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Foreign Institutional Investors – Understanding the Indian Advent

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Abstract

The paper aims to tell the story of foreign institutional investors, advent in India. The study examines the nature of the FII flows into India. The study is spread across mainly four points of investigation. It attempts to understand if there was a significant change in the flow of FII investment before and after the economic crisis of 2008.The study intends to investigate if investments made in India, by FIIs of different countries are significantly different, quantum of investment made by FIIs in different Industrial sectors significantly differ, if there is significance of difference between the FII and DII investment flows. Data form the website of NSDL and SEBI was used in the study . FII & DII fund flows, in India, of the last 27 years have been used for the study. Based on the results of the test conducted it was concluded that there is no significant statistical difference in the quantum of FII flows before and after the financial crisis of 2008.The amount invested by the FII's in various Industrial sectors in India, was found to be significantly different. There was no significant difference in the yearly investments made by different countries investing in India. The difference between the flows of FII and DII in India was found to be insignificant and negatively correlated.

The current study could be extended in the future to study the impact of FII on the Indian retail investors' investment choices. More study on whether the retail investors follow the investment pattern of the FII and DII needs to be done. A predictive model for the investor could be devised, to make better investment choices, by following the foreign institutional investor and domestic institutional investors.

Key words: Securities and Exchange Board of India, Foreign institutional investors, Domestic Institutional Investors, Sub Account, National Securities Depository Limited.

1. INTRODUCTION

The idea of foreign investment was alien to India until the 1980's. The focus of the Nation and the Government was on self-sustenance and economic growth that was intrinsic in nature. This reluctance towards foreign cash flows gradually changed in early 1990's and India. To attain the goal of rapid growth and improve the standard of living, a huge gamut of economic reforms were introduced by the government of India in July of 1991.There was rapid opening up of the economy. In a span of about 25- 28 yrs. India has grown from being a very slow moving economy to the fastest growing economy in 2016.

One of the major changes that were a part of the reforms apart from capital account convertibility was permitting the foreign institutional investment in the country. This was a huge change which financed the deficit in BOP through non debt creating flows. There were very tight regulations regarding the flow of foreign money into and from the country. FII‘s were allowed to invest in the country from 14th of September 1992. The FII were required to get their name registered with SEBI and the RBI as per FERA, which stands valid for a period of five years. The modus operandi is the transfer of a corpus of funds to a bank in India which deals with such operations and the FII can invest in all recognized stock exchanges. Also there exists a set of guide line issued by the government in the year 1992 and incorporated in the SEBI regulations (2005), which list out the criteria that is used for granting permission to a FII to operate in the country. The guidelines have a check on the eligibility criteria, financial stability, professional conduct, other such relevant criteria, whether the institution is registered with the authorized body. The government of India from time to time specifies the investment limits for the FII's. FEMA which came in to effect in the year 2000 issued regulations to manage the foreign institutional investment.

The following table gives a picture of the evolution if the FII in India.

Date	Policy Changes
September 1992	As per Government guidelines FII' are allowed to invest in Primary, Secondary markets and also mutual funds. A FII can invest up to 5%, if made singly, in a company's paid up capital. A company's paid up capital can have an FII investment to the max of 24 % of all FII's put together
April 1997	Aggregate limit of FII investment in the paid up share capital of a company was raised to 30 % from 24 %.
April 1998	Permission was granted to the FII's to invest in the government securities (dated).An upper limit of $1 billion was prescribed. The limit was later raised to US $1.75 billion.
February 2000	Permission was granted to domestic fund manages to get registered as FII's and manage the funds of sub accounts in order to increase the operational flexibility, and give opportunity to the domestic fund management capability . High net worth foreign individuals and foreign firms could invest in the form of sub accounts under the registered FII
March 2001	FII upper limit was raised to 49 %
September 2001	Sectorial cap was the maximum limit of FII under special procedure
December 2003	The approval process for FII participation in India was a Dual one. FII previously needed to take permission from both SEBI and RBI. In order to simplify the registration process the, approval system was modified. The FII's now needed to take permission only from SEBI.
November 2004	A limit of US $ 0.5 billion was the prescribed outstanding corporate debt.

April 2006	The outstanding corporate debt limit was raised to $1.5 billion.
November 2006	23 % was the limit of investment permitted in the infrastructure institutions such as depositories, clearing houses and stock exchanges.
January and October, 2007	Investment limit raised to US $ 3.2 billion in Govt. securities.
June, 2008	Government securities Investment limit was raised to US $ 5 billion and Corporate Debt limit was US $ 3 billion.
October 2008	Cumulative debt investment limit was raised to US $ 6 billion for investment in corporate debt.
October 2008	The earlier regulation of 7: 30 investment ration between equity and debt was removed.
October 2008	Restrictions on the overseas derivatives Instruments was removed
March 2009	E bid platforms for FII's created.
August 2009	Interest rate futures opened up to FIIs.
November 2010	Investment cap in government securities increased to US $ 10 Billion and US $ 20 billion in corporate bonds
March 2011	Investment cap of US $ % billion in corporate bonds of Infrastructure sector raised to US $ 25 billion.

Table 1

Monitoring of Foreign Institutional Investments by RBI:

Reserve bank of India is the governing authority that lays down the rules and regulations and does monitoring of the investment ceiling with regard to FII investment in Indian companies. The operational ceiling, applicable for the FII investment in India, stands 2 % lower than the actual investment ceiling set by the RBI, for proper monitoring. For example the false ceiling for companies with an actual ceiling of 30 % is 28 %.

When the net purchases of an FII reaches the false ceiling which is 2% lower than the actual ceiling set, RBI intimates all the related banks, giving instructions, that no more purchases can be made before taking a prior permission from RBI. The Link office is needed to inform RBI if there is a further purchase intention proposed by the FII. The number of debentures or shares that the link office would purchase for the FII needs to be informed. The RBI on review of such a proposal gives a clearance on first come first serve basis, as long as the investment of the FII does not cross the limit imposed on the firm or the sector . Once the statutory ceiling is reached in a firm or a particular sector, reserve bank issues notices through a press release.

Institutions which are eligible to participate under the FII route

1. Institution incorporated as an insurance company or reinsurance company, pension fund, mutual fund, investment trust fund, outside India.
2. A foreign central bank, sovereign wealth fund, government agency, any multilateral or international agency or organization.

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3. An investment manager, advisor bank, asset Management Company, institutional portfolio manager, which is established outside the country.
4. A trustee of a trust that is established outside India.
5. Charitable societies, charitable trusts, endowment, foundations, university funds belonging to foreign soil. Broad based fund also can invest under the FII route. A fund to categorize as a broad based fund should have been constituted by a min of 20 investors. Individual investors can hold only up to 49 % of the broad based fund.

Sub account

A person falls under the category of sub account if she or he does not reside in India. If a person not residing in India is registered as a subaccount with SEBI under the FII Regulations, 1995, then an investment can be made by the foreign institutional investor on behalf of the sub account.

The sub account may be categorized in to any of the following:

1. Broad based fund established outside India.

2. A registered foreign institutional investor, investing its proprietary fund in India.

3. A foreign national holding a valid passport for a minimum of last five years, is the client of a registered FII , for the last three years , and has a good standing certificate from a bank. The net worth of the individual shall not be less than $ 50 million.

4. A foreign company which has its share listed on a stock exchange outside India. The asset base of such a company should not be less than US $ 2 billion and the company should have earned a net profit of at least $ 50 million in the last 3 years preceding the application date.

Investment avenues in India for foreign institutional investors

1. The foreign institutional investors may invest in stock markets or subscribe to the Initial Public offering made by a company. They may invest in debentures, shares of companies, which are listed, unlisted or to be listed.
2. Commercial Papers in India
3. Security receipts
4. Mutual funds.
5. Derivatives traded on a recognized stock exchange in India
6. Government securities
7. India depository receipts
8. Units of scheme under the collective investment scheme.

Investment restrictions on foreign institutional investors

Primary Market Investment

1. Foreign institutional Investors or sub accounts, who subscribe to equity shares in the IPO issued by an unlisted company in India, might need to hold the shares for a lock in, if any such policy is suggested by the central government at the time of purchase of shares.

2. Investment made in the equity and equity related instruments by the foreign institutional investors for itself or for the sub accounts should be more than seventy percent of the total investment made by them in India on its own account or because of the sub account.

3. The above restriction of 70% is not applicable if the investment is made in the debt securities, either on its own behalf or the behalf of a sub account. The prior approval of SBI needs to be taken by the FII if the investment is to be made in debt instruments. SBI may impose restrictions as to the maximum level of investment that can be made

4. There is no restriction of the FII investment, on the receipts issued by the securitization companies .The foreign institutional investors are allowed to make investment in the security receipts only on their own behalf.

Secondary Market Investment

1. Foreign Institutional investor or sub account interested in operating in the secondary market, can only on take and give delivery of securities purchased or sold.
2. December 2007 SBI has permitted the FII and subaccounts to enter into short selling transactions.
3. Transactions entered into by the FII cannot be carried forward and must be through a stock broker certified by the SBI.
4. The purchase of equity shares by the FII on its own accord cannot be more than ten percent of the company's paid up capital. In case the equity shares are purchased on behalf of the sub account , the amount of money invested through the secondary market should not be more than 10 % of the paid up share capital of the company.

2. LITERATURE REVIEW

Acharya A, Salvi P & Kumar S (2017) examine how liquidity in the global field acts as a cause of flow investment into India. Bose S & Coondoo D (2004) stated that the restrictive FII policy reforms intended to achieve greater control on the FII flows do not impact the flows negatively. Garg A & Chawla K (2015), it was found that there is a very strong negative relation between both the flows. Gordon &Gupta (2003), a combination of Global, domestic and regional variables have an impact on the inflows into India.Joshi, Desai &Choksi (2018) most of the FIIs prefer to invest large caps. EPS and DPS form a major deciding factor in selecting the company. Paliwal, Minakshi S. & Vashishtha D (2010) FII flows in Indian Economy and BSE averages causal relationship is investigated. Prasanna, P. K. (2008), It was found that companies which have a huge volume of public holding in the capitalization attract FII investment. Prusty T. & Vishwakarma R. (2014) discussed the factors influencing FII s while making an investment in the Indian market.Rai Kulwant &

Bhanumurthy (2004), studied the various determinants causing a foreign institutional investment in India. Inflation. Kumar S. (2001) inferred that the FII inflows are determined not by the movement in the market but due to the Fundamental indicators. Srinivasan P & Kalaivani M (2013) FII flows are determined by domestic inflation, exchange rate, equity returns in the domestic market, and the risk and return of US market.

Research Gap:

Liquidity in the global markets causes the FII to invest in India has been stated by (Acharya A, Salvi P & Kumar S, 2017)**,** however, the current study helps to identify, which foreign country has a strong investment history in India. Previous research on the topic of FII, mainly dealt with, the factors influencing the FII flows into India, as stated in (Kumar S ,2001) and (Srinivasan P & Kalaivani M ,2013).The current study focusses on finding out the Industrial sectorial investment allocation of the FII funds. Existence of a causal relationship between the FII flows and the BSE has been studied in the previous research, (Paliwal, Minakshi S & Vashishtha D 2010), relationship between the FII and DII has still a lot of scope for investigation, and has been included in the current research. Not much has been written on the initiation of FII in India and how the flows have changed after the global financial crisis of 2008 in the earlier studies.

3. RESEARCH METHODOLOGY

Research Questions

1. If in depth study on the functioning of the FIIs can help in better investment planning for the retail investors
2. Similarity and differences between FII and DII investment patterns, could have an impact on Indian economy and retail investors'

Objectives of the Study

1. To study if the financial crisis of 2008 has made any difference to the quantum of FII flows to India after the crisis.
2. The examine the difference in the sectorial investments made in India by the FII's
3. To study the similarity or difference in the amount of money invested in India, by FII's of different countries.
4. The differences in the investments made by foreign institutional investors and domestic institutional investors to be studied.

Hypothesis

1. H_0: There is no difference in the FII net investment amount before 2008 and after 2008

H_1: There is a significant difference in the FII net investment amount before 2008 and after 2008

2. H_0: There is no significant difference in the categories in which FII's invest

H_1: There is a significant difference in the categories in which FII's invest

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3. H$_0$: There is no significant difference between the yearly investments made by FII's from various countries.

H$_1$: There is a significant difference between the yearly investments made by FII's from various countries.

4. H$_0$: There is no difference in the investments made by FII and DII

H$_1$: There is difference in the amount of investments made by FII and DII

Sample Design: Convenience sampling has been used to collect the sample units. Sample units for the research are the annual FII and DII flows. 27 units (years) of data has been used to test if the FII flows, before and after the financial crisis were significantly different . 8 units of data have been considered for the analysis of FII flows from different home countries and their investment into different industrial sectors. 12 units of data have been taken to test the differences between FII and DII investment flows.

Research tools

't' Test – Significance of difference between the FII flows before and after the financial crisis has been tested using 't' test

ANNOVA- Level of significance in the differences between amounts invested by FII's in different industrial sectors, differences in the FII inflows from different countries, differences in the inflows of FIIs and DIIs

Correlation- To check if the FII and DII Net flows are correlated

Data Collection

The paper is based on the secondary data that is published by the government of India. The data has been taken from online sites of BSE (Bombay Stock Exchange), NSDL (National depository services limited) and Money control.com, and NSE (National Stock Exchange)

4. DATA ANALYSIS AND INTERPRETATION

I. Trends in the FII Net Investments in India

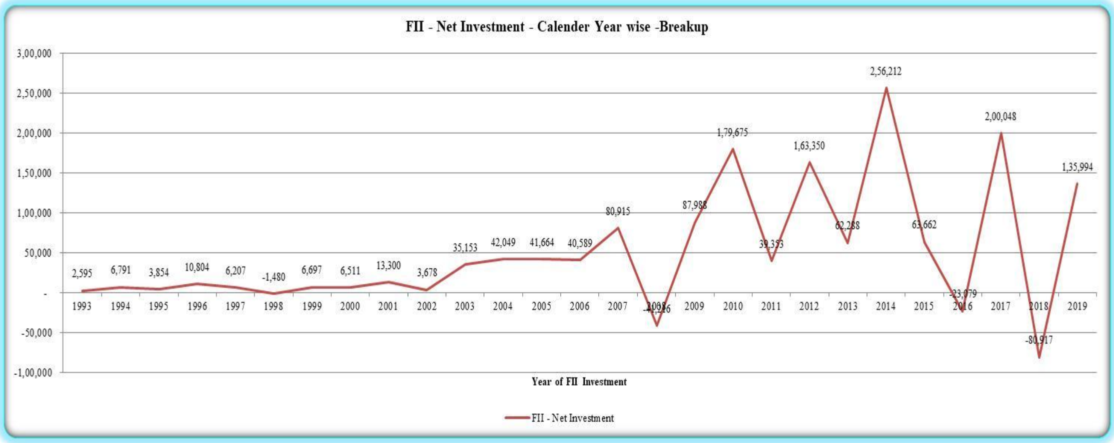

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Chart 1

The above chart shows a steep increase in see saw fashion a in the FII inflows into India post 2008. The graph shows a significant rise in the FII investments after 2008

II. Top 8 categories in which the FII have invested between 2012 thru 2019

Top 8 - FII - Investment Categories	
FII - Investment Category	**% of total**
Others4	37
Sovereign	20
Banks	12
Other Financial Services1	7
Oil & Gas	6
Utilities3	5
Insurance	5
Telecom Services	2

Source : https://www.fpi.nsdl.co.in/web/Reports/FPI_Fortnightly_Selection.aspx

INRs in Crores

Table 2

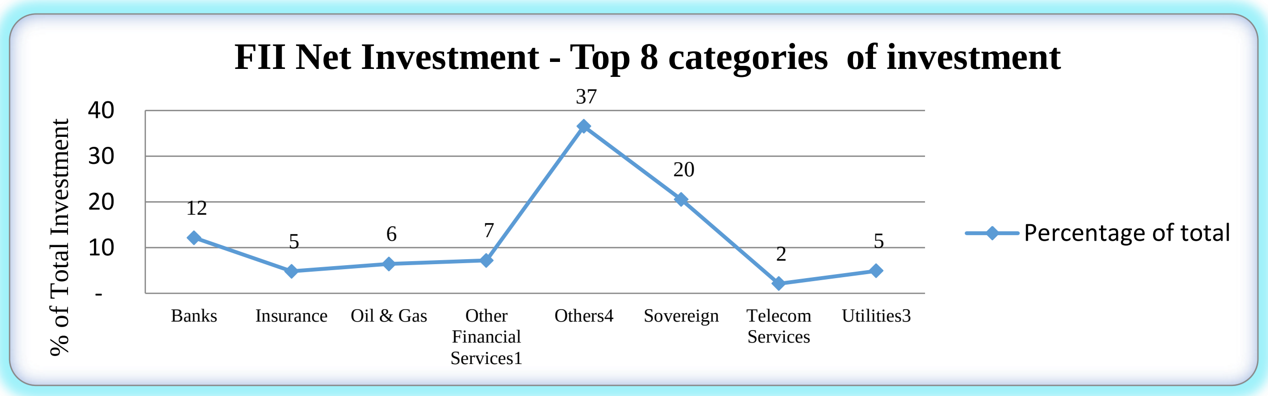

Chart 2

Others is the top most category of investments made by the FIIs at 37 %, followed by Sovereign at 20 %. Banks and Financial services amount to almost 20 % of the FII investment.

III. FII - AUC - Country-wise (Jan 2012 thru Aug 2019)

SUMMARY -FII - Asset under custody - Held by NSDL Country Wise Break up		
Country Name	Avg. AUC per year 2012-2019	% of Total FII -AUC (NSDL)
Mauritius	4,28,766	24
Other	2,52,600	14
Singapore	2,44,900	14
The Netherlands	2,44,900	14
Luxembourg	2,11,094	12
United States of America	1,08,044	6
Canada	58,931	3
Norway	54,669	3
Ireland	52,804	3
Netherlands	48,076	3
Japan	44,780	3
United Kingdom	31,314	2
Australia	6,294	0
United Arab Emirates	1,202	0
France	1,148	0
Total	**17,89,522**	**100**

Source :
https://www.fpi.nsdl.co.in/web/Reports/FPI_Fortnightly_Selection.aspx
INRs in Crores

Table 3

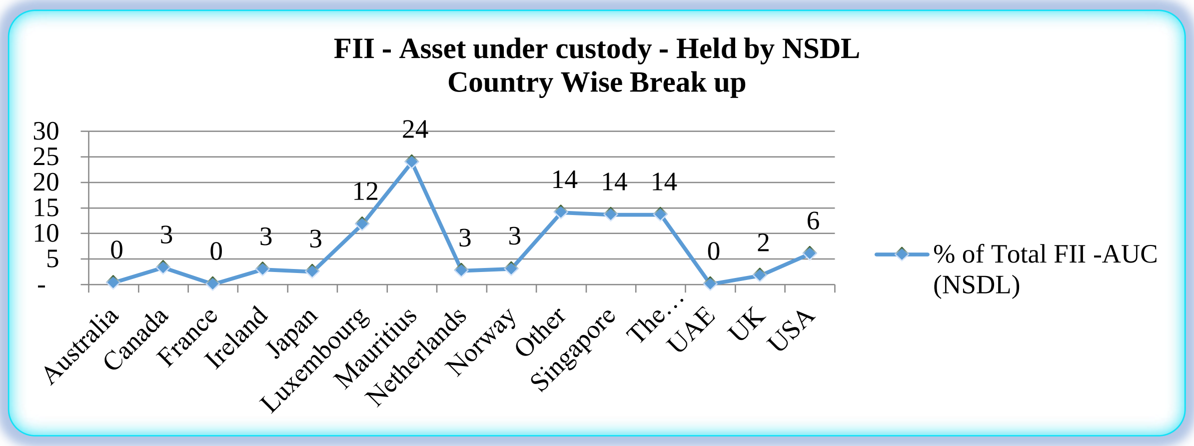

Chart 3

Mauritius stands in the No.1 position when it comes to investing in India over the last 8 years. Singapore, Netherlands stand next in position.

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5. FII Vs DII

Net Amount Invested by FII and DII (2008 - 2019)

Year	FII	DII
2008	-41,216	72,967
2009	87,988	26,106
2010	1,79,675	-19,227
2011	39,353	29,206
2012	1,63,350	-55,800
2013	62,288	-73,052
2014	2,56,212	-28,557
2015	63,662	67,587
2016	-23,079	35,363
2017	2,00,048	90,738
2018	-80,917	1,09,662
2019	1,35,994	42,257
Grand Total	**10,43,357**	**2,97,249**

INR in Crores

Source : NSDL,Money control

Table 4

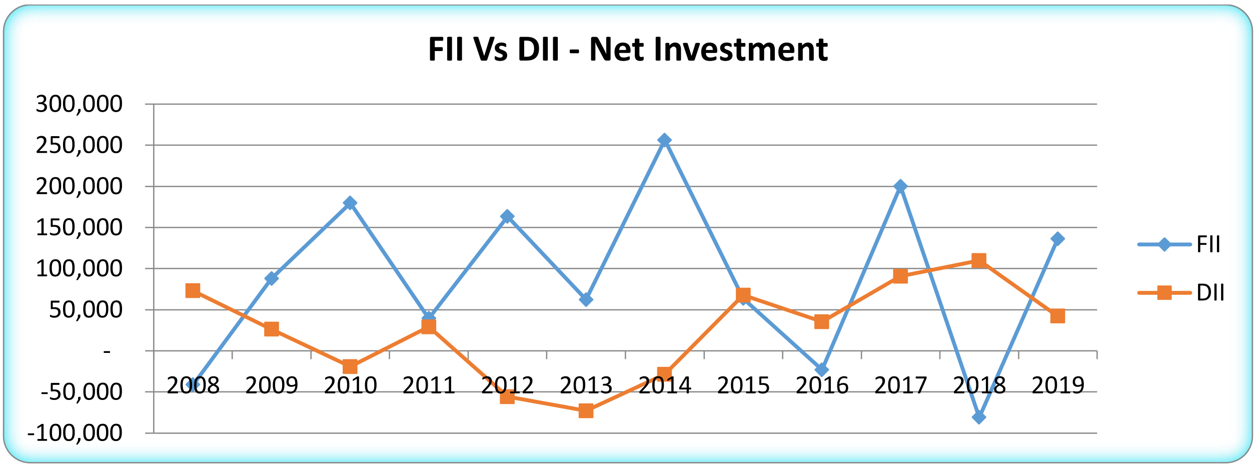

Chart 4

Highest amount of investment made by the domestic institutional investors is in the year 2018. However the Foreign institutional investors have sold more than they have purchased in 2018.

Hypothesis testing:

H_0: There is no difference in the FII net investment amount before 2008 and after 2008

$H_{1:}$ The is a significant difference in the FII net investment amount before 2008 and after 2008

Table 5: t- Test results

t-Test: Paired Two Sample for Means

	Variable 1	*Variable 2*
Mean	20,714	98,598
Variance	1,01,92,88,355	10,04,91,51,109
Observations	11	11
Pearson Correlation	-0.4	
Hypothesized Mean Difference	0	
df	10	
t Stat	-2.2	
P(T<=t) one-tail	0.0	
t Critical one-tail	1.8	
P(T<=t) two-tail	0.1	
t Critical two-tail	2.2	

Interpretation: ‘t’ test on paired samples, conducted on the investment of the FII before and after the financial crisis of 2008 yielded the following results. It is evident from the above results that, P- two tailed value is 0.1 which is more than the 0.05 significance level. Hence the alternate hypothesis is rejected. It is concluded that there is no difference in the FII net investment before 2008 and after 2008. The financial crisis of 2008 did not alter the choice of the FIIs for investment purposes.

H_0: There is no significant difference in the categories in which FII‘s invest

H_1: There is a significant difference in the categories in which FII’s invest

Table 6 : ANNOVA – Difference in the investment made in the industrial categories

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	1,56,70,61,797	7	22,38,65,971	2.21	0.03	2.03
Within Groups	41,40,77,13,727	408	10,14,89,494			
Total	42,97,47,75,524	415				

Interpretation: ANNOVA test was conducted on the investment made by the FII in different Industrial sectors between the years 2012 thru. 2019. F calculated value is 2.21 and F table value is 2.03 at 5% significant level. As the calculated value of F is greater than table value of F, Null hypothesis is rejected, and alternative hypothesis is accepted. The calculated P value is less than 0.05 also indicating that the NULL hypothesis is rejected.

H_0: There is no significant difference between the yearly investments made by FII’s from various countries.

H_1: There is a significant difference between the yearly investments made by FII’s from various countries.

Table 7 : ANNOVA – Difference in the annual investments made by FII's from different home countries

ANNOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	3.09209E+11	7	44,17,27,20,056	1.0	0.5	2.1
Within Groups	5.2008E+12	112	46,43,57,25,503			
Total	5.51001E+12	119				

Interpretation:

ANNOVA test was conducted to find if there is a significant difference in the investment made in India between 2012 thru 2019 by the FIIs hailing from different home countries. It is observed from above ANNOVA table that, F calculated value is 1.0 and F table value or F Critical value at 5% significant level is 2.1. Here, F calculated value is less than F table value. The calculated P value is 0.5, Hence Null hypothesis is accepted. Therefore, it is concluded that, the yearly investments made by FII's from various countries are not different.

H_0: There is no difference in the investments made by FII and DII

H1: There is difference in the amount of investments made by FII and DII

Table 8 : ANNOVA – Difference in the investments made by FIIs' and DIIs'

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*
Between Groups	23194877422	1	23,19,48,77,422	3	0
Within Groups	1.55404E+11	22	7,06,38,39,962		
Total	1.78599E+11	23			

Interpretation:-

ANNOVA test was conducted to check if the investments made by the FII and DII are significantly different .In the above ANNOVA table, the P-value is 0 which is very small that means the results are highly significant. It reveals that there was no chance of getting these results if the null hypothesis was true. Further, it is also evidenced from the table that, F calculated value is 3 and F table value at 1 & 22 degree of freedom at 5% significant level is 4.30. This means that the calculated value of F is less than that of the table value of F (i.e. 3<4.30), hence null hypothesis is accepted. Therefore, it is concluded that the quantum of investments made by FII and DII were not different .

Table 9 : Correlation – Between investments made by FIIs' and DIIs'

Correlation Value between FII and DII

	FII	*DII*
FII	1	
DII	-0.5	1

The value of the correlation between the FII and DII fund flows stands at stands at -0.5. Correlation test results indicates an inverse relation between the flows of FII and DII and India.

6. FINDINGS:

The data of the DII shows the increasing significance of DII on the Indian economy. By and large the swing in the Indian stock markets based on the FII flows has reduced over period of time. T test conducted on the Net FII flows in India, shows that there is no difference in the Net funds flowing in to India before 2008 (year of the financial crisis) and the post crisis era. ANNOVA test conducted on the categories in which the FII funds are invested concluded that there is a significant difference in the categories in which the FII's have invested between 2012 and 2019.ANNOVA test conducted on the assets under custody data, with NSDL, related to the FII's has concluded that the source countries from which India has received investments between 2012 and 2018 is not very difference in the years under consideration.t test conducted on the inflows of FII and DII between 2008 and 2019 shows that the data is not very different . Correlation test conducted on the same data suggest that the FII and DII flows are negatively correlated. Further studies can be conducted to determine the strength of factors which impact an FII to invest in India (outside the home country of an FII). Also it would be interesting to study the impact of the FII and DII's have on the mutual fund industry on India. Another area in which research cold be carried out would be a study on whether the retail investors follow the FII flows in India before making an investment.

7. CONCLUSION:

The results of the research help us to conclude that the investment volume of the FIIs have increased beyond 2008, which means that India is a desired destination .It has been observed that the investment timing of inflows and outflows of the FII and DII do not match , which is shown by the negative correlation . When the FII pull out funds from India, they are balanced by the inflows of DII funds into the Indian Economy, hence saving the country from major financial imbalance. FII's have invested mainly in the industrial category of others followed by Sovereign and Banks. These sectors need a close monitoring by the government, as a major pull out by FII's could cause a damage to the economy. Out of all institutional investors from various countries that have invested in India, Mauritius is the biggest stake holder, followed by Singapore, Netherlands and Luxemburg. Any internal disturbance in these countries might also have a deep impact on the economy of India.

8. DISCUSSION:

Investment trends of the Foreign Institutional investors has remarkably increased after the 2008 financial crisis. It indicates positive sentiment of the foreign countries in India. There was a time in the economic history, where the inflows and outflows of the foreign institutional investors, caused severe fluctuations in the Indian Economy. There are many problems faced by the Indian economy, because of the 'hot money 'movement of the Foreign Institutional Investor's money in India. In the year 2016, there was a pullout of nearly USD 2 billion, and the financial markets hit rock bottom .It was the highest withdrawal, since the massive pull out by the FIIs in 2008. The one thing that is worth noting is that, when the FII pulled out from the Indian markets DII have always invested in the markets. This is indicated by the negative correlation between the investment flows of FII and DII. Domestic institutional investors are also slowly emerging as a major player in the growth story of India. More research needs to be directed in the area of investment patterns of the DIIs. There is also an increase in the awareness levels of the Indian retails investors .The Indian retail investors are now making informed investment choices. They would want to invest in the same sectors in which FII's have invested. Following the FII and DII investment choices, would help them earn good return on their money invested. If the countries investing majority of funds are identified, it would be helpful if the Indian government is always watchful of any Macro economic trends in the home countries of the FIIs.

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