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Growth of FII and its impact on Indian Economy

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Abstract - Foreign Institutional Investors play a key role in any economy. FIIs invest in the assets belonging to a different country other than that where these organisations are based. India gained favour among investors, offering relatively higher growth than the developed economies. India has been an attractive investment destination for Foreign Institutional Investors (FIIs). A FII is a large investor, who does business in a country other than the one in which the invest instrument is being purchased. Countries with developing economies have the greater volume of FIIs. The developing countries provide investors with higher growth potential than the developed countries.

Since Liberalization, FII flows have grown importance in India. An economic growth of a country requires a greater role of the foreign capital. There was a surge in foreign capital flows into India after 1992-93 because of severe changes in India's policies. Then, Government of India started relaxing certain barriers to facilitate the foreign capital flows and an improvement of financial structure. Today, FII are the driving factors of the Indian financial markets. Investors are optimistic on India and sentiments are favourable following government's introduction of reform measures. Institutional Investors mostly include hedge funds, insurance companies, pension funds, and mutual funds. FII also include investment banks, large corporate buyers of large institutions. The number of FIIs, registered with SEBI doubled to 1050 between March 2001 and June 2007. Further there is significant growth with the number of FIIs in India.

Key Terms - FII, Trends of FII in India, Determinants of FII flow in India, India's GDP

I. INTRODUCTION

Foreign investments refer to the investments made by the residents of a country in the financial assets and production process of another country. This foreign investment is necessary for all developing as well as developed countries, which may differ from country to country. The need of these foreign investments are for the developing economies, which are in mostly needed for boosting up the entire development of the nation in productivity of the labour, machinery etc. The foreign investment helps to build up the foreign exchange reserves, which is necessary to meet trade deficit. These foreign investments provides a channel through which developing countries gain access to foreign capital which is needed most for the development of the nations in the area of industry, telecom, agriculture, IT etc. The foreign investment also effects on the recipient country as it effects on its factor productivity as well as effects on balance of payments. Foreign investment can be discussed in two forms - Foreign Direct Investment and Foreign Institutional Investment. Foreign Direct Investment involves in direct production activities and in a long and medium term nature. As far as the FIIs concern it is the short term nature and short term investments. FIIs invest in financial markets such as money markets, stock markets and foreign exchange markets.

II. LITERATURE SURVEY

Definition of Foreign Institutional Investor (FII)

Section 2 (f) of the SEBI (FII) Regulations 1995: Foreign Institutional Investor (FII) means an institution established or incorporated outside India which proposes to make investment in securities in India. They are registered as FIIs in accordance with the SEBI regulations. FII as a category does not exist now. It was decided to create a new investor class called "Foreign Portfolio Investor" (FPI) by merging the existing three investor classes viz. FIIs, Sub Accounts and Qualified Foreign Investors. Accordingly, SEBI (Foreign Portfolio Investors) Regulations, 2014 were notified on January 07, 2014 followed by certain other enabling notifications by Ministry of Finance and RBI. In order to ensure the seamless transition from FII regime to FPI regime, it was decided to commence the FPI regime with effect from June 1, 2014 so that the requisites systems and procedures are in place before migration to the new FPI regime.

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With the new FPI regime, which has commenced from 1 June 2014, it has now been decided to dispense with the mandatory requirement of direct registration with SEBI and a risk based verification approach has been adopted to smoothen the entry of foreign investors into the Indian securities market.

Foreign Institutional Investors (FIIs) are those institutional investors which invest in the assets belonging to a different country other than that where these organizations are based.

Objectives

1. To find out the determinants of FII flow in India
2. To study the trends of FII over the years and
3. To analyse growth of FII with Indian economy

Foreign Institutional Investors play a very important role in any economy. These are the big companies such as investment banks, mutual funds etc, who invest considerable amount of money in the Indian markets. With the buying of securities by these big players, markets tend to move upward and vice-versa. They exert strong influence on the total inflows coming into the economy. Market regulator SEBI has over 1450 Foreign Institutional Investors registered with it. The Foreign Institutional Investments are considered as both a trigger and a catalyst for the market performance by encouraging investment from all classes of investors which leads to growth in financial market trends under a self-organized system.

In India, a particular FII is allowed to invest upto 10% of the paid up capital of a company, which implies that any investment above 10% will be construed as FDI, though officially such a definition did not exist. It may be noted that there is no minimum amount of capital to be brought in by the foreign direct investor to get the same categorised as FDI.

Foreign Institutional Investment - Regulations

Foreign Institutional Investors (FIIs), Non-Resident Indians (NRIs), and Persons of Indian Origin (PIOs) are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS). Under this scheme, FIIs/NRIs can acquire shares/debentures of Indian companies through the stock exchanges in India.

The ceiling for overall investment for FIIs is 24 per cent of the paid up capital of the Indian company and 10 per cent for NRIs/PIOs. The limit is 20 per cent of the paid up capital in the case of public sector banks, including the State Bank of India.

The ceiling of 24 per cent for FII investment can be raised up to statutory ceiling, subject to the approval of the board and the general body of the company passing a special resolution to that effect. And the ceiling of 10 per cent for NRIs/PIOs can be raised to 24 per cent subject to the approval of the general body of the company passing a resolution to that effect.

The ceiling for FIIs is independent of the ceiling of 10/24 per cent for NRIs/PIOs.

III. Research Methodology

Need for the Study: India, with a savings of roughly 35 per cent of GDP, needs formidable domestic investors, which can boost liquidity even during cash crunch circumstances, which leads to development. India can use this FII to formulate policies like Pension Finds, Provident Funds and other Corpus Funds, which ensure domestic funds in the country. India should encourage foreign investment. FII have high significant impact on the Indian capital market. FIIs have certainly contributed to the growth of stock market activity in India. The volume and value of India’s trade grew significantly along with FII flows.

IV. Analysis and Interpretation

Analysis of the Study

According to International Monetary Fund World Economic Outlook (October-2016), India contributes 2.99% of total world's GDP in exchange rate basis. Also India shares 17.5 percent of the total world population and 2.4 percent of the world surface area. India is now 7th largest economy of the world. It is projected that India will be 6th largest economy of the world in 2019 by overtaking France and will become 5th largest in 2019 by overtaking United Kingdom with GDP (Nominal) of $3,297. India is at 3rd position after China and Japan among Asian Countries. India shares 8.50% of total Asia's GDP (nominal).

On the basis of PPP, economy of India stands at 8,720.5 billion international dollar, 3rd largest economy of the world after United States and China. India contributes 7.32% of total world's GDP (PPP). India shares 15.98% of total Asia's GDP (PPP). Gross domestic product (GDP) of India at purchasing power parity (PPP) is 3.87 times more than GDP at nominal.

FII plays a vital role in the Indian equity market as they are the main source of foreign investments in India. There is a predominant rise in the inflow of FII in India. FIIs have a craving for equity than debt in their asset structure. The opening up the economy to FIIs has been permitted with the condition that preference for non-debt creating foreign inflows over foreign debt. The continuous flow of equity capital improves the capital structure and contributes towards bridging the investment gap.

FIIs are the key factors of the Indian financial market and rising stakes in Indian companies. At the same time there is disturbance over the volatility in foreign institutional

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investment flows and its impact on the different segments of the economy. The increase in the volume of FII inflows has led to concerns regarding the volatility of these flows, threat of capital flight, its impact on the stock markets and influence of changes in regulatory regimes. There was a surge in foreign capital flows into India after liberalization, because of drastic changes in India's policies. Since then Government of India have been relaxing capital control measures and taking large number of policy decisions towards the improvement of local financial infrastructure. Because of this, foreign capital has become an integral part of the development strategy of India.

FIIs constitute professional bodies of asset managers and financial analysts, who contribute for the improvement of corporate governance. The FIIs help in the process of economic development by increasing firm's incentives to supply more information about them. The increasing FII inflow to India for a period of 15 years, from 2003-04 to 2017-18, is given in the following table.

Table: FII Inflows from 2007-08 to 2017-18 (Financial Year)

(INR Crores)

S.No	Year	Equity	Debt	Total	GDP	GDP GrowthRate *
1	2003-04	39960	5805	45765	30.04	
2	2004-05	44123	1759	45881	32.42	
3	2005-06	48801	-7334	41467	35.43	9.48%
4	2006-07	25236	5605	30840	38.71	9.57%
5	2007-08	53404	12775	66179	42.51	9.32%
6	2008-09	-47706	1895	-45811	44.16	6.72%
7	2009-10	110221	32438	142658	47.90	8.59%
8	2010-11	110121	36317	146438	52.82	8.91%
9	2011-12	43738	49988	93726	87.36	6.69%
10	2012-13	140033	28334	168367	92.27	4.47%
11	2013-14	79709	-28060	51649	98.39	4.74%
12	2014-15	111333	166127	277461	105.23	7.40%
13	2015-16	-14172	-4004	-18176	113.50	7.93%
14	2016-17	55703	-7292	48411	121.65	7.11%
15	2017-18	25635	119036	144682		

Source:(i) https://www.fpi.nsdl.co.in/web/Reports/Yearwise.aspx?RptType=5

(ii) NITI Aayog/Planning Commission

(iii) Directorate of Economics & Statistics of respective State Governments, and for All-India — Central Statistics Office.

Note: (i) GDP of India at constant prices (i.e. at the price level of the base year 2004-05 from 2003-04 to 2010-11)

(ii) GDP of India at constant prices (i.e. at the price level of the base year 2011-12 from 2011-12 to 2017-18)

The Table reflects the inflow credit of FIIs into India for a period of 15 years, from 2003-04 to 2017-18. The FII flow was really high in the initial period of study, which slows down in 2006-07 and picked up to rise in the next year. In 2008-09, there was only45.81 INR crores, which rose sharp to 142.658 INR crores in 2009-10, which is really appreciable. Simultaneously, the GDP growth rate can be seen a rising trend with the increase of the credit inflow. When there was a fall in 2011-12, the GDP was also only 6.69%, a steep fall. Though in the year 2015-16, the total FII was -18176 INR crores, the GDP growth rate was managed at the same status for the latest consecutive years.

FIIs impact on Indian Economy

India's economy became the world's fastest major economy in recent years and has the potential to become the world's 3rd largest economy by the next 5 years. According to the IMF, the Indian economy is the "bright spot" in the global landscape. India topped the World Bank's growth outlook for 2015-16 for the first time with the economy having grown 7.6% in 2015-16 and expected to grow approximately 8.0% in 2016-17. FII increases or decreases where there are expectations of domestic currency appreciation. Since liberalization, India's Balance of Payments has almost strengthened, just with the important contribution of FII flows.

Inflation, which means a price rise and fall in the purchasing value of money. Economic growth is the growth of goods and services produced over a period, according to the population. FII is integrated with both the exchange rate and inflation, are interrelated. When there is a high flow of FII into India, there will be a big demand for Indian currency. Reserve Bank of India needs to print more currency to manage the situation, which paves way for Inflation. FIIs invest in that particular country, where there is a faster growth.

The strength of the capital account reflected the success of an approach to liberalization with an opening up of the economy to FIIs, and restricting debt flows, FII flows have made an important contribution to the Balance of Payments. The RBI, with the best international practices, made certain changes in the system of recording BOP flows.

Indian markets are completely controlled by the FII and their impact has been seen globally during 2008 and 2011, when our stock market gave negative return of 52 % and

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24% respectively, as FII had pulled out the money. FIIs are attracted by returns calculated in foreign currency. Finally FII leads to appreciation of currency and to inflation, with the huge amount of FII flow into the country. When FII cap is on high, they can bring in lot of funds in stock market. FII inflow of capital helps in financial innovation and development of hedging instruments. FII improves capital markets and corporate governance.

V. CONCLUSION

The Indian Financial Markets have made remarkable changes in the last 15 years. With the contribution of FIIs, Indian markets have become more efficient and competitive. The FII inflows are meant to have a positive impact on the country's economic development. By reviewing the major economic indicators, it can be realised that FIIs play a significant role in the financial stability of the country.

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