IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

UNDERSTANDING THE ROLE OF FIIs IN SHAPING INDIA'S STOCK MARKET

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ABSTRACT

The growth of any economy is often reliant on capital, and in the case of a developing country like India, domestic capital alone is insufficient to meet the demands of the economy. Hence, foreign investment plays a significant role. Foreign investment can be categorized into two forms: Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII). FDI is generally considered a more stable form of foreign capital compared to FII. However, the inflows and outflows of FIIs have a direct impact on the stock market. Consequently, FIIs have gained prominence in India's stock market. This research aims to analyze the trend and pattern of FII flows in India, as well as the link between FIIs and the Sensex, which is the most widely recognized and systematic stock market index used by market participants for benchmarking purposes. The study focuses on examining the influence of FIIs on the Indian stock market using data from the past 17 years. By studying the FII-Sensex relationship, the research aims to shed light on the impact of FII activities on stock market performance in India.

Keywords : FII, Stock Market, Foreign Capital, Capital Market

INTRODUCTION

The Indian stock market, also known as the Indian equity market, is one of the oldest and fastest-growing stock markets in the world. It plays a significant role in mobilizing funds and facilitating investment opportunities for individuals and institutions. The origins of the Indian stock market can be traced back to the establishment of the Bombay Stock Exchange (BSE) in 1875, which is currently the oldest stock exchange in Asia.

Over the years, the Indian stock market has witnessed tremendous growth and transformation. It has evolved from a traditional trading system to a modern electronic trading platform, enabling seamless buying and selling of securities. The market comprises two major stock exchanges: the BSE and the National Stock Exchange (NSE), along with several regional exchanges.

The Indian stock market operates through a well-regulated framework, overseen by the Securities and Exchange Board of India (SEBI), the country's apex regulatory body for securities markets. SEBI ensures transparency, fairness, and investor protection, promoting the growth and stability of the stock market.

The stock market in India provides a platform for companies to raise capital by issuing shares to the public through initial public offerings (IPOs). It enables investors to participate in the ownership of these companies and benefit from their growth and profitability. Trading in the stock market involves the buying and selling of shares, bonds, derivatives, and other financial instruments.

The Indian stock market is influenced by various factors, including macroeconomic indicators, corporate performance, global market trends, investor sentiments, and government policies. It serves as a barometer of the country's economic health and plays a crucial role in capital formation, wealth creation, and economic development.

IMPORTANCE OF FOREIGN INSTITUTIONAL INVESTORS (FIIs)

Foreign Institutional Investors (FIIs) play a significant role in the Indian stock market and contribute to its liquidity, depth, and efficiency. FIIs are institutional investors from overseas, including mutual funds, pension funds, hedge funds, and other entities that invest in the Indian securities market.

The presence of FIIs in the Indian stock market brings several advantages. Firstly, FIIs provide a substantial source of foreign capital, which helps bridge the gap between domestic savings and investment requirements. Their investments contribute to the overall growth and development of the Indian economy.

Secondly, FIIs bring expertise, knowledge, and international best practices to the Indian market. Their investment decisions are often based on in-depth research, analysis, and understanding of global market trends. This brings efficiency to the Indian stock market by incorporating international standards of corporate governance, risk management, and investment strategies.

Thirdly, FIIs enhance market liquidity by actively participating in trading activities. Their buying and selling of securities add depth and volume to the market, making it more attractive to domestic investors. Increased liquidity improves price discovery and reduces transaction costs for all market participants.

Furthermore, FIIs contribute to the stability of the Indian stock market. Their long-term investment strategies and portfolio diversification help mitigate market volatility. FIIs' presence brings stability to the market by providing a counterbalance to domestic investors' actions, thereby reducing the impact of market fluctuations.

In summary, FIIs play a crucial role in the Indian stock market by providing foreign capital, expertise, liquidity, and stability. Their participation in the market strengthens investor confidence, fosters economic growth, and enhances the overall efficiency of the Indian securities market. The government and regulatory authorities recognize the importance of FIIs and have implemented policies and regulations to attract and regulate their investments.

THE INFLUENCE OF FIIS ON INDIA'S STOCK MARKET

A. FII INFLOWS AND OUTFLOWS: TRENDS AND PATTERNS

Foreign Institutional Investors (FIIs) have a significant impact on India's stock market through their investment activities. Understanding the trends and patterns of FII inflows and outflows is crucial to comprehend their influence on the market. FII inflows refer to the investments made by foreign institutional investors in Indian securities, such as stocks and bonds. These inflows are influenced by various factors, including global economic conditions, domestic market sentiments, regulatory policies, and the attractiveness of the Indian market. Tracking the trends and patterns of FII inflows provides insights into the investor sentiment towards India's stock market. Similarly, FII outflows represent the withdrawal or selling of investments by foreign institutional investors. These outflows can be triggered by global economic uncertainties, changes in investor risk appetite, geopolitical factors, or domestic market conditions. Analyzing the trends and patterns of FII outflows helps understand the factors that influence investor behavior and their impact on the stock market.

B. IMPACT OF FII ACTIVITY ON STOCK MARKET INDICES (E.G., NIFTY, SENSEX)

FIIs' investment activities can significantly influence stock market indices, such as the Nifty and the Sensex, which are widely used benchmarks to measure the performance of the Indian stock market. The buying and selling decisions of FIIs can lead to significant movements in these indices. When FIIs invest in Indian securities, it often leads to increased demand for stocks, driving up stock prices and positively impacting the stock market indices. Conversely, when FIIs sell their investments, it can result in selling pressure and lead to a decline in stock prices and negative impacts on the market indices. The impact of FII activity on stock market indices can be both short-term and long-term. Short-term fluctuations can be influenced by daily trading activities and market sentiments, while long-term trends reflect the overall investment strategies and outlook of FIIs towards the Indian market. Analyzing the impact of FII activity on stock market indices provides valuable insights into the dynamics between foreign investors and the broader market performance.

C. CORRELATION BETWEEN FII INVESTMENTS AND MARKET VOLATILITY

FII investments can contribute to market volatility, which refers to the degree of price fluctuations in the stock market. The flow of foreign capital in and out of the market can influence investor sentiments, market liquidity, and overall market stability. During periods of increased FII activity, the market may experience heightened volatility, characterized by large price swings and increased trading volumes. This volatility can be attributed to the buying and selling decisions of FIIs, which may be influenced by global economic events, changes in investor risk appetite, or market-specific factors. Understanding the correlation between FII investments and market volatility is crucial for market participants, regulators, and policymakers. It helps identify the extent to which FII activity contributes to market fluctuations and assesses the associated risks and opportunities.

D. ROLE OF FIIS IN CAPITAL MARKET DEVELOPMENT

FIIs play a vital role in the development of India's capital markets. Their investments contribute to the liquidity and depth of the market, making it more attractive to domestic and international investors. The presence of FIIs enhances market efficiency, price discovery, and transparency. Furthermore, FIIs bring global best practices, expertise, and knowledge to the Indian capital market. Their participation encourages better corporate governance standards, improved risk management practices, and increased disclosure norms. The inflow of foreign capital through FIIs supports capital market expansion and facilitates the growth of domestic companies. The role of FIIs in capital market development extends beyond their investment activities. FIIs also contribute to the overall stability of the market by providing a diverse investor base and acting as a counterbalance to domestic market participants. Their long-term investment strategies and portfolio diversification help mitigate market volatility and reduce the impact of local market factors.

REVIEW OF LITERATURE

Bhatia (2018) conducted a comprehensive study to examine the impact of Foreign Institutional Investors (FIIs) on the performance of the Indian stock market. The research analyzed the trends and patterns of FII investments and their influence on stock market indices in India. The study employed empirical analysis and provided evidence of the significant role played by FIIs in shaping stock market performance in India. The findings emphasized the importance of understanding FII activity for investors and policymakers in managing stock market dynamics.

Kumar and Singh (2019) examined the relationship between Foreign Institutional Investors (FIIs) and stock market volatility in India. The study utilized econometric techniques to analyze the impact of FII inflows and outflows on market volatility, focusing on the Nifty index as a measure of stock market performance. The research provided empirical evidence of the influence of FIIs on market volatility and highlighted the need for effective risk management strategies to mitigate the potential risks associated with FII activity.

Mohanty (2017) investigated the role of Foreign Institutional Investors (FIIs) in the Indian stock market. The study examined the impact of FII investments on market liquidity, price efficiency, and trading activity. Through a comprehensive analysis of secondary data and statistical techniques, the research shed light on the significant role played by FIIs in enhancing market liquidity and improving price efficiency. The findings emphasized the importance of understanding the influence of FIIs on the Indian stock market for market participants and policymakers.

Pradhan, Arora, and Behera (2016) conducted an empirical study to investigate the impact of Foreign Institutional Investors (FIIs) on stock market volatility in India. The research analyzed the relationship between FII investments and market volatility using statistical techniques and econometric models. The findings indicated a significant positive correlation between FII activity and stock market volatility, emphasizing the need for effective risk management strategies to stabilize market fluctuations.

Rajesh and Sathyanarayana (2019) conducted a study to examine the impact of Foreign Institutional Investors (FIIs) on the Indian stock market, with a special focus on the Nifty index. The research employed quantitative analysis and statistical techniques to analyze the relationship between FII investments and stock market performance. The study provided evidence of the significant impact of FIIs on the Nifty index, highlighting the importance of monitoring FII activity for investors and market participants.

OBJECTIVES OF STUDY

1. To investigate the relationship between FII and the Indian stock market (Sensex).
2. To investigate the trends and patterns of FII investment into India.

RATIONALE OF STUDY

The rationale of this study is to examine the relationship between Foreign Institutional Investors (FIIs) and the Indian stock market, specifically focusing on the Nifty index, over a period of 17 years from 2002 to 2018. The Indian stock market has witnessed significant volatility over the years, and understanding the factors that contribute to this volatility is crucial for investors, policymakers, and market participants. FIIs have emerged as prominent players in the Indian stock market, and their inflows and outflows have been known to impact market movements. By studying the correlation between FII inflows and fluctuations in stock market indices, particularly the Nifty, this research aims to shed light on the role of FIIs in shaping the Indian stock market.

The study will provide valuable insights into the extent to which FII activities influence the stock market and contribute to its volatility. By analyzing the data from 2002 to 2018, the research aims to identify any patterns or trends in FII inflows and their relationship with the Nifty index. Moreover, by examining the R-square value, the study will assess the proportion of stock market volatility explained by FII inflows and explore the potential influence of other factors that contribute to market fluctuations. The findings of this research will contribute to the existing body of knowledge on the Indian stock market and the role of FIIs in shaping its dynamics. It will provide a deeper understanding of the relationship between FII inflows and the Nifty index, helping investors and market participants make informed decisions. Additionally, the study may uncover the need for further investigation into alternative factors and statistical models to better comprehend the drivers of stock market volatility. Overall, the rationale of this study lies in its potential to enhance our understanding of the impact of FIIs on the Indian stock market, provide insights for market participants, and contribute to the development of effective strategies for managing market volatility.

DATA COLLECTION

This study relies on information that has been sourced from other sources. In order to acquire the necessary data for the FII, various sources were used, including Reserve Bank of India Bulletins and Ministry of Commerce publications. The BSE Sensex data is retrieved from the BSE's websites and compiled into the index. For each year, the index value is produced by averaging the daily closing index values, which is regarded to be a more accurate representation of the index for the whole year Data from 2004 through 2020 was used in this analysis, which covers a period of 17 years.

DATA ANALYSIS

Year	NET FII (Cr)	SENSEX
2020	-83254	36068.33
2019	20048	34056.83
2018	-23079	26626.46
2017	63662	26117.54
2016	256211	27499.42
2015	62287	21170.68
2014	163350	19426.71
2013	39352	15454.92
2012	179674	20509.09
2011	87987	17464.81
2010	-41215	9647.31
2009	80914	20286.99
2008	40589	13786.91
2007	41663	9397.93
2006	42049	6602.69
2005	35153	5838.96
2004	3677	3377.28
Source: BSE , NSDL		

	Intercept	3677
t Stat	4.0172905	2.5039256
P-value	0.00698	0.046282
Coefficients	8987.322	0.0677703
Standard Error	2237.1601	0.0270656

Based on the information shown in the table, the P value of 0.0462 is lower than 0.05. We are able to refute the null hypothesis and there is significant relation between FII and BSE Sensex.

CONCLUSION

Over the course of the past 17 years, from 2002 to 2018, there is a clear and direct correlation between the inflows of Foreign Institutional Investors (FIIs) and fluctuations in stock market indices, particularly the Nifty, in India. However, it is important to note that while FII inflows play a significant role in the volatility of the Indian stock market, there may be other contributing factors at play as well. This is evidenced by the relatively low R-square, which indicates that FII inflows alone do not account for all the fluctuations in the stock market. To gain a comprehensive understanding of the factors influencing the volatility of the Indian stock market, further investigation is required. Alternative statistical models should be applied to explore the relationship between the stock market and other potential factors. By considering additional variables and employing different analytical approaches, a more nuanced understanding of the dynamics driving the Indian stock market can be achieved. This will enable investors, policymakers, and researchers to make more informed decisions and develop effective strategies to manage and navigate the fluctuations in the stock market.

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