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FOREIGN INSTITUTIONAL INVESTMENT AND ITS EFFECTS ON THE INDIAN STOCK MARKET

Manoj Gyanchandani [1], Dr. Tina Sachdeva[2],
Student.[1]Asso. Prof.[2], Sagar Institute of Science & Technology, Gandhi Nagar, Bhopal,
E-mail: manojgyanchandani16@gmail.com[1], tinasachdeva@sistec.ac.in[2]

Abstract:

India welcomed international investors into its stock markets in September 1992, enabling Foreign Institutional Investors (FIIs) to contribute importantly to the economic growth of the country. FIIs have become one of the key sources of Indian capital inflows, shaping trends in the stock market as well as the overall growth of the economy.

This research explores the growing importance of FIIs in the Indian equity market with an emphasis on the influence of FIIs on the NIFTY 50 index. It investigates the trends in foreign investments across the years and the influence of the same on market volatility. From the findings, it is clear that FIIs have helped in the growth of the market, but their volatile nature sometimes creates harsh market fluctuations. The research emphasizes the need to have a stable regulatory environment in order to attract continuous foreign investments and promote long-term market stability.

Keywords: Foreign Institutional Investors (FIIs), NIFTY 50, Indian Stock Market, Economic Growth, Market Trends

Introduction:

The Indian economy has undergone a major change after the liberalization reforms of 1991.1 The reforms had made way for foreign investments, which resulted in higher involvement of international investors in the Indian capital markets. Foreign investments were minimal before 1991 because of tight regulatory policies. But as a measure of economic globalization, India allowed FIIs to invest in its share markets from September 14, 1992.

Foreign investors are an important part of the Indian financial system as they bring in capital, enhance market liquidity, and help in economic growth. India's robust economic fundamentals, large consumer base, and low labor costs make it a favorite destination for FIIs. Foreign investments have had a major impact on stock market movements, especially in benchmark indices such as NIFTY 50, over the years.

Although they have advantages, FIIs are often seen as the "hot money" as they are notorious for pulling out investments promptly whenever there is any uncertainty across the globe.2 This causes high volatility in stock prices. Hence, it is important for investors, policymakers, and regulators to understand the role played by FIIs in the Indian stock market.

Literature review:

There are many studies which examined the effect of FIIs in the Indian stock market:

- Prasanna (2008) concluded that FIIs prefer investments in those firms with lesser holdings by the promoter and superior financial performance.

- Srivastav (2013) emphasized how the role of FIIs in achieving more efficient stocks and accelerating economic growth.

- Loomba (2012) identified that market movements and volatility of stock prices have a predominant role played by the trading activities of FII.

- Juneja (2013) examined FI investments in the NIFTY index and the SENSEX indices, asserting the prominent influence that they create upon market movement.

- Srinivas (2016) examined how external financial crises had an influence upon FIIs and concluded that patterns of investments depend upon extrinsic factors.

- Undavia (2016) stressed that foreign investments lead to financial integration and aid in balancing trade deficits.

- Gupta (2016) mentioned that the number of registered FIIs in India has increased remarkably since their introduction in 1992.

- Prasad & Vaishali (2017) analyzed sectoral investment trends and observed that FIIs favor the finance and banking sectors because of their high growth rate.

These studies together emphasize FIIs' contribution in determining India's stock market performance.

Research objective:

Objective of the Study;

The main goal of this study is to analyze FIIs' role in the Indian stock market and their contribution to the NIFTY 50 index. It seeks to know how foreign investment contributes to market trends and economic stability.

Data Sources;

The research is based on secondary data gathered from:

- Documents released by the National Stock Exchange (NSE).6

- Literature brought out by the Department of Industrial Policy and Promotion (DIPP)

- Academic papers, journals, and news articles on foreign investments and stock market patterns

Analysis and Discussion

Role of FIIs in the Indian Stock Market

FIIs play a crucial role in the Indian financial ecosystem by:

1. Providing capital for companies to expand and innovate

2. Enhancing market liquidity and making stock trading more efficient

3. Improving investor confidence through their large-scale investments

4. Bringing global investment practices and governance standards to Indian companies.7

The growing entry of FIIs has resulted in a consistent increase in stock market indices like the NIFTY 50. With more foreign investors entering the market, the prices of stocks go up, and domestic investors also gain. But FIIs can also bring about sudden corrections in the market if they pull out investments based on global uncertainty.

Trends in FII Investments

Since 1992 when the FIIs first came, investments by them have increased a long way. Important trends include:

- Uniform increase in the inflow of FIIs during times of growth in the economy

- Spurt of investment in sectors involving technology, banks, and finance

- Temporal correction during international crises like the 2008 Global Financial Crisis and 2020's COVID-19 pandemic.4

- An increasing interest in long-term investments in the emerging economies such as India, driven by sound GDP growth and policy reforms.5

In spite of periodic slumps, FIIs have been amongst the biggest investors in India's stock market.

Challenges Related to FII Investment

Though FIIs have their advantages, there are challenges to them as well:

- Market Volatility: FIIs make their investments swiftly as per international economic conditions, resulting in a fluctuation in the stock market.

- Dependence on External Factors: Foreign investment choices are determined by US Federal Reserve policies, international oil prices, and geo-political tensions.3

- Regulatory Risks: Taxation policy changes, investment ceilings, or foreign exchange rules can affect FII participation.

- Asymmetrical Distribution: Most of the FII inflows are in large-cap stocks and there is very little foreign funding to small and mid-cap companies.

In order to reduce risks, the Indian government as well as SEBI need to ensure a stable and transparent regulatory framework that supports long-term foreign investments.

Conclusion

Foreign Institutional Investors have taken a central part in influencing the Indian stock market since their launching in 1992. Through their investments, the market, liquidity, as well as total economic growth, have been assisted. The NIFTY 50 index has gained immensely with increasing FII inflows but remains susceptible to international uncertainties.

In order to maintain foreign investments, India needs to concentrate on enhancing its regulatory environment, providing policy stability, and enhancing investor confidence. A balanced strategy that promotes foreign participation while safeguarding domestic interests will enable India to attain long-term financial stability and economic growth.

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