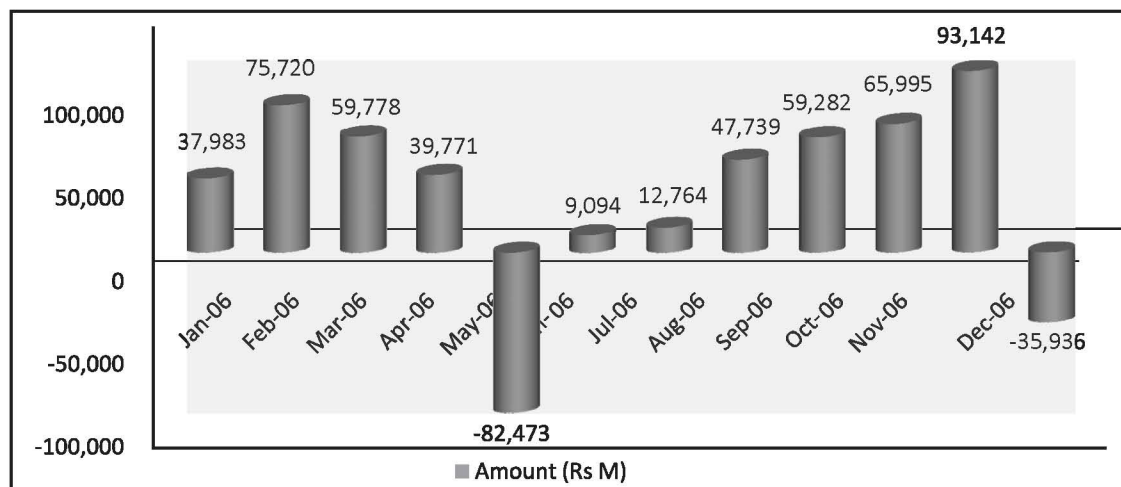


Exhibit 7: FIIs investment in India in 2007

Month Ended	Amount (Rs M)
Jan-2007	-41,761
Feb-2007	55,954
Mar-2007	14,033
Apr-2007	59,987
May-2007	40,968
Jun-2007	71,694
Jul-2007	189,953
Aug-2007	-41,913
Sep-2007	189,485
Oct-2007	173,613
Nov-2007	-45,974
Dec-2007	37,558

Exhibit 8: FIIs investment in India in 2007

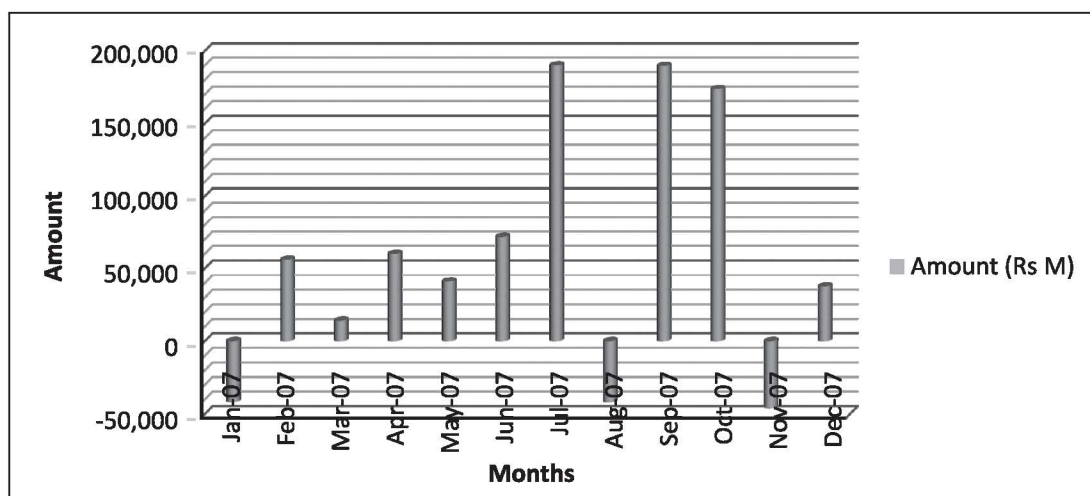


Exhibit 9: FIIs investment in India in 2008

Month Ended	Amount (Rs M)
Jan-2008	-172,269
Feb-2008	48,827
Mar-2008	1,244
Apr-2008	5,080
May-2008	-46,722
Jun-2008	-105,777
Jul-2008	1,758
Aug-2008	-35,979
Sep-2008	-65,996
Oct-2008	-142,486
Nov-2008	-35,037
Dec-2008	14,260



Exhibit 10: FIIs investment in India in 2008

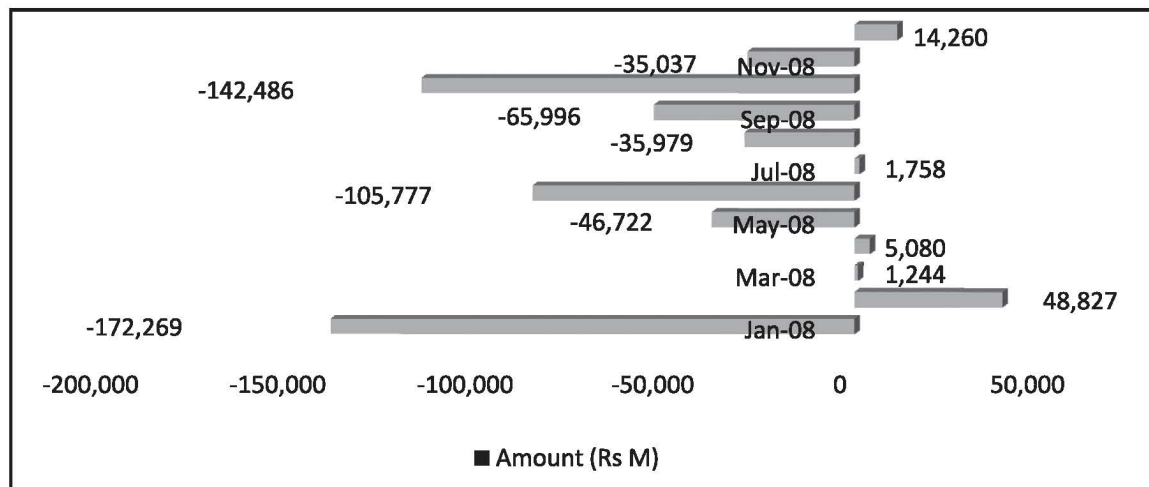


Exhibit 11: FIIs investment in India in 2009

Month Ended	Amount (Rs M)
Jan-2009	-42,502
Feb-2009	-26,905
Mar-2009	2,690
Apr-2009	73,842
May-2009	206,069
Jun-2009	32,249
Jul-2009	116,253
Aug-2009	40,287
Sep-2009	199,395
Oct-2009	83,042
Nov-2009	54,692
Dec-2009	103,514

Exhibit 12: FIIs investment in India in 2009

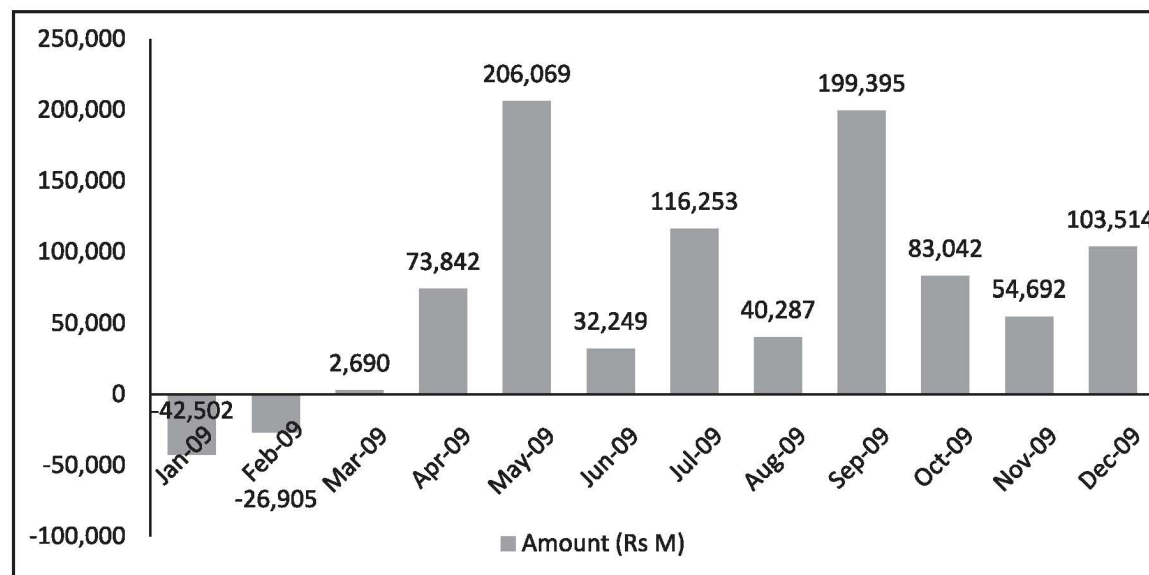


Exhibit 13 :FII's investment in India in 2010

Month Ended	Amount (Rs M)
Jan-2010	4,629
Feb-2010	21,135
Mar-2010	188,336
Apr-2010	91,569
May-2010	-91,745
Jun-2010	97,076
Jul-2010	176,576
Aug-2010	44,768

Exhibit 14:FII's Investment in India in 2010

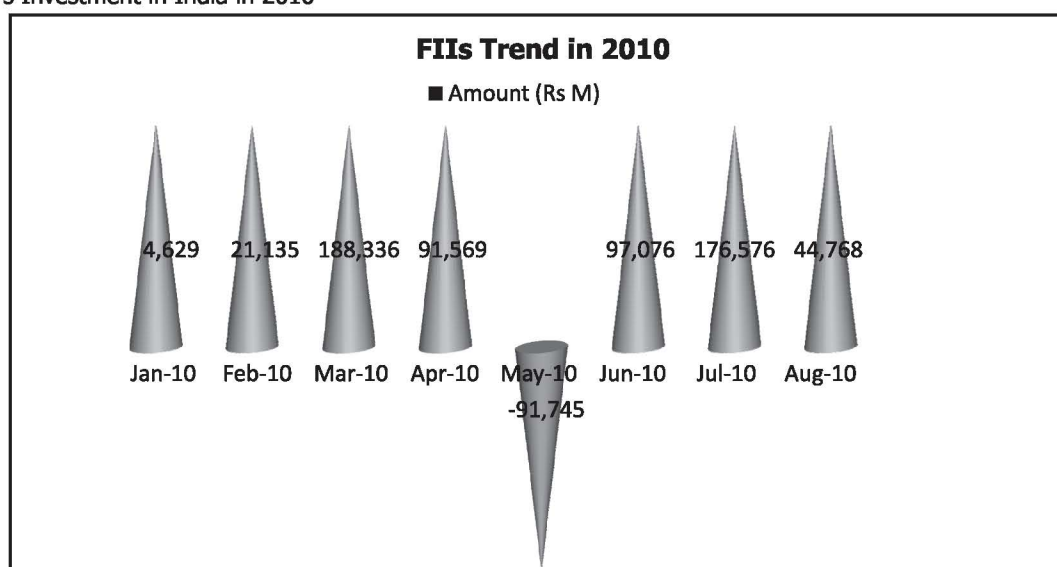


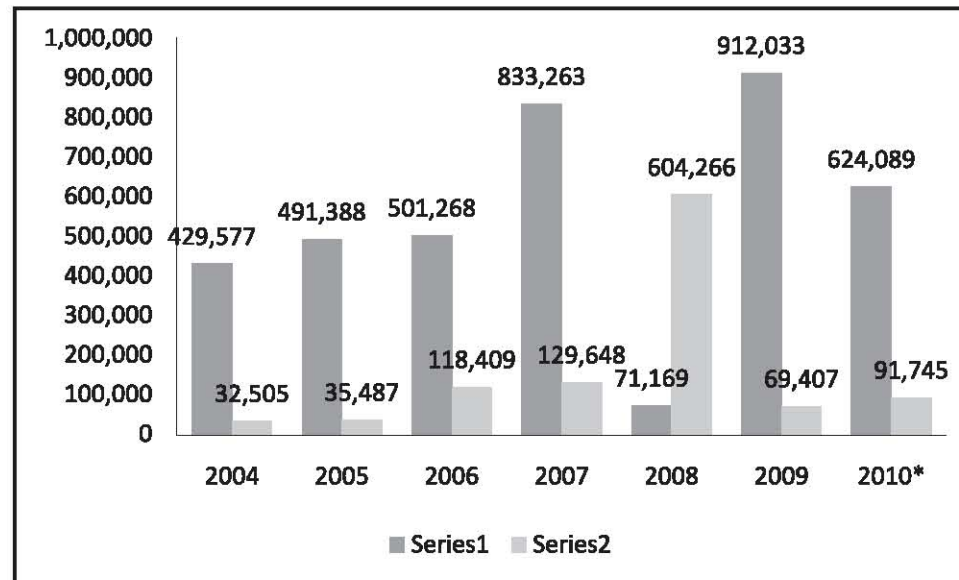
Exhibit 15 :FII's investment in India from 2004 to 2010

Year	Amount (in Rs. Million)	
	Total Inflows	Total Outflow
	Investment by FIIs in India	Withdrawal by FIIs from India
2004	429,577	32,505
2005	491,388	35,487
2006	501,268	118,409
2007	833,263	129,648
2008	71,169	604,266
2009	912,033	69,407
2010*	624,089	91,745

\*From Jan. 2010 to Aug. 2010. Data were not available  
Source: RBI, Annual Manual



Exhibit 16:FII's Investment in India from 2004 to 2010



### Findings:

1. We found that in 2009 FIIs have invested Rs. 912,033 million. While they have withdrawn Rs. 604,266 million in 2008 it was the effect of global meltdown or recession in world economy.
2. FIIs have less impact on Indian stock indices and other unexplained variables are also influencing the Indices.
3. We found that in 2008 FII's have invested lowest amount of Rs. 71,169 million.
4. We found that domestic sources of outside finance are limited in many countries, particularly those with emerging markets. Through capital market liberalization, foreign capital has become increasingly significant source of finance.
5. We also found that FIIs Investment is depend on the economic condition of the nation, as we can observe from table-8 that during the time of economic recession FIIs have withdrawn their maximum amount.
6. As table 8 shows that there was highest inflow of funds by FIIs in 2009. One of the reasons was the growth of stock market. The FII money found its way to the different financial asset classes, including emerging Indian capital markets.
7. The main reason why FIIs put their money in India is because goods and providing services at a lower cost. The scarcity employment opportunities can easily hire a well qualified or even an over qualified professional at lower cost.
8. During the study we found that Market size, Political scenario, Labour cost and productivity, Liberalized Trade Policy, Infrastructure, Incentives and Operating conditions and Disinvestment policy were the causes of FIIs investment in India.

### Conclusion:

The important result of this analysis is that the FIIs investment behaviors are determined by stock market return and risk in and

economic factors of India. FIIs investment decisions are not major factors for stock market boom and crash in India but there are numerous other reasons which determine the trend of FIIs inflows and outflows from and in India. As we have seeing that India's rapid annual growth rate of more than 8 per cent is reflected in the performance of funds investing in the country. In 2008 FIIs have withdrawn Rs. 604,266 million and on the contrary FIIs invested Rs. 912,033 million in 2009 which reflect that strong economic conditions plays very vital role in influencing FIIs inflows in the country. One of the impacts of Global Meltdown has been observed during the year 2007-08 while in the year 2009 FIIs have again infuse money into the Indian financial market because they may predict the positive signs of Growth of Indian Economy. Nowadays FIIs are the major contributors to the stock markets. The pros of allowing FIIs to invest in the Indian markets far outweigh the cons. simply banning participatory notes cannot be a solution. It is up to the policy makers of India to allow to operate and provide them with more opportunities and reasons to invest in Indian markets. Domestic sources of outside finance are limited in many countries, particularly those with emerging markets. Through capital market liberalization, foreign capital has become increasingly significant source of finance. Since India is a labour intensive country. Therefore, in developing countries like Indian foreign capital helps in increasing the productivity of labour and to build up foreign exchange reserves to meet the current account deficit. Foreign Investment provides a channel through which country can have access to foreign capital. It is required to understand when they withdraw their funds and when they pump in more money. Higher Sensex indices and high price earnings ratio are the country level factors attracting more foreign investment in India. Our study reveals that there is a growth trend in FIIs investment in India. Investment of FIIs kept on growing from 2004 to 2009.

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