Analyzing Factors Influencing "Foreign Institutional Investment in India: A Comprehensive Study"

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Abstract

Institutional inflows from abroad sped up globalization at the turn of the 21st century in both developed and developing nations. To better understand what has made India an attractive market for FIIs from around the world, the current study studied a time series of data from 2000-2017. The influx of FII (foreign institutional investment) has been crucial to the development of India's financial markets and economy. It is critical for regulators and traders to comprehend the elements that influence FII inflows. Finding out what factors encourage foreign organizations to set up shop in India is the driving force behind this study. By examining a wide range of economic, financial, and regulatory factors, this study will provide insight into the factors that encourage FII inflows and the effects these inflows have on the Indian economy. It was also found in this article that economic risk and financial market risk have very little of a role when it comes to the decision of foreign institutional investment in India.

Keywords: Foreign Institutional investments, Financial, Economic risk, Financial Market, etc

INTRODUCTION

The term "foreign institutional investment" is used to describe the capital that is invested in a country's financial markets by foreign institutions such pension funds, mutual funds, and hedge funds. Foreign direct investment (FDI) has grown into a major contributor to India's economy, influencing the country's stock and bond markets as well as GDP expansion. Therefore, it is crucial to comprehend what draws in and motivates the investment decisions of international institutional investors.

Capital flows, especially portfolio flows, have shifted significantly in India as a result of recent trade and industrial policy reforms. Institutional investors that are not based in India yet make investments there are known as FIIs. Foreign institutional investors may put their money primarily in Treasury bills and notes issued at a later date. Allowing FIIs cut back on the need for commercial borrowing from outside. Seventy-0.29% of the 2001-2002 net capital account came from private foreign investment, up from 21% in 1985-86. Since 2002–03, FIIs have steadily increased. The stock market's meteoric ascent can be directly attributed to the influx of FII capital. The macroeconomic climate has improved as a result of liberalization and reform programs. Reserves of foreign currency increased by about 28 percent due to net FII investments, as reported. Foreign institutional investors (FIIs) are a source of liquidity for the capital markets and a driver of increased trading volume forecasts. Stock prices would rise if there was a greater inflow of capital. With more money flowing into the primary markets from FIIs, a company's cost of capital would go down. The price-earnings ratio of a company would improve as a result.Foreign direct investment (FDI) serves as a supplement to national savings, allowing economies to expand and perform better.

LITERATURE REVIEW

(Suchismita Bose, 2003) Forerunners of the Mexican financial crisis(1990–1994), most emerging markets outperformed their matured counterparts in the developed world in terms of return and associated risk. However, this trend was reversed during the years following the Asian financial crisis (1995–2001). While returns and risks have dropped in Western markets, emerging markets (particularly in Asia and Latin America) have shown spectacular growth. Such swings in market performance make foreign equity investment extremely risky and can disrupt economies in countries that receive it. Insight into the strength of different variables likely to affect FII flows into a country, as well as the potential influence of FII flows on the performance of the equities market in that economy, may be gained by taking a thorough look at the nature of FII flows into that economy.

(Virupaxi, 2021) The individual's actions result from his or her responses to various aspects of their environment. To better understand the factors that impact the investor's investment choice, a research was done in the Indian stock market, which comprises of 10 sectors and 30 enterprises listed on the BSE-30 SENSEX. A survey with 14 different characteristics was developed and sent out to 2100 participants. Over the course of 6 months, we gathered 467 responses and used the KANO model to categorize them into "must be," "linear," and "delight" categories. It was determined that the health of the financial accounts, the situation of the economy, and the outcome of technical analysis are all "must have" characteristics, while "insider information" is a "delight" characteristic. The research uncovered the determinants of investors' choices.

(Parminder Singh, 2018) The Indian market has attracted attention as an emerging industry ever since it opened up to Foreign Institutional Investment in its Capital Market. The Indian Stock Exchange Now Welcomes FDI. This developing economy stopped enforcing its measures meant to entice investors in September of 1992. To entice the foreign institutional investment, various economic reforms have been implemented. After the economic changes, this was an issue that gained traction among academics.

(Sagar Patil, 2021) A research instrument with 14 criteria was developed and distributed to 2100 participants. Over the course of 6 months, we gathered 467 responses and used the KANO model to categorize them into "must be," "linear," and "delight" categories. It was determined that the health of the financial accounts, the situation of the economy, and the outcome of technical analysis are all "must have" characteristics, while "insider information" is a "delight" characteristic. The research uncovered the determinants of investors' choices. Sector-specific consideration of elements for Understanding the thought processes behind investors' choices is facilitated by the study of investing decision making.

(Mahesh Sarva, 2020) This study analyzes time series data from 2000-2017 to learn more about the factors that have led to India's success as a worldwide market for foreign institutional investors. According to the research, India has a lot of work to do in a few key areas before it can compete with other countries for foreign institutional investments. Among these are the reduction of political risk, the expansion of financial markets, the liberalization of trade, the growth of the economy, and a satisfactory rate of return. The uncertainty of India's financial markets and economy has not deterred multinational corporations from investing in the country. Current government and market authorities can use the study's findings to craft policies aimed at attracting more money from overseas institutional investors.

(P. Srinivasan, 2015) This research will use an autoregressive distributed lag (ARDL) bounds testing strategy to investigate the factors that attract FIIs to India. The empirical research used quarterly time series data from 2004-2011. Our findings suggest that a decline in the value of the Indian rupee reduces FDI inflows both quickly and over the long term. As a corollary, the short-term decline in the value of the Indian equity market has a favorable effect on Foreign direct investment into India. Trading hypotheses based on positive and negative feedbacktrading hypothesis benefit from this finding. Short-term beneficial effects of US stock market returns on FII flows are minimal, whereas long-term positive effects are large.

(Hemantkumar P Bulsara, 2016) These inflows may go unnoticed by the country of origin, but the total volume of rupees they represent can have a profound impact on the economy and currency exchange rates. The factors' impact is examined using a monthly data set starting in January 2000 and ending in August 2013 and an ARDL Bounds Testing Approach. It was discovered that FIIs were affected by a wide variety of regional and international variables. Monthly returns, market capitalization, price earnings ratios of domestic markets, and currency exchange rates are just few of the domestic macroeconomic factors that have a significant impact on FIIs in India.Monthly losses in the S&P 500 Index and the US Producer Price Index (PPI), a proxy for inflation in FIIs' home countries, have a negative impact on FIIs' portfolios.

(Vaishali S. Dhingra, 2016) Using daily data and static and dynamic models, this research investigates the relationships between foreign investment return and changes in the value of Indian stocks. Those who had previously traded in the Indian market negatively are now trading in the positive feedback segment of the market are two phenomena that are found by both models to be true of international investors. Using impulse response functions developed from vector autoregression, we show that the withdrawal of FIIs significantly raises market volatility.

The purpose of this study is to address the question "What drives FII into India?" by examining a number of 'push' and 'pull' factors, as well as two dummy variables for the financial crises in 1997 and 2008. The model is initially established inside a multiple regression framework, and then the analytic depth is enhanced by means of principal component analysis. Based on our research, we have determined that the MSCI Emerging Market Index's returns, the values of FII inflows in the past, and the IIP index are the most important variables. Furthermore, it is found that the crisis of 2008 had a significant impact on net FII flows.

(Ajay Shah Ajay Shah, 2013) There are no clear conclusions to be drawn from the literature comparing the investing strategies of international and domestic investors. In this study, we explore this subject and analyze how asset allocation and security selection contribute to portfolio performance. We show that there are substantial gaps in how international and domestic investors are exposed to systematic asset pricing forces. To evaluate the impact of asset allocation on security selection, we present a quasi-experimental approach. Our data reveals that overseas investors in India are shockingly bad at picking stocks.

(Hayelom Abrha Meressa, 2022) Diagnostic tests for the assumptions of the traditional linear regression model were done, and econometric model estimation methods were used, before any meaningful analysis could be conducted. However, there was no discernible impact from factors like external debt, inflation, or regulatory quality. As a result, in order to increase steady inflows, member nations should take steps to eliminate obstacles to financial development, enhance infrastructure, deepen trade integration, raise the level of human capital, promote greater political stability, and rein in corruption.

(Leonard K. Cheng, 2000) Wage cost was a negative factor, However, 29 countries were able to attract FDI because of their huge regional markets, superior infrastructure, and favourable policies.Chinese regions between 1985 and 1995. Although education had a favorable effect, this was not a statistically significant finding. Foreign direct investment also had a substantial multiplier effect within itself. Between 1985 and 1995, regional equilibrium FDI stocks did not converge, but regional departures from equilibrium FDI stocks did converge.

(Friedrich Schneider, 1985) Four models are econometrically calculated to explain the flow of FDI in 80 developing nations, and then contrasted using ex post projections. The most accurate prediction may be made using a politico-economic model that takes both economic and political factors into account. As a result of increased FDI, both real per capita GDP and the balance of payments deficit improve. When compared to bilateral and multilateral aid from the West, the amount of aid from communist nations has a depressing effect. Political unpredictability is a major barrier to attracting foreign direct investment.

(Alan A. Bevan, 2004) Unit labor costs, gravitational considerations, market size, and proximity are deemed to be the most significant variables. Surprisingly, the risk of the host country turns out not to be a major factor. Our data also shows that announcements of proposed EU accession have an effect on foreign direct investment for the candidate countries.

(V. N. Balasubramanyam, 1996) This study applies a new growth theory framework to the scenario of developing nations with varying trade policy regimes to investigate the impact that FDI has on economic growth. In this paper, they test Jagdish Bhagwati's claim that nations with an outwards oriented trade policy will gain more from FDI in the form of stronger economic growth than countries with an internally oriented strategy using cross-section data for 46 developing countries..

(Agnès Bénassy-Quéré, 2007) These findings are promising because they suggest that developing nations can increase their inflow of FDI without relying solely on the multiplicative effect of a greater per capita income. The paper's findings, which are massive orders of magnitude, suggest that improving institutional quality from a low to high level may have the same effect as suddenly becoming a neighbor of a source country.

(Luiz R. de Mello Jr., 2007) The effect of FDI on the GDP of developing nationsis discussed in depth in this article. The influence of FDI on growth is expected to be complex and significantly variable among technologically developed and developing countries because FDI is often considered as a whole package of capital stocks, know-how, and technology.

(LiAuthor, Xiaoying Liu, 2007) Directly and indirectly, FDI from outside helps the economy expand.via the conditions of its interactions, and indirectly, via other factors. The impact of the technology gap on developing country GDP development is substantial because of the interplay between FDI and human capital.

(Mohsin Habib, 2002) The research confirms that both have harmful effects. Corruption is viewed negatively and can lead to operational inefficiencies, hence the findings show that international investors tend to avoid the practice.

(Golubeva, 2016) The research also shows that it's impossible to expect a project's aims to be met without first creating a favourable business environment can spell death for efforts to improve the investment climate in beneficiary countries.

"OBJECTIVES OF THE STUDY":

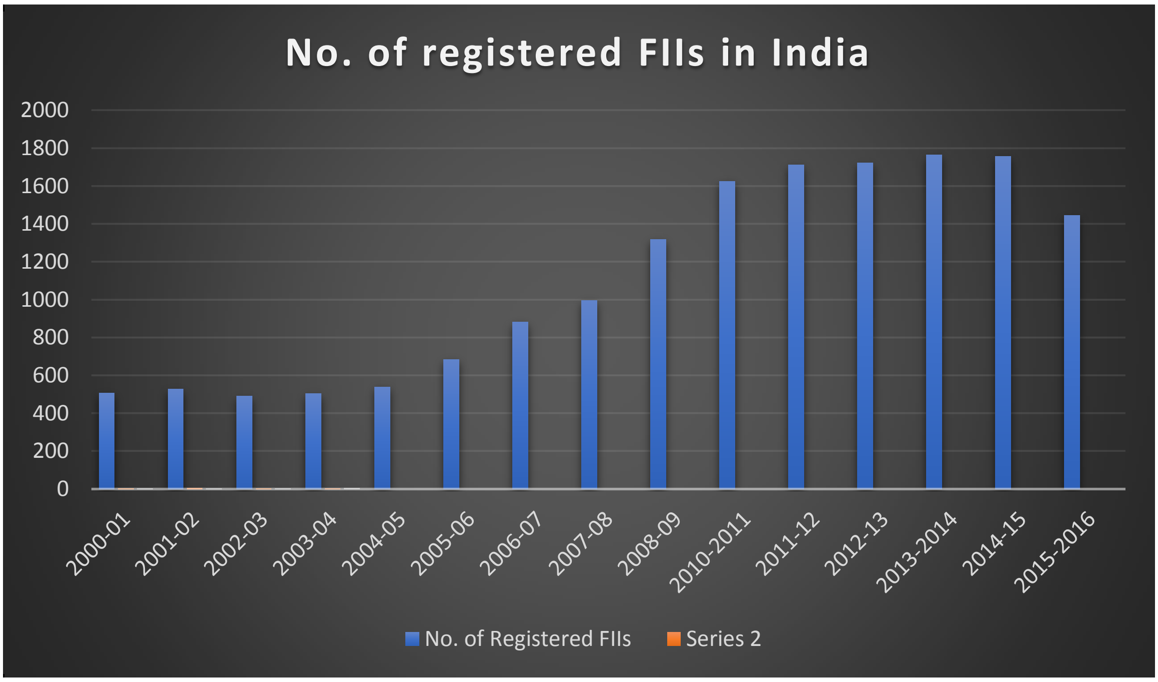
- "Examining the Growth Dynamics of Foreign Institutional Investments in India": A Comprehensive Study
- "Exploring Factors "Influencing Foreign Institutional Investments in India": An In-depth Study".

METHODS AND METHODOLOGY

The websites of the BSE, SEBI, and RBI were mined for the secondary data required for the study. Stationarity tests were performed because the data was a time series. Auto Regressive Distributed Lags was used to calculate the lag lengths, the Granger causality test was run to find out what factors had an impact on FII and why.

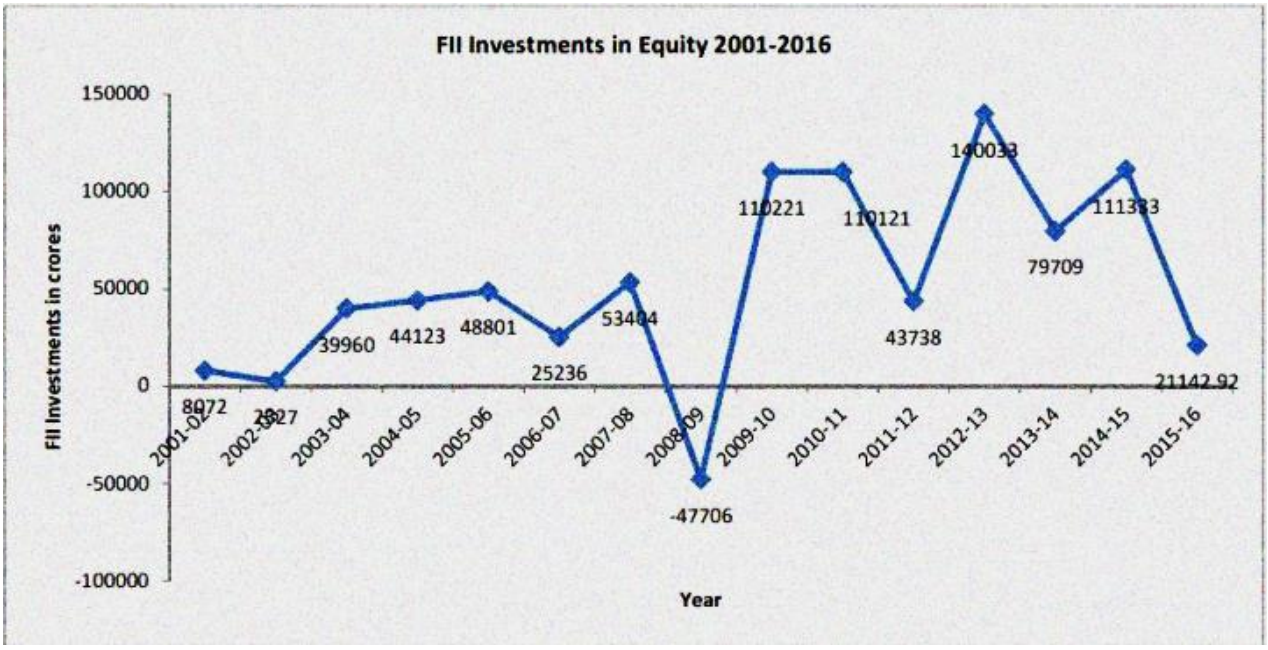
"Period of the study":

The research spanned 15 years, from 2001 to 2016, and relied on monthly data. Two time periods, are examined to determine the global financial crisis's effects. After trend fitting, it was agreed that September and October of 2008 represented the crisis period and would therefore be excluded from the analysis.



Graph No. 1

The number of FIIs registered with SEBI for trading in India has been on the rise, as seen by the preceding chart. In 2012–2013, there were 1,765 new registrations, but by 2015–2016, that number had dropped to 144.



Graph No. 2

"The above graph displays the increase in FII investments between 2001–02 and 2015–16.

- The total amount invested has increased steadily from Rs. 8072 crores in 2001-02 to Rs. 53404 crores in 2007-08.
- "Net FII investments dropped dramatically as outflows surpassed inflows." [Rs. 47706] as a result of the global financial crisis in 2008-09.
- ""Dramatically increased inflows" of Rs. 110,121 in 2009–10 show that FIIs have gained confidence in the Indian stock market.
- In the 2012–13 fiscal year, foreign institutional investors poured in a record Rs. 140033 crores.
- The decrease in inflow is significant, reaching Rs. 21143 crores in 2015–16.

Determinants of Foreign Institutional investments flows:

There is debate over what factors affect the movement of FIIs, but there is little agreement. This is due to the fact that the micro and macroeconomic conditions prevalent in any given country can have a significant impact on how friendly or unfriendly the country is to attracting FIIs. After looking at how FII investments have been affected in the past, the following elements have emerged as the most important.

- **Inflation**

Foreign investment flows are negatively correlated with inflation because investors always take inflation and its effect on the value of their money into account.

An increase in the inflation rate causes an investor's purchasing power to decrease. As a result, the investor wants to get his money out. Likewise, if the rate of inflation in a foreign country rises, the purchasing value of money stashed there will fall. The result would be the investor selling their holdings and moving them to a country with lower inflation.

- **Index of industrial Production (IIP)**

The increase in an economy's IIP is also a crucial response on that economy's growth. Manufacturing, mining, quarrying, electricity generation, etc., all contribute to an economy's overall growth, and this is represented in the improvement of industrial output. The Index of Industrial Production (IIP) in India calculates the percentage increase or decrease in output volume over a given base period on an annually basis. For a limited amount of time, this is carried out. It is reasonable for IIP to be a factor in deciding FII flows into India because FIIs are driven by the expansion of the companies or industries they invest in.

- "**Comparative Analysis of Interest Rates in India and Other Countries: A Comprehensive Study" [MIBOR]**

Since the cost of capital increases when interest rates in India are high, the profitability of businesses suffers. A loss in a company's profits will lead to a decrease in the price of an equity share in that company's stock market. This will make the investment opportunity less appealing to both domestic and international investors. As a result, changes in an economy's interest rates will have an effect on the flows of FII investment into stock and equity-related securities.

- **"Foreign exchange rate"**

The supply and demand for different currencies causes the foreign exchange rate, or the value difference between the host country's currency and the investor's home currency, to fluctuate. This is because the supply of and demand for various currencies influence their relative values. Both the actual and expected rates of return on investments are affected by fluctuations in the exchange rate.. When the value of the country's native currency improves, foreign direct investment will unquestionably go up as a result. In other words, the value of FII assets will grow at a faster rate if the value of the currency of the host country drops, commonly known as a depreciation.

- **Money Supply**

The amount of money that is actively being used in an economy at any one period in time is referred to as the money supply at that economy. Personal and corporate cash and coin holdings, as well as the value of savings accounts and other short-term investments, are all included. There is a negative correlation between a shrinking money supply and economicgrowth, and a positive correlation between a rising money supply and falling interest rates. The term "M 3" refers to a broader concept that encompasses both savings and time deposits that are kept by financial institutions.

- **"Impact Cost"**

ForeImpact costs, also called transaction costs, are those incurred by a buyer or seller of shares at the time the contract is performed. This metric is useful for determining whether or not a market is adequately supplied with cash.

- **Government Policies**

The government policies of the country that is the recipient of foreign direct investment (FDI) also exert a significant amount of influence over these flows. Foreign institutional investors (FIIs) in India saw volatility in the stock market when the government imposed a capital gains tax and a minimum alternative tax. The policy of the government is not taken into consideration because it cannot be quantified

CONCLUSION

Several factors, some of which are highly significant, affect the total amount of FDI that a country receives. This research found that FII investments lead to both higher exchange rates and higher IIP in India, but only in one direction. The study's authors concluded as much. Investments from foreign institutions (FIIs) were found to be correlated with changes in money supply and consumer price index, but not with changes in interest rates (MIBOR) or impact costs. This was another finding that emerged from the research. International investors bring foreign currency into any economy through their investments. In this research, we looked at the varying patterns of when international investors register with SEBI and when they withdraw their funds.

LIMITATION OF THE STUDY

However, only the macroeconomic variables are taken into consideration in this analysis, despite the fact that there is a very wide range of factors that influence FII investments.

SCOPE OF THE STUDY

One is able to carry out research taking into account both macro and micro economic factors, such as the price earnings ratio, return rates, and volatility of the companies that make up the index.

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