Stock Market (Overview) and The Role of FII's – Pertaining to the Indian Economy

Objective of the study :

- To study the evolution of the Stock Market in India
- Emphasis on the trading mechanism in Indian stock market
- To determine the behavior and trend of FII's on Indian stock market
- To study the impact of FII on Indian capital market

Literature Review :

AnubhavShrivastav (2013) , in his paper "A study of Influence of FII Flows on Indian Stock Market" focuses on the role of FII on the Indian stock market by deeply analyzing the behavior and trends of FII's in India from the year 1992 – 2010. He further studies the determinants of FII flow in India and reviewing the possitives and negatives of such flows. Towards the end of his paper, he examines whether FII's have any influence on various BSE indices.

Karan Walia, Dr. RimpiWalia, Monika Jain (2012) , in their paper have examined the positive and negative impacts of FII's flows on the Indian Stock market and also computed Correlation between FII Investment and BSE sensex .

HemkantKulshrestha (2014) ,in his paper he studied the regulatory framework of FII's in India . He further analyses the relationship between BSE Sensex and FII's and CNX Nifty and FII's and computes the correlation .

A **stock market**, **equity market** or **share market** is the aggregation of buyers and sellers (a loose network of economic transactions, not a physical facility or discrete entity) of stocks (also called shares); these may include *securities* listed on a stock exchange as well as those only traded privately. In simple words ,it is a place where shares of pubic listed companies are traded. The origins of stock market and shares go back to the middle-ages. A stock is a general term used to describe the ownership certificates of any company. A share, on the other hand, refers to the stock certificate of a particular company. Holding a particular company's share makes the person a shareholder.

The financial market is divided into two categories :**primary market** is where companies float shares to the general public in an Initial Public Offering (IPO)[1] to raise capital. Once new securities have been sold in the primary market, they are traded in the **secondary market**—where one investor buys shares from another investor at the prevailing market price or at whatever price both the buyer and seller agree upon. The secondary market (or the stock exchanges) are regulated by the regulatory authority.

Stock market provides liquidity to the financial instruments which are issued in the primary market. Players in the capital market are broadly divided in to three categories:

- **Companies issuing securities** and includes new companies, existing unlisted companies and the existing listed companies.
- **Intermediaries** who assist in the process of transferring savings into investment and they include merchant bankers, underwriters, registrars to issue and share transfer agents, brokers, depositories, collecting agents, advertising agencies, agents, mutual funds etc.
- **Investors consisting of institutional investors and the general public-** Capital market consists of equity market as well as debt market.

In India, the secondary and primary markets are governed by the **Security and Exchange Board of India (SEBI)**.A stock exchange is a place or organization by which stock traders (people and companies) can trade stocks. Companies may want to get their stock listed on a stock exchange. Other stocks may be traded "over the counter", that is, through a dealer. A large company will usually have its stock listed on many exchanges across the world.

An Introduction To The Indian Stock Market :

Mark Twain once divided the world into two kinds of people: those who have seen the famous Indian monument, the TajMahal, and those who haven't. The same could be said about investors. There are two kinds of investors: those who know about the investment opportunities in India and those who don't. India may look like a small dot to someone in the U.S., but upon closer inspection, you will find the same things you would expect from any promising market.

Trading in the Indian Stock Market :

The Indian secondary capital market or the stock market mainly consists of the stock exchanges, Over the Counter Exchange of India and Stock Holding Corporation of India. Indian stock market can be quoted as one of oldest stock markets in Asia which is almost 200 years old. Stock Holding Corporation of India Ltd was incorporated in 1986 as a public limited company. It has been jointly promoted and owned by the All India Banks and Financial Institutions, viz., IDBI Bank Ltd, ICICI Bank, Axis bank, IFCI Ltd, LIC, GIC, NIA, NIC, UIC, and TOICL, who are all leaders in their fields of business. SHCIL has been established as a one stop provider of all financial services. It began its operations by offering custodial and post-trading services and later added depository and other services to its business portfolio.

Stock exchange represents an organized market in trading of securities. The organized stock exchanges in India are of recent origin when compared with other financial markets. The first stock exchange was set up in India under the name of Native share and Stock Broker’s Association of Bombay (now, Bombay Stock Exchange) in 1875. At the end of March 2009, there were 20 stock exchanges registered with SEBI (Securities Exchange Board of India) having a total of 8,652 registered brokers and 62,471 registered sub-brokers trading on them. The stock exchanges need to be recognized under the Securities Contracts (Regulation) Act 1956. As of now SEBI has approved and notified the Corporatisation and Demutualisation scheme of 20 stock exchanges.

Capital Market Turnover on Stock Exchanges in India

Stock Exchanges		Capital Market Turnover (Rs. million)			Share in Turnover (%)		
		2007-08	2008-09	2009-10 (Apr-June 09)	2007-08	2008-09	2009-10 (April-June 09)
1	NSE	35,510,380	27,520,230	11,316,710	69.21	71.43	75.03
2	BSE	15,788,570	11,000,740	3,766,790	30.77	28.55	24.97
3	Calcutta	4,460	3,930	0	0.01	0.01	0
4	Uttar Pradesh	4,750	890	50	0.01	0.0023	0.0003
5	Ahmedabad	0	0	0	0	0	0
6	Delhi	0	0	0	0	0	0
7	Pune	0	0	0	0	0	0
8	Ludhiana	0	0	0	0	0	0
9	Bangalore	0	0	0	0	0	0
10	ICSE	0	0	0	0	0	0

11	Madras	0	0	0	0	0	0
12	Madhya Pradesh	0	0	0	0	0	0
13	Vadodara	0	0	0	0	0	0
14	OTCEI	0	0	0	0	0	0
15	Gauhati	0	0	0	0	0	0
16	Cochin	0	0	0	0	0	0
17	Bhubaneshwar	0	0	0	0	0	0
18	Coimbatore	0	0	0	0	0	0
19	Jaipur	0	0	0	0	0	0
	Total	51,308,160	38,525,790	15,083,550	100	100	100

Source: www.nseindia.com

From the above table it is very evident that NSE and BSE were the only two stock exchanges which reported significant trading volumes during the last 3 financial years. Other than Calcutta and Uttar Pradesh Stock exchanges all other exchanges did not have any trading volumes during 2008-09 and 2009-10 (April-June). National Stock exchange (NSE) consolidated its position as the market leader with 71.43% of the total trading volume.
The BSE has been in existence since 1875. The NSE, on the other hand, was founded in 1992 and started trading in 1994. However, both exchanges follow the same trading mechanism, trading hours, settlement process, etc. At the last count, the BSE had about 4,700 listed firms, whereas the rival NSE had about 1,200. Out of all the listed firms on the BSE, only about 500 firms constitute more than 90% of its market capitalization; the rest of the crowd consists of highly iiliquid[2] shares.
Almost all the significant firms of India are listed on both the exchanges. NSE enjoys a dominant share in spot trading [3] , with about 70% of the market share, as of 2009, and almost a complete monopoly in derivatives [4] trading, with about a 98% share in this market, also as of 2009. Both exchanges compete for the order flow that leads to reduced costs, market efficiency and innovation. The presence of arbitrageurs[5]keeps the prices on the two stock exchanges within a very tight range.

Trading Mechanism :

Trading at both the exchanges takes place through an open electronic limit order book[6], in which order matching is done by the trading computer. There are no market makers or specialists and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain anonymous. The advantage of an order driven market is that it brings more transparency, by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed.
All orders in the trading system need to be placed through brokers, many of which provide online trading facility to retail customers.Institutional Investors [7] can also take advantage of the direct market access (DMA)[8] option, in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system.

Settlement Cycle and Trading Hours :

Equity spot markets follow a T+2rolling settlement [9]. This means that any trade taking place on Monday, gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 am and 3:30 pm, Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk, by serving as a central counterparty.

Stock Market Indicators:

Rise or fall of share prices on a particular trading day depends on many factors. The success of an investor in the stock market always depend on how well he is able to incorporate all these factors while taking up his investment decisions. Stock market indicators are extremely used by investors across the world while taking various buy or sell decisions in the market. Any indicator which is used to project future financial and economic trends can be called as market indicators. The following are some of the popular stock market indicators used by Indian Investors:

a) Market Capitalisation: It refers to the total value of all outstanding shares which is found out by multiplying the number of shares by the current market price. The market capitalization to GDP ratio is another parameter for evaluation of stock markets. Liquidity of the market can be measured by comparing the traded value to
b) Price to earnings ratio (P/E ratio): It refers to a valuation of a firm's current share price compared to its earnings per share (EPS). Usually EPS is calculated by using the previous four quarters. A high P/E indicates significant projected earnings in future.
c) Return on Equity (ROE): Investment in company's equity being compared with the return on equity. It is a measure of company's profitability compared with other firms in the same industry.
d) Dividend Yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price. It is calculated by dividing annual dividend per share by price per share.
e) Price to book value: It refers to the process of comparing a stocks market value to its book value. A low price to book value would be either because the stock is undervalued or it could mean that the company is not in the best of health.

Market Indexes:

The two prominent Indian market indexes are Sensex and Nifty. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 45% of the index's free-float market capitalization[10]. It was created in 1986 and provides time series data from April 1979, onward.
Another index is the S&P CNX Nifty ; it includes 50 shares listed on the NSE, which represent about 62% of its free-float market capitalization. It was created in 1996 and provides time series data from July 1990, onward.

Market Regulation:

The overall responsibility of development, regulation and supervision of the stock market rests with the Securities & Exchange Board of India (SEBI), which wasformed

in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach.

Who Can Invest In India?:

India started permitting outside investments only in the 1990s. Foreign investments are classified into two categories: foreign direct investment (FDI) and foreign portfolio investment (FPI). All investments in which an investor takes part in the day-to-day management and operations of the company, are treated as FDI, whereas investments in shares without any control over management and operations, are treated as FPI.

For making portfolio investment in India, one should be registered either as a foreign institutional investor (FII)[11] or as one of the sub-accounts of one of the registered FIIs. Both registrations are granted by the market regulator, SEBI. Foreign institutional investors mainly consist of mutual funds, pension funds, endowments, sovereign wealth funds, insurance companies, banks, asset management companies etc. At present, India does not allow foreign individuals to invest directly into its stock market. However, high-net-worth individuals (those with a net worth of at least $US50 million) can be registered as sub-accounts of an FII.

Foreign institutional investors and their sub accounts can invest directly into any of the stocks listed on any of the stock exchanges. Most portfolio investments consist of investment in securities in the primary and secondary markets, including shares, debentures and warrants of companies listed or to be listed on a recognized stock exchange in India. FIIs can also invest in unlisted securities outside stock exchanges, subject to approval of the price by the Reserve Bank of India. Finally, they can invest in units of mutual funds and derivatives traded on any stock exchange.

An FII registered as a debt-only FII can invest 100% of its investment into debt instruments. Other FIIs must invest a minimum of 70% of their investments in equity. The balance of 30% can be invested in debt. FIIs must use special non-resident rupee bank accounts, in order to move money in and out of India. The balances held in such an account can be fully repatriated.

Restrictions/Investment Ceilings :

The government of India prescribes the FDI limit and different ceilings have been prescribed for different sectors. Over a period of time, the government has been progressively increasing the ceilings. FDI ceilings[12] mostly fall in the range of 20-100%.By default, the maximum limit for portfolio investment in a particular listed firm, is decided by the FDI limit prescribed for the sector to which the firm belongs. However, there are two additional restrictions on portfolio investment.

First, the aggregate limit of investment by all FIIs, inclusive of their sub-accounts in any particular firm, has been fixed at 24% of the paid-up capital. However, the same can be raised up to the sector cap, with the approval of the company's boards and shareholders.Secondly, investment by any single FII in any particular firm should not exceed 10% of the paid-up capital of the company. Regulations permit a separate 10% ceiling on investment for each of the sub-accounts of an FII, in any particular firm. However, in case of foreign corporations or individuals investing as a sub-account, the same ceiling is only 5%. Regulations also impose limits for investment in equity-based derivatives trading on stock exchanges.

Review of Recent Policy developments and Programmes:

SEBI along with other regulators and government have initiated number of policies and programmes during the financial year 2008-09 in order to improve the efficiency of operations in capital market. Basically these measures are aimed at protecting the interests of the investors. Major policy developments pertaining to capital market are enumerated below:

a) Shareholding in stock exchanges: To encourage competition in the stock exchange space, SEBI board decided to enhance the shareholding in the stock exchanges from 5 percent to 15 percent in respect of six categories of share holders namely, public financial institutions, stock exchanges, depositories, clearing corporations, banks and insurance companies as on December 23,2008.

b) Securities Lending and Borrowing (SLB): In pursuant of the feedback from the market participants, the Securities Lending and Borrowing scheme was revised with effect from April 21, 2008.Key modifications include increasing the tenure of SLB, extending the duration of SLB sessions and allowing margins in SLB. The securities lending and borrowing scheme has the potential of taking the Indian stock market to great heights. But unfortunately this scheme till now has not been able to show its presence in the market to its fullest.

c) Guidelines in respect of exit option to Regional Stock Exchanges: Broad guidelines were issued by SEBI with the objective of providing an exit option to Regional stock exchanges (RSEs) whose recognition was withdrawn or if renewal of recognition was refused by SEBI or for RSEs who would like to surrender their recognition. As per the SEBI guidelines such RSEs may be permitted to retain movable and immovable assets and to deal with such assets as they deem fit, subject to the compliance with SEBI norms in this regard.

d) Introduction of Direct Market Access (DMA): Direct Market Access allows brokers to offer his clients access to the exchange trading systems through broker's infrastructure without manual intervention by the broker. SEBI introduced DMA with a view to increase liquidity, to have more transparent trading and to reduce the risk of error associated with manual execution of client orders.

e) Margining of Institutional Trades in the Cash Market: Margining for institutional trades was made mandatory by SEBI w.e.f April 21; 2008.This initiative by SEBI was to strengthen the risk management frame work in capital market operations. Margins have to be collected from institutional investors on a T + 1 basis and the institutional investors can maintain the entire margin in the form of approved securities.

f) Mandatory Permanent Account Number (PAN) Requirement: SEBI exempted investors residing in the state of Sikkim from the mandatory requirement of PAN for their investments in mutual funds.

g) Advertisement by Mutual Funds: Investments in mutual funds are subject to market risk and an investor has to read the entire offer document before going for such investments. Hence it was made mandatory by SEBI that such statement i.e statements appearing in clauses of 10, 13 and 14 of schedule VI of SEBI (Mutual Fund) Regulations 1996, on advertisement code should appear in all advertisements. However with effect from January 18, 2010 such advertisement should be printed in bold .This was because these statements were not often brought to the notice of investors due to the lengthy nature of mutual fund advertisements.

h) Application supported by blocked amount (ASBA) facility in public issues and right issues: In its endeavor to make the existing public issue facility more efficient SEBI has introduced the ASBA facility as on July.Such facility is made available to retail investors also. ASBA is an application containing an authorization to block the

application money in the bank account, for subscribing to an issue. If an investor is applying through ASBA, his application money shall be debited from the bank account only, if his/her application is selected for allotment.
i) Quarterly Reporting by Foreign Venture Capital Investors (FVCI): With effect from the quarter that ended in 31st March 2010, all FVCI operating in India have to submit quarterly reports with SEBI. The report is to be uploaded in the SEBI portal within 7 days from the end of each calendar quarter. This measure can be looked upon as one taken for bringing more transparency in the operations of FVCI.
Indian markets had recorded severe volatility at the close of 2007-08. However towards the beginning of 2008-09 the market started recovering and registered gains during April –May 2008.One of the major reason for such speedy recovery was due to the timely regulations and policies introduced by various market regulators.

FOREIGNINVESTMENT :

Foreign investment refers to the investments made by the residents of a country in the financial assets and production process of another country. It is necessary for all developing nations as well as developed nations but it may differ from country to country. The developing economies are in a most need of these foreign investments for boosting up the entire development of the nation in productivity of the labour, machinery etc. It helps to build up the foreign exchange reserves needed to meet trade deficit and also has affects on factor productivity as well as on balance of payments of recipient country. Foreign investment can come in two forms: **Foreign Direct Investment(FDI)** and **Foreign Institutional Investment(FII).** FDI involves in direct production activities and in a long and medium term nature. Whereas, the FIIs concern with the short term nature and short term investments. FIIs invest in financial markets such as money markets, stock markets and foreign exchange markets.

INTRODUCTION OF FII's IN INDIA :

"Few nations have the growth potential that India already enjoys. India holds the promise of most successful future .."

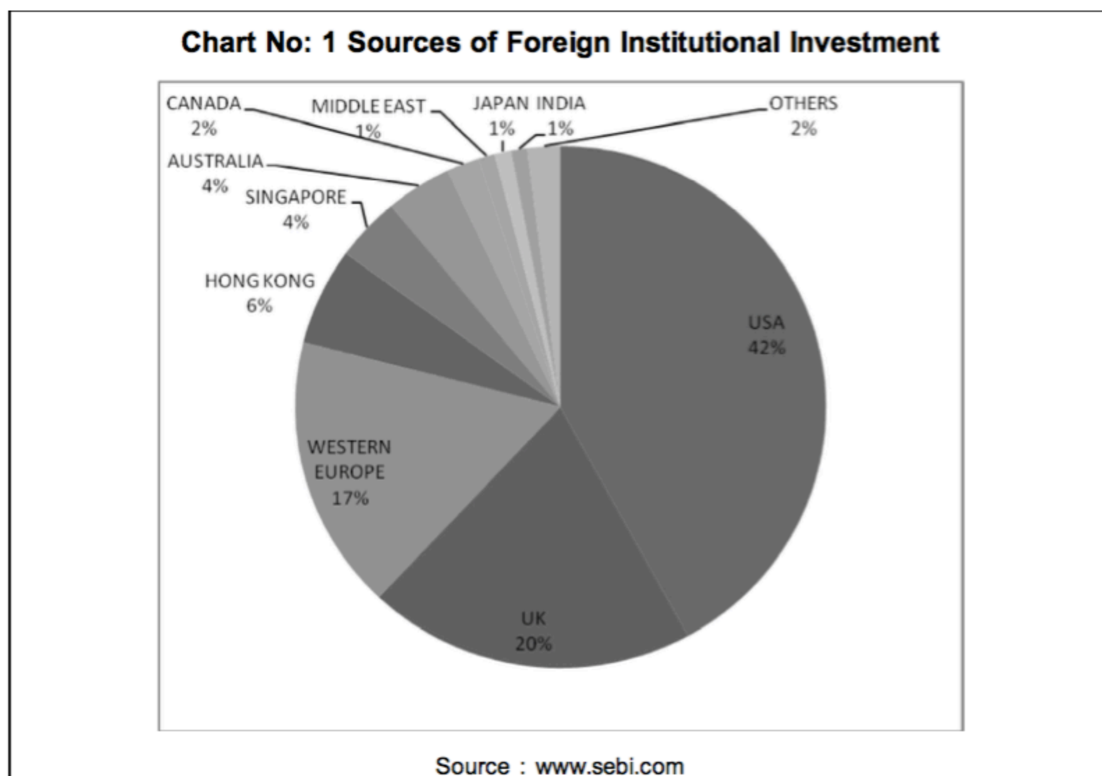
-Klaus Schwab, Founder & Chairman, World Economic Forum

Until the 1980s, India's development strategy was focused on self-reliance and import substitution. Current account deficits were financed largely through debt flows and official development assistance. There was a general disinclination towards foreign investment or private commercial flows.Since 1990-91, the Government of India embarked on liberalization and economic reforms with a view of bringing about rapid and substantial economic growth and move towards globalization of the economy. As a part of the reforms process, the Government under its New Industrial Policy revamped its foreign investment policy recognizing the growing importance of foreign direct investment as an instrument of technology transfer, augmentation of foreign exchange reserves and globalization of the Indian economy. Simultaneously, the Government, for the first time, permitted portfolio investments from abroad by

foreign institutional investors in the Indian capital market. The entry of FII's seems to be a follow up of the recommendation of the Narsimhan Committee Report on Financial System. While recommending their entry, the Committee, however did not elaborate on the objectives of the suggested policy. The committee only suggested that the capital market should be gradually opened up to foreign portfolio investments.
From September 14, 1992 with suitable restrictions, Foreign Institutional Investors (FII) were permitted to invest in all the securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India. While presenting the Budget for 1992-93, the then Finance Minister Dr. Manmohan Singh had announced a proposal to allow reputed foreign investors, such as Pension Funds etc., to invest in Indian capital market.

Sources of Foreign Institutional Investment:

Foreign Institutional investment is used to denote an investor mostly in the form of an institution or entity, which invests money in the financial markets of a country different from the one where the institution or entity was originally incorporated. FII is frequently referred to hot money for the reason that it can leave the country at the same speed at which it comes in. In India SEBI has prescribed norms to register FIIs and also to regulate such investments flowing through in the form of FIIs.



The above chart clearly depicts major portion of FIIs come from USA [42%], followed by UK [20%], Western Europe [17%], Hong Kong[6%], Singapore [4%], Australia [4%], Canada [2%], middle east countries [1%], and other countries contribute 2% of investment.

Market design in India for foreign institutional investors:

A Working Group for Streamlining of the Procedures relating to Foreign Institutional Investors, constituted in April, 2003, inter alia, recommended streamlining of SEBI registration procedure, and suggested that dual approval process of SEBI and RBI be changed to a single approval process of SEBI. This recommendation was implemented in December 2003.
Currently, entities eligible to invest under the FII route are as follows:

- As FII: 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 with no single investor holding more than 10 per cent of the shares or units of the fund.
- As Sub-accounts: The sub account is generally the underlying fund on whose behalf the FII invests. The following entities are eligible to be registered as sub-accounts, viz. partnership firms, private company, public company, pension fund, investment trust, and individuals.

FIIs registered with SEBI fall under the following categories:

- Regular FIIs (Equity Investment)[13] - those who are required to invest not less than 70 % of their investment in equity-related instruments and 30 % in non-equity instruments.
- 100 % debt [14] - those who are permitted to invest only in debt instruments.

Eligible securities for FII's:

A Foreign Institutional Investor may invest only in the following:-

(a) Securities in the primary and secondary markets including shares, debentures and warrants of companies, unlisted, listed or to be listed on a recognized stock exchange in India.
(b) units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed or not listed on a recognized stock exchange.
(c) Dated Government securities.
(d) Derivatives traded on a recognized stock exchange.
(e) Commercial paper.
(f) Security receipts.

Channels of FII's In India :

Portfolio investments in India include investments in American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs), Foreign Institutional Investments and investments in offshore funds. Before 1992, only Non-Resident Indians (NRIs) and Overseas Corporate Bodies were allowed to undertake portfolio investments in India. Thereafter, the Indian stock markets were opened up for direct participation by FIIs. They were allowed to invest in all the securities traded on the primary and the secondary market including the equity and other securities/instruments of companies listed/to be listed on stock exchanges in India.
Entities who propose to invest their proprietary funds or on behalf of "broad based" funds (fund having more than twenty investors with no single investor holding more than 10 per cent of the shares or units of the fund) or of foreign corporate and

individuals and belong to any of categories given below can be registered for Foreign Institutional Investors (FII's).

- Pension Funds
- Mutual Funds
- Investment Trust
- Insurance or reinsurance companies
- Endowment Funds
- University Funds
- Foundations or Charitable Trusts or Charitable Societies who propose to invest on their own behalf
- Asset Management Companies
- Nominee Companies
- Institutional Portfolio Managers
- Trustees
- Power of Attorney Holders
- Banks
- Foreign Government Agency
- Foreign Central Bank
- International or Multilateral Organization
- or an Agency thereof

FII TRENDS IN INDIA :

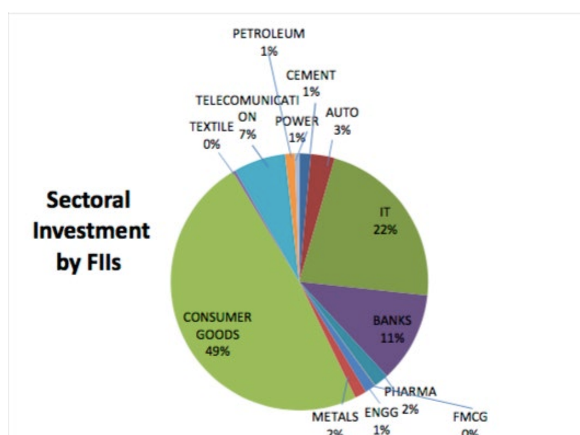
FIIs were allowed to invest in capital market securities since September 1992. However, these have invested from January, 1993 only.

YEAR	YEARLY TREND	Change	Percentage change
2010	141627.1	56259.49	66%
2009	85367.6	138419.3	261%
2008	-53051.7	-123992	-175%
2007	70940.05	39658.97	127%
2006	31281.08	-14544.5	-32%
2005	45825.6	7137.2	18%
2004	38688.4	8735.2	29%
2003	29953.2	26325.97	726%
2002	3627.23	-9667.47	-73%
2001	13294.7	6941.94	111.92%
2000	6202.51	-220.26	-3.43%
1999	6422.77	7343.73	789.91%
1998	-930.96	-7369.49	-114.46%
1997	6432.53	-3130.84	-31.71%
1996	9559.37	5554.34	137.93%
1995	4015.53	-2877.63	-41.79%
1994	6842.66	4283.53	164.26%
1993	2608.13	-	-

Source : SEBI

The net inflow has risen from Rs. 2608.13 crores in 1993 to Rs. 141627.1 crores in 2010 with relative ups and downs during the period as per the above table .during the period of 18 years there has been increase in in nine years while decline in the rest years It may be concluded that there are significant variations in the yearly inflow of FIIs into the Indian capital market during 1993-2010. During the initial year **1992-93**, the FII flows started in September 1992, which amounted to Rs. 13 crores because at this moment government was framing policy guidelines for FIIs. However, within a year, the FIIs rose to 39338 i.e. 46% of 1992-93 during **1993-94** because government had opened door for investment in India. Thereafter, the FII inflows witnessed a dip of 6.45%. However, the year **1995-1996** witnessed a turnaround, gliding up the contribution by FII to enormous amount of Rs. 6942 crores.
Investments made by FIIs during **1996-1997** rose a little i.e. 23.52% of that of the preceding year. This period was ripe enough for FII Investments as that time the Indian economy posted strong fundamentals, stable exchange rate expectations and offered investment incentives and congenial climate for investment of these funds in India. During **1997-98**, FII inflows posted a fall of 30.51%. This slack in investments by FIIs was primarily because of the S-East Asian Crisis and the months of volatility experienced during November 1997 and February 1998. The net investment flows by FIIs have always been positive from the year of their entry. However, only in the year 1998-99, an outflow nearly of Rs. 17699 crores was witnessed for the first time. This was primarily due to the economic sanctions imposed on India by Japan, US and other industrialized economies. These economic sanctions were the result of the testing of series of nuclear bombs by India in May 1998.FII investment posted a year-on-year decline of 1.8 % in 2000-01, 11.87 % in 2001-02 and 69.29 % in 2002-03. Investments by FII posted a fall of 80 % in 2002-03 as compared with investments in the period of 1999-00. Investments by FIIs rebounded from depressed levels from the year 2003-04 and witnessed an unprecedented surge. FIIs flows were recycled to India following readjustment of global portfolios of institutional investors, triggered by robust growth in Indian economy and attractive valuations in the Indian equity market as compared with other emerging market economies in Asia. The slowdown in 2004-05 was on account of global uncertainties caused by hardening of crude oil prices and the upturn in the interest rate cycle. The resumption in the net FII inflows to India from August 2004 continued till end 2004-05. The inflows of FIIs during the year 2004-05 was Rs. 45881 crore. During 2006-07 the foreign institutional investors continued to invest large funds in Indian securities market. Strong FII flows had been a key characteristic of the period prior to December 2007.

Sectoral investment by FIIs in India:



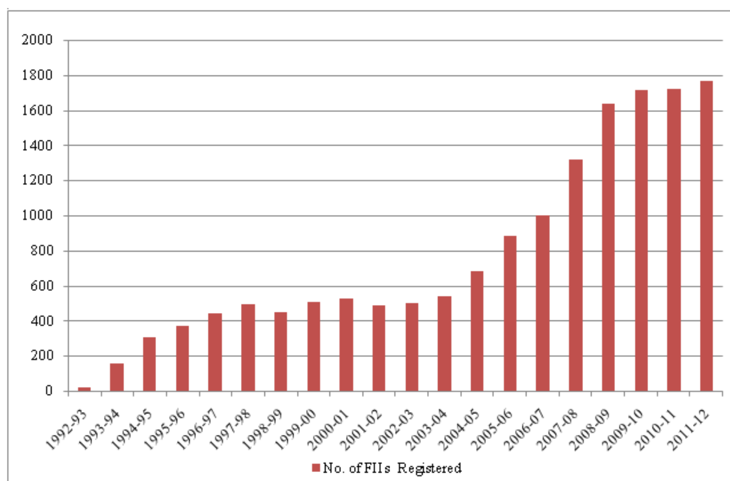
It can be seen from the diagram above that the major proportion of FII investments is into consumer goods and then followed by investments in the IT and the banking sector. It can be observed from the table below that India is one of the preferred investment destinations for FIIs over the years. The total number of FIIs in India has almost grown 99 times since the beginning they were allowed to enter the Indian equity markets

REGISTRTIONS :

No. of registered foreign institutional investors increases from the year to year when they are allowed to invest in Indian capital market Year wise registration of FIIs is given by the following table :

Year	No. of FIIs Registered	Trend %
1990-91		
1992-93	18	
1993-94	158	777.77
1994-95	308	94.93
1995-96	367	19.15
1996-97	439	19.61
1997-98	496	12.98
1998-99	450	-9.27
1999-00	506	12.44
2000-01	527	4.15
2001-02	490	-7.02
2002-03	502	2.44
2003-04	540	7.56
2004-05	685	26.85
2005-06	882	28.75
2006-07	997	13.03
2007-08	1319	32.29
2008-09	1635	23.95
2009-10	1713	4.77
2010-11	1722	0.52
2011-12	1765	2.49

Source: Compiled from Various Issues of SEBI Handbook



From the above table and figure it is revealed that India is the important destination for foreign investment therefore the number of FIIs is going on increasing year to year. The number of FIIs in 1992-93 was only 18 which are increased to 1765 in 2011-12; maximum number of FIIs registered 322 in 2007-08 subsequently 316 in 2008-09. No. of FIIs registration was decreased in 1998-99 due to Asian financial crises in 1997 and subsequently in 2001-02 due to early 2000s recession in USA. Major increase in the trend of registration of FIIs in 1993-94 and 1993-94 i.e. 777.77 % and 94.93 %.

DETERMINANTS OF FII FLOW IN INDIA:

- **Risk:** Whenever risk in home market increases, the foreign investors would start to pull out their money to their home country thereby creating a deficiency of funds in domestic market, so to attract the foreign investment domestic interest rate would increase thereby to ensure that the above equality is restored.

- **Inflation:** At the time of high inflation, the real return on fixed income securities like bonds and fixed deposits declines. Thus a bond which gives say around 8.5% interest rate actually gives a real return of just 1% if the inflation is 7.5%. If the inflation increases further, the real return would decline more.

- **Interest Rates:** For the business, cost of borrowing rises this has a negative result on their profit margins. As a result they might even delay any investment activity which may be funded by borrowing to some later period when the interest rates are lower so as to reduce their investment costs. Over the past year RBI has increased the repo rate reverse repo rate, CRR and SLR. This has led to an increase in the Prime Lending Rate (PLR) and hence the general interest rate in the economy.
- **GDP of India:** Both have more or less direct relationship. The reason is change in capital account. When interest rates were high India was attracting lot of investments so the credit balance was high for that period. It kept on increasing form 2003-04 to 2007-08 and interest rates also kept on increasing from 2003-04 to 2007-08. Besides there are various other factors like rules and regulation, taxation, govt. policies .

Impact of FII on Economic Indicators in India:

- **Balance of Payment:** A net positive swing in invisibles (due to increase in software exports and remittances sent by Indians working abroad) and increase in investments (both FDI and FII), has been improving the Balance of Payment (BOP) of the Indian economy and increasing the demand of rupee in the international currency market. In view of this the RBI had been following a policy of buying dollars (by selling rupee) in the international market, thereby avoiding an appreciation of rupee viz-a-viz the dollar.
- **Currency Fluctuation:** FIIs convert Dollars to Rupees to invest in Indian Markets- FII money comes in India at high Dollar rates. FII money would go out when Dollar dips to low values. Thereby the new nomenclature for this FII dollars let be SMART MONEY which finds more money. We'll now see some major points on Sensex from 2003 with peaks of dollar as that could trigger money push into India ideally-
    1. Jan -May 2003 - USD/INR roughly 47-48. Sensex moved from 3000 to 6000 and dollar dipped till 43 by May. Market corrected to 4200 after that.
    2. July - Sept 2005 - USD/INR 46 Sensex again moved from 5k to 12k and dollar dipped to 44- 43.5. Market corrected to 8800 after that.
    3. July - Sept 2006 - USD /INR 46 -47 Sensex moved from 9k to 21k and dollar dipped to 39. Market corrected to 13k. Maybe this is confusing but from the data it seems FII dollars starts entering into India when Dollar is quoting at a price of 45-47 or tops out and this money creates the next Bull Run.

The withdrawal by the FIIs lead to a sharp depreciation of the rupee Between January 1 and October 16, 2008, the RBI reference rate for the rupee fell by nearly 25 per cent, in relative to dollar, from Rs 39.20 to the dollar to Rs 48.86. This was despite the sale of dollars by the RBI, which was reflected in a decline of $25.8 billion in its foreign currency assets between the end of March 2008 and October 3, 2008. The result has been observed sharp Depreciation of the rupee. While this depreciation may be good for India's exports that are adversely affected by the slowdown in global markets, it is not so good for those who have accumulated foreign exchange payment commitments. Nor does it assist the Government's effort to rein in inflation.

- **Stock Market** : Mathematicians and Statisticians use a measure known as the correlation coefficient, which is used to depict a relationship between two variables mathematically. This coefficient ranges from minus 1 to plus 1. So, if we consider two variables, and the coefficient is -1, it means that when one moves up, the other moves down in the same proportion. When it is 1, it means when one moves up or down, the other also moves in the same manner, and when it is zero, it means there is no correlation. So when one moves up (or down), there's no way to figure out how the other variable will behave. So basically, one can compute the correlation coefficient between the Sensex and FII flows.

INFLUENCE OF FII ON INDIAN MARKET:

Positive fundamentals combined with fast growing markets have made India an attractive destination for foreign institutional investors (FIIs). Portfolio investments brought in by FIIs have been the most dynamic source of capital to emerging markets in 1990s. At the same time there is unease over the volatility in foreign institutional investment flows and its impact on the stock market and the Indian economy.

Apart from the impact they create on the market, their holdings will influence firm performance. For instance, when foreign institutional investors reduced their holdings in Dr.Reddy's Lab by 7% to less than 18%, the company dropped from a high of around US$30 to the current level of below US$15. This 50% drop is apparently because of concerns about shrinking profit margins and financial performance. These instances made analysts to generally claim that foreign portfolio investment has a short term investment horizon. Growth is the only inclination for their investment.

Some major impact of FII on stock market:

- They increased depth and breadth of the market.
- They played major role in expanding securities business.
- Their policy on focusing on fundamentals of share had caused efficient pricing of share. These impacts made the Indian stock market more attractive to FII & also domestic investors. The impact of FII is so high that whenever FII tend to withdraw the money from market, the domestic investors fearful and they also withdraw from market.

FIIs not only enhance competition in financial markets, but also improve the alignment of asset prices to fundamentals. FIIs in particular are known to have good information and low transaction costs. By aligning asset prices closer to fundamentals, they stabilize markets. In addition, a variety of FIIs with a variety of risk-return preferences also help in dampening volatility.

A. IMPROVING CAPITAL MARKETS: FIIs as professional bodies of asset managers and financial analysts enhance competition and efficiency of financial markets. By increasing the availability of riskier long term capital for projects, and increasing firms' incentives to supply more information about them, the FIIs can help in the process of economic development.

B. IMPROVED CORPORATE GOVERNANCE: Good corporate governance is essential to overcome the principal-agent problem between share-holders and management. Information asymmetries and incomplete contracts between share-holders and management are at the root of the agency costs. Bad corporate governance makes equity finance a costly option. With boards often captured by managers or passive, ensuring the rights of shareholders is a problem that needs to be addressed efficiently in any economy. Incentives for shareholders to monitor firms and enforce their legal rights are limited and individuals with small share-holdings often do not address the issue since others can free-ride on their endeavor. FIIs constitute professional bodies of asset managers and financial analysts, who, by contributing to better understanding of firms' operations, improve corporate governance. Among the four models of corporate control - takeover or market control via equity, leveraged control or market control via debt, direct control via equity, and direct control via debt or relationship banking-the third model, which is known as corporate governance movement, has institutional investors at its core. In this third model, board representation is supplemented by direct contacts by institutional investors.

NEGATIVE IMPACT: If we see the market trends of past few recent years it is quite evident that Indian equity markets have become slaves of FIIs inflow and are dancing to their tune. And this dependence has to a great extent caused a lot of trouble for the Indian economy. Some of the factors are:

A. POTENTIAL CAPITAL OUTFLOWS: “Hot money” refers to funds that are controlled by investors who actively seek short-term returns. These investors scan the market for short-term, high interest rate investment opportunities. “Hot money” can have economic and financial repercussions on countries and banks. When money is injected into a country, the exchange rate for the country gaining the money strengthens, while the exchange rate for the country losing the money weakens. If money is withdrawn on short notice, the banking institution will experience a shortage of funds.

B. INFLATION: Huge amounts of FII fund inflow into the country creates a lot of demand for rupee, and the RBI pumps the amount of Rupee in the market as a result of demand created. This situation leads to excess liquidity thereby leading to inflation where too much money chases too few goods.

C. PROBLEM TO SMALL INVESTORS: The FIIs profit from investing in emerging financial stock markets. If the cap on FII is high then they can bring in huge amounts of funds in the country’s stock markets and thus have great influence on the way the stock markets behaves, going up or down. The FII buying pushes the stocks up and their selling shows the stock market the downward path. This creates problems for the small retail investor, whose fortunes get driven by the actions of the large FIIs.

D. ADVERSE IMPACT ON EXPORTS: FII flows leading to appreciation of the currency may lead to the exports industry becoming uncompetitive due to the appreciation of the rupee.

BSE SENSEX AND FII INVESTMENT CORRELATION:

Sensex is the commonly used name for the Bombay Stock Exchange Sensitive Index – an index Composed of 30 of the largest and most actively traded stocks on the Bombay Stock Exchange (BSE). The term FII is used most commonly in India to refer to outside companies investing in the financial markets of India. FII investment is frequently referred to as hot money for the reason that it can leave the country at the same speed at which it comes in. In country like India; statutory agencies like SEBI have prescribed norms to register FIIs and also to regulate such investments flowing in through FIIs.

BSE SENSEX AND FII (IN RS CR.)

Years	Sensex Value (points)	Net Investment of FII
2000	3,972	6,510.9
2001	3,262	12,494.8
2002	3,377	3,677.9
2003	5,838	35,153.8

2004	6,602	42,049.1
2005	9,397	41,663.5
2006	13,786	40,589.2
2007	20,286	80,914.8
2008	9,647	-41,215.5
2009	17,464	87,987.6
2010	20,509	179,674.6

This table shows the relationship between Sensex value and FII investment.

FII & BSE SENSEX CORRELATION

Years	Sensex Value(X)	Deviation(dx) 11016.8	Standard Deviation	FII (Y)	Deviation(dy) 48298.98	Standard Devaition	dxdy
2001	3,262	-7,755	60136923.04	12,494.80	-35,804.18	1281939305	277654255.1
2002	3,377	-7,640	5866544.04	3,677.90	-44,621.08	1991040780	340896127
2003	5,838	-5,179	26819969.44	35,153.80	-13,145.18	172795757.2	68076258.18
2004	6,602	-4,415	19490459.04	42,049.10	-6,249.88	39061000.01	27591970.22
2005	9,397	-1,620	2623752.04	41,663.50	-6,635.48	44029594.83	10748150.5
2006	13,786	2,769	7668468.64	40,589.20	-7,709.78	59440707.65	-21349922.78
2007	20,286	9,269	85918068.64	80,914.80	32,615.82	1063791714	302322558.7
2008	9,647	1,370	1876352.04	41,215.50	-89,514.48	8012842130	122616934.7
2009	17,464	6,447	41566387.84	87,987.60	39,688.62	1575186558	255880470.9
2010	20,509	9,492	90101860.84	179,674.60	131,375.62	17259553530	1247043660
Total	110,168	0	394568785.6	482,989.80	0.00	31499681077	2631480463
	$\bar{x} = \frac{fx}{n} = \frac{110168}{10} = 11016.8$		$\sigma x = \sqrt{\frac{\sum dx^2}{N}} = \sqrt{39}$	$\bar{y} = \frac{fy}{n} = \frac{48}{}$		$\sigma y = \sqrt{\frac{\sum dy^2}{N}} =$ 56124.57668	

Karl Pearson' coefficient of Correlation

$$r = \frac{\sum dxdy}{n\sqrt{\frac{\sum d^2x \sum d^2y}{n \quad n}}} = \frac{2631480463}{10\sqrt{\frac{394568785.6}{10} \times \frac{31499681077}{10}}} = .746424196$$

It can be said from the above calculation that BSE sensex and foreign institutional investment has followed a close relationship. The Pearson correlation values indicate positive correlation between the foreign institutional investments and the movement

of sensex (pearson' correlation value is (0.746424196). It is therefore clear that the FIIs are influencing the sensex movement to a greater extent. Further it is evident that the sensex has increased when there are positive inflows of FIIs and there were decrease in sensex when there were negative FII inflows.

FII's Impact On Stock Market via analysis of Gross sales and Gross purchases graphs :

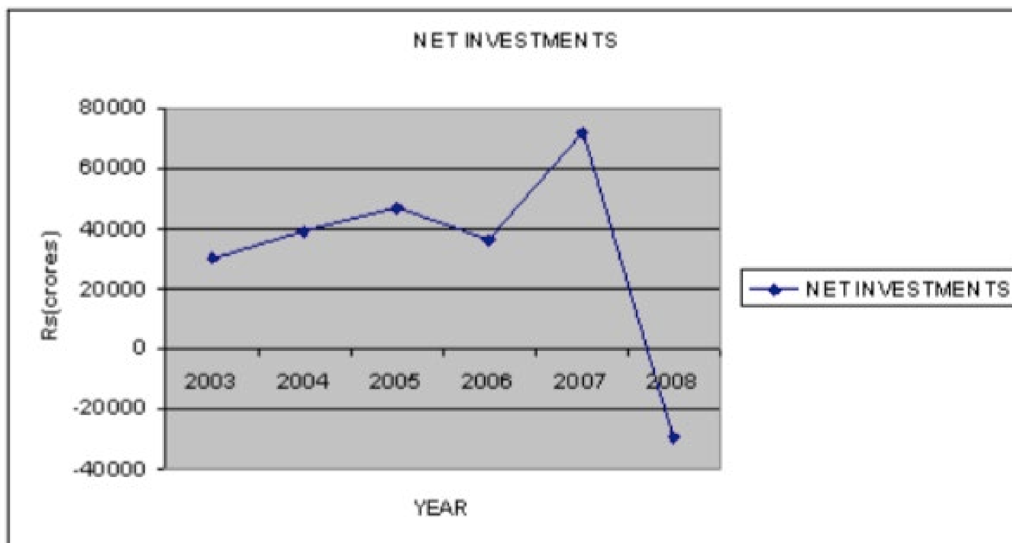
The current investments of FIIs is Rs. 2,55,464.40 Crores. This is almost 9% of the total market capitialisation. The impact of FIIs on Indian Stock Market is so high that whenever FIIs tend to withdraw the money from market, the domestic investors become fearful and they also withdraw from market.

In order to show the impact, we analyze below the 10 biggest falls of stock market: -

Day (Points Loss in Sensex)	Gross Purchases (Rs. Crores)	Gross Sales (Rs. Crores)	Net Investments (Rs. Crores)
21/01/2008 (1408)	3062.00	1060.30	2001.80
22/01/2008 (875)	2813.30	1618.20	1195.10
18/05/2006 (856)	761.80	527.40	234.40
17/12/2007 (826)	670.00	869.00	-199.00
18/10/2007 (717)	1107.00	1372.50	-265.50
18/01/2008 (687)	1077.20	1348.40	-271.20
21/11/2007 (678)	640.70	791.80	-151.10
16/08/2007 (643)	989.50	750.30	239.20
02/08/2007 (617)	534.50	542.00	-7.50
01/08/2007 (615)	809.40	956.90	-147.50

From above table, we can see that the major falls are accompanied by the withdrawal of investments by FIIs. Take the case on January 18, 2008, the Sensex lost almost 687 points. Here, the net sales by FIIs wasRs. 1348.40 Crores. This is a major contributor to the fall on that day. But contrary to that day, take the case on January 21, 2008, the Sensex lost 1408 points and the gross sales was Rs. 1060.30 Crores and the purchases were Rs. 3062.00 Crores. So this can be concluded that after the fall of market, FIIs had invested again into the market. From this, we can see the effect of FIIs.

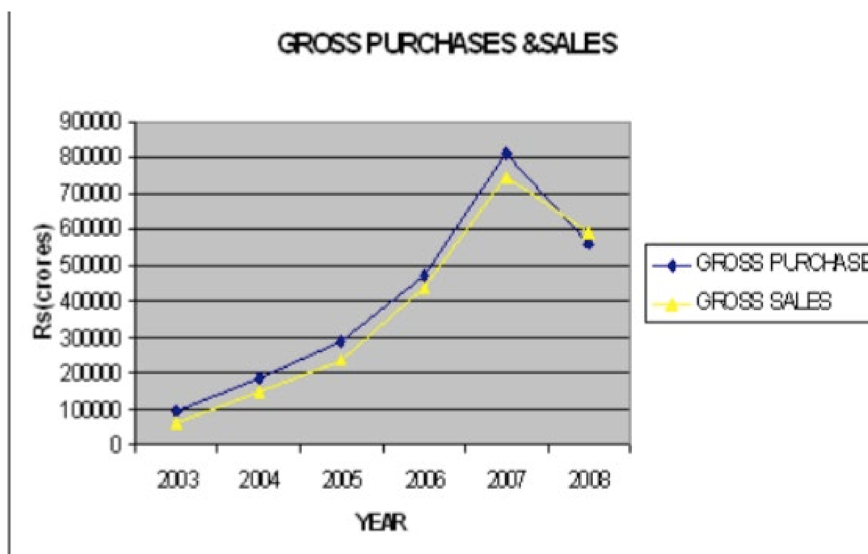
Year	Gross Purchases	Gross Sales	Net Investment	% Change
2003	94410.5	63951.8	30458.7	0
2004	185671.5	146706.4	38965.1	27.92765
2005	286020.5	238839.4	47181.2	54.90221
2006	475622.5	439082.8	36539.7	19.96474
2007	814877	743390.7	71486.5	134.6998
2008 (10/08/08)	560480.9	589650	-29169	-195.766



From the graph above,we analyze the net investments' graph from 2003 to 2008. From this, we can see that there is a constant increase in net investments till 2005 and there was small decrease in investments in the year 2006. But there was a steep increase in the year 2007-08. This was the best period in Indian stock market where stock prices were at peak and the market was in good mood.

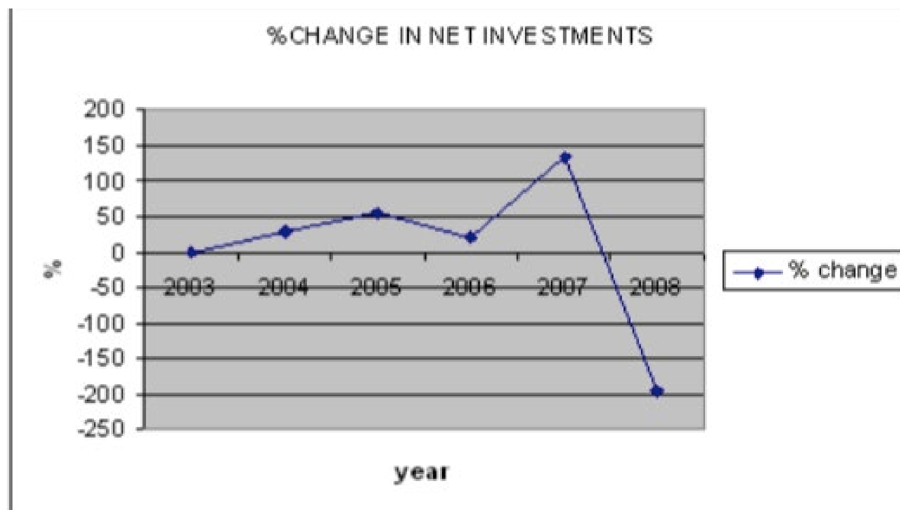
When we take the investments in 2008, the net investments is negative. And we know the market is volatile in this year. So we find that there is direct relation between net investments and movement of stock market.

FIIs Gross Purchases & Sales from 2003-08 :



Now this graph represents the relation between gross purchases and gross sales. We can see from the graph that gross purchases are increasing from 2003 to 2007 and gross sales are lower than gross purchases. So we conclude that this caused the market to reach the magical figure of 21,000 in Sensex. But when we look at the year of 2008, the involvement of FIIs is reduced, and we can also find in this year the gross sales is higher than gross purchases. This analysis also indicates the impact of FIIs in markets.

FII's Percentage Change in Investment :
(Here we are taking 2003 as the base year and calculating the percentage change for remaining years.)



In this graph, we took the base year as 2003 and the trends of the investments by FIIs are plotted. We can see from the graph that till 2007, the investment is more than that of 2003, and the most interesting thing is that when we look at 2008, the percentage change in investments is much lower than 2003, even going to the negative side. This finding also leads to our conclusion that the FII's impact on stock market is high.

CONCLUSION :

From all the above discussions and data analysis, we conclude that FII has a major impact in Indian stock market. Particularly, the fall on October 17, 2007, in which just a speculation about governments plan to control P-Notes had caused the biggest fall in Indian stock market, even market had to be closed for one hour without trading. The impact is that even the domestic players and MFs also follow a close look on FIIs. So if FIIs are confident about Indian markets, there is a general perception that market is on the rise. We had also found that the major (almost 50%) of FIIs' investments are from P-Notes. So it implies that major forces behind the FII investments are anonymous. This has a negative impact on stock market. Because money launders use this facility to pump money to Indian market and their sudden withdrawal causes volatility in markets.
From the above graphs , we can see that the major falls in stock market is accompanied by the withdrawal of money by FIIs. So there is a direct relation between the FII's money flow and the movement of sensex. The biggest fall in stock markets occurred in 2007 and 2008. This means the volatility of market is more during this period.There was an increase in registration of FIIs and the investments reached almost Rs. 283468.40 Crores by the end of 2007. The present situation is that the investments have reduced by 9% to 255464.40 Crores as on September 5,2008. So this reduction is also one cause of volataity. In 2008, the net buying was only Rs. 5603 Crores compared to Rs. 36,869 Crores in 2007. Hence we have seen that FIIs also influence the markets in a major way.

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APPENDIX:

[1] An initial public offering (IPO) is the first sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking the capital to expand, but can also be done by large privately owned companies looking to become publicly traded.

[2] Illiquid is the state of a security or other asset that cannot easily be sold or exchanged for cash without a substantial loss in value. Illiquid assets also cannot be sold quickly because of a lack of ready and willing investors or speculators to purchase the asset. The lack of ready buyers also leads to larger discrepancies between the asking price (from the seller) and the bidding price (from a buyer) than would be found in an orderly market with daily trading activity.

[3] A spot market is a commodities or securities market in which goods are sold for cash and delivered immediately. Contracts bought and sold on these markets are immediately effective.

[4] A derivative is a security with a price that is dependent upon or derived from one or more underlying assets. The derivative itself is a contract between two or more parties based upon the asset or assets. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks , bonds, commodities, currencies, interest rates and market indexes.

[5] An arbitrageur is a type of investor who attempts to profit from price inefficiencies in the market by making simultaneous trades that offset each other and capturing risk-free profits. An arbitrageur would, for example, seek out price discrepancies between stocks listed on more than one exchange, and buy the undervalued shares on one exchange while short selling the same number of overvalued shares on another exchange, thus capturing risk-free profits as the prices on the two exchanges converge.

[6] A limit Order Book is a record of unexecuted limit orders maintained by the specialist. Whereas ,alimit order is an order to buy or sell a stock at a specific price or better. A buy limit order can only be executed at the limit price or lower, and a sell limit order can only be executed at the limit price or higher. A limit order is not guaranteed to execute.

[7] An institutional investor is a non-bank person or organization that trades securities in large enough share quantities or dollar amounts that they qualify for preferential treatment and lowercommissions. Institutional Investors face fewer protective regulations because it is assumed that they are more knowledgeable and better able to protect themselves.

[8] This refers to electronic facilities, often supplied by independent firms, that allow buy side firms to access liquidity for securities they may wish to buy or sell. Buy side firms are customers of sell side firms - brokerages and banks which may act as market makers in a security. Buy side firms will still use the trading infrastructure of sell side firms, but have more control over how the trade is executed.

[9] Rolling settlement is the process of settling security trades on successive dates so that trades executed today will have a settlement date one business day later than trades executed yesterday. This contrasts withaccount settlement , in which all trades are settled once in a set period of days, regardless of when the trade took place.

[10] Market capitalization is the total dollar market value of all of a company's outstanding shares. Market capitalization is calculated by multiplying a company's shares outstanding by the current market price of one share. The investment community uses this figure to determine a company's size, as opposed to sales or total asset figures.

[11] A foreign institutional investor (FII) is an investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds.

[12]

New FDI Limits 2015 of various sectors
Agriculture - 100%
Asset Reconstruction Companies - 100%
Civil aviation - 49%
Courier service - 100%
Credit rating / Information - 74%
FDI Limits in Defence - 49%
Education - 100%
FM radio - 26%
FDI Limit in Insurance & Sub-activities - 49%
Medical Devices - 100%
Multi brand - 51%
Pension - 49%
Pharma - 100%
Power - 49%
Print media - 26%
Public Sector Banks - 20%
Private bank - 74%
Railway infrastructure - 100%
Single brand Retail - 100%
Stock exchange - 49%
Telecom Sector - 100%
Tourism - 100%

[13] In case of Equity route the FIIs can invest in the following instruments:
A. Securities in the primary and secondary market including shares which are unlisted, listed or to be listed on a recognized stock exchange in India.
B. Units of schemes floated by the Unit Trust of India and other domestic mutual funds, whether listed or not.
C. Warrants

[14] In case of Debt Route the FIIs can invest in the following instruments:
A. Debentures (Non Convertible Debentures, Partly Convertible Debentures etc.)
B. Bonds

C. Dated government securities
D. Treasury Bills
E. Other Debt Market Instruments
It should be noted that foreign companies and individuals are not be eligible to invest through the 100% debt route.