



Foreign Investments in India with special reference to FII.

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Business environment in India is passing through the process of globalization and liberalization and it has been showing increasing economic integration as well as growing independence among countries in the world. The economies have found new channels to mobilize domestic and international savings. The emerging markets offer an excellent opportunity to the domestic and foreign institutional investors (FIIs) to benefit from arbitrage and to diversify their investment in these markets (Biswas, 2005). With other structural changes, India opened its capital market to foreign investors. Present Study analyses foreign investment in India with special reference to FII.

Keywords : Foreign Investment, FDI, FPI

Introduction

The success story of any economy can only be scripted on the basis of sound financial system of the country. Economy reform process of 1991 had a great impact on the financial system of the country leading to the overall development of the Indian economy.

Being capital scarce economy, it initiated a lot of measures to attract international investors. This transformation of economic structure paved the way for rapid and sustained economic growth in India and it became an attractive destination for international investors seeking diversification of risk and higher return on their investments.

Foreign investment takes two form- Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). Foreign Direct Investment helps to increase the productive capacity of the economy while Foreign Portfolio Investment is of more speculative nature and is thus very volatile. The Foreign Portfolio Investment (FPI) includes receipts through American Deposit Receipt (ADR), Global Depository Receipt (GDR), offshore funds and foreign Institutional investors. Institutional investors from abroad who are registered with SEBI to operate in the Indian capital market are called foreign institutional investors. There are about 600 of them and they have emerged as a major force in the Indian market. FII investment flows into the secondary market which increases capital availability in general, rather than availability of capital to a particular enterprise. It has been channelized within the framework of guidelines from the Government / RBI/ SEBI.

Indian companies are allowed to raise equity capital in the international market through the issue of GDRs/ ADRs/ FCCBs (Foreign Currency convertible Bonds). Offshore funds are mutual funds of a given country which collects subscription from the residents abroad. Apart from facilitating transfer of capital of the host country, they widen the choice of investment for the individual and institutional investors abroad.

Methodology

This study is based on secondary data from the period of 1993 to 2010. The data have been collected from the official websites of SEBI and RBI and various publications such as the hand book of statistics on Indian Economy (RBI), THE HINDU, national newspaper and monthly SEBI Bulletins.

Objective

The main objective of the study is to analyze the composition, trends and growth of FIIs and the policy of government of India towards the FII.

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Foreign Investment Inflows

After the announcement of new Industrial policy (1991), there has been an acceleration in the flow of foreign capital in India.

A careful perusal of the data on foreign investment given in table 1 reveals that during the period 1990-91 and 1994-95, the share of FDI in total investment inflow was only 24.2 percent and that of FPI was 75.8 percent. For the 5-year period (1995-96 to 1999-00), the proportion of FDI in total investment improved to 54.8 percent. During the next 8-year period (2000-01 to 2008-09) the share of FDI was 68.1 percent.

Table 1: Foreign Direct Investment Inflows in India

Years	FDI (US \$ million)
1990-91	97
1991-92	129
1992-93	315
1993-94	586
1994-95	1314
1995-96	2114
1996-97	2821
1997-98	3557
1998-99	2462
1999-00	2155
2000-01	4029
2001-02	6130
2002-03	5035
2003-04	4322
2004-05	6051
2005-06	8961
2006-07	22826
2007-08	34362
2008-09	35180
2009-10(P)	34167
1990-91 to 1994-95	2441 (24.2%)
1995-96 to 1999-2000	13139 (54.8%)
2000-01 to 2009-10	161063 (63.7%)

Source: Reserve Bank of India Bulletin, March 2008, May 2010.

The data about FDI shows a gradual upward growth from \$ 124 million in 1991-92 to \$ 1314 million in 1994-95, to further rise to \$ 3557 million in 1997-98. Subsequently we find increase in FDI in leaps and bound to \$ 34167 million by 2009-10. It implies that as a matter of policy, the host country can depend on a regular inflow of FDI if it creates a conducive climate for the purpose.

Finance Minister Pranab Mukharjee on March 8, 2011 hinted at further liberalization of the Foreign Direct Investment (FDI) policy to catalyse larger capital inflows so as to meet the \$1 trillion funding needs over the next five years. The various measures proposed in the budget for 2011-12 aimed at attractive private and foreign funds for core sector development. He said “ Our resource requirement for infrastructure over the next five year plan, that is, 2012-17, has been estimated at \$1 trillion. Discussions are also under way to liberalise the FDI policy.”

The FII investment was initially limited to a selected group of stocks and they were excluded from the growing market for bonds, the government securities. Their entry into latter was permitted only in the late 1990s.

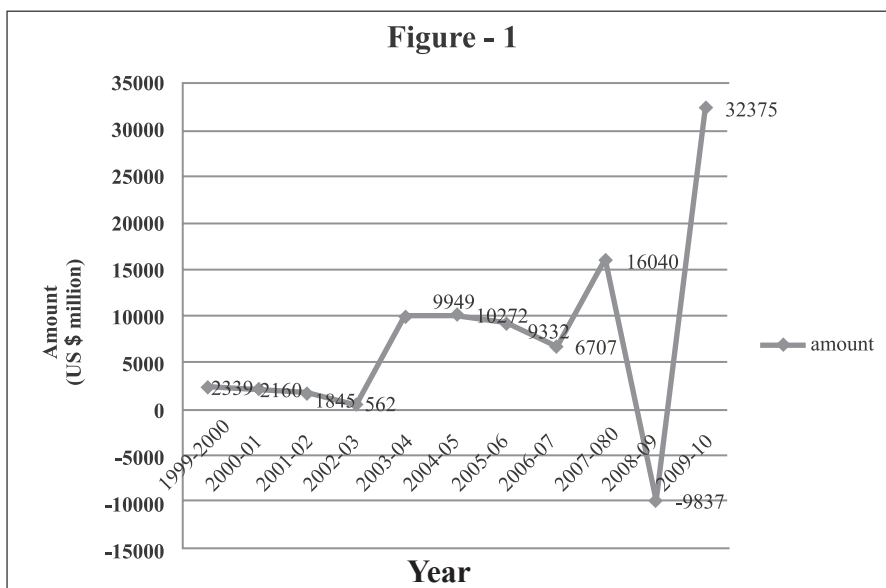
The most immediate effect of Financial Crisis on India has been an outflow of foreign institutional investment from the equity market. Foreign institutional Investment (FIIs), which need to retrench assets in order to cover losses in their home countries and are seeking havens of safety in an uncertain environment, have become major sellers in Indian markets. Despite many measures taken by the RBI and government of India, the fact remains that the health of the Indian Economy is linked to the American financial system. FII inflows into India depend on the liquidity in the American financial system. As FIIs pull out their money from the stock market the large corporate will no doubt be affected, the worst affected are likely to be the exports and small marginal enterprises that contribute significantly to employment generation.

In 2007-08, net foreign Institutional Investment (FIIs) inflows into India amounted to \$ 16040 million but in 2008-09 it was negative to \$ 9837 million. In 2009-10, again we find total FII of 32.3 billion.

Table 2. Net Investment of FIIs at Monthly Exchange Rate (in US \$ million)

Year	Amount
1999-2000	2339
2000-01	2160
2001-02	1846
2002-03	562
2003-04	9949
2004-05	10272
2005-06	9332
2006-07	6707
2007-08	16040
2008-09	-9837
2009-10(P)	32375

Source: Security and Exchange Board of India (SEBI).



Due to this there is a collapse in stock prices in 2008-09. As a result, the sensex fell from its closing peak of 20873 on Jan 08 to nearly 8000 in Oct-Nov 2008. From early 2008 rupee started depreciating again due to large scale out go of foreign exchange as a result of recession in USA

and European Union. As there was a crisis of liquidity in these countries foreign institutional investors (FIIs) transformed a large amount of foreign exchange to their respective countries. As a result of all this rupee depreciated to nearly Rs. 56 per US dollar by March 2009. Again as a result of a surge in the inflow of FII in the last three months of 2009 rupee again started appreciating and reached a record of last 18 months at Rs. 45.34 per US dollar on Jan 11, 2010 but later the value of Rupee has come down slightly.

FII Inflows and Rising Rupee

The upward movement of the rupee against the US dollar was sharp in recent weeks of September 2010 as the Indian currency has climbed about 5.6 percent since the beginning of September due to sustained capital inflows. Inflows from Foreign Institutional Investors (FIIs) so far in the calendar year have topped a record 24billion and the rupee is up 4.4 percent in September alone, net FII inflows touched a record 8billion. For the first time in this year, the reserve bank of India intervened and bought dollars from the market to cool the rupee appreciation. The sharp pick-up in daily inflows has largely been due to the impressive initial public offers in the primary market. This suggest that a slowdown may be in the offering once the major IPOs are completed and the forms shifts to the impending monetary policy meeting of the RBI and the U.S fed, says Priyanka Chakravarthy, forex strategist of standard chartered bank. She expects the value of the rupee to revert to choppy range-trading against the greenback into year-end. In september2010 Indian market recorded average net daily inflows of 401million against 160million during June-August2010. India's capital account outlook remains optimistic but some market watchers feel that current pace of equity FII inflows may not be sustainable. Once the major IPOs are completed, valuations may come into investor focus, leading to a lull in equity inflows. According to the price/earnings ratio, Ms Chakravarthy believes that Indian equities now appear overvalued not only by historical standards but also by other major Asian markets.

Table 3. Rupee US Dollar Exchange Rate since 2003 (Rupees per U.S. Dollar)

Year	Average	End-year
2002-03	48.3953	47.5050
2003-04	45.9516	43.4450
2004-05	44.9315	43.7550
2005-06	44.2735	44.6050
2006-07	45.2849	43.5950
2007-08	40.2410	39.9850
2008-09	45.9170	50.9450
April 30, 2010	44.4400	

Besides, with rapid development of the economy, India stock market started booming after 2000. Foreign Institutional Investors (FIIs) registered themselves with securities exchange board of India (SEBI) and brought foreign exchange for investment in Indian securities in the stock market.

Trends of FIIs Investment in India

The influence of foreign institutional investors has been growing in emerging markets and the same is true for the Indian equity market. The table given below reveals that the net flows have been positive except in 2008. Further it continues to be negative in 2009.

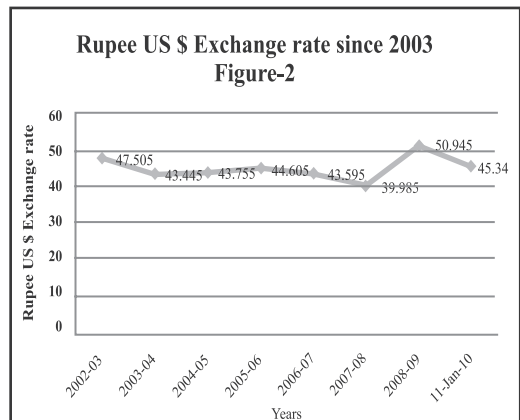


Table 4. FII trading in Indian Equity Market (Rs. Crores)

Year	Gross purchases	Gross sales	Net FII	Cumulative investment
1999-00	56856	46734	10122	39949
2000-01	74051	64116	9935	49884
2001-02	49920	41165	8755	58639
2002-03	47061	44373	2688	61327
2003-04	144858	99094	45764	107091
2004-05	216953	171072	45881	152972
2005-06	346978	305512	41466	194438
2006-07	520508	489667	30841	225279
2007-08	948020	881842	66178	291457
2008-09	769628	810845	-41217	250240
2009-10	63765	70333	-6568	243672

Source: handbook of statistics of Indian Economy (RBI)

Table 3 shows that with just a net investment of Rs. 10122 Crores in 1999-00, their net investment rose to Rs. 243672 Crores at the end of March 2010. There is an increase in net FII during 2007-08 as compared to the previous year. However, from 2008-09, net FII has been declining. The year 2008 faced the US financial crisis with subprime effect which led the major financial companies to post heavy losses, bankruptcy and collapse of huge investment banks of US and Europe one after another causing trillions of dollars of losses to investors, shareholders, lenders, borrowers and common people resulting in credit crunch, crisis of consumer confidence and low output and employment in the west and its spill over the rest of the world.

This led the foreign institutional investors to direct its trading activities in the same way by offloading its holdings in equities in the Indian equity markets. Hence the table shows that the FII gross sales exceed the gross purchases in the Indian equity markets in the year 2008. Further, it continues to show negative FII in 2009-10 too.

Trends in FIIs Registration in India

The government of India has allowed Foreign Institutional Investors (FIIs) such as pension funds, mutual funds, investment trust, asset or portfolio management companies etc. to invest in the Indian capital market provided they are registered with SEBI (Securities and Exchange Board of India). In 1989, SEBI was created by an administrative fiat of the Ministry of Finance. Since then, SEBI has gradually been granted more and more powers. With the repeal of the capital issues Control Act and the enactment of the SEBI Act in 1992, the regulation of the primary market has become the preserve of SEBI. Further the Ministry of Finance, Government of India, has transferred most of the powers under the security contracts (Regulations) Act, 1956 to SEBI. Till January 1995, as many as 286 FIIs have been registered with SEBI. They were only 10 in January 1993 and 136 in January 1994.

Since the opening of Indian market to FIIs in 1992, their number has increased exponentially except in the year 1998-99 and 2001-02. As many as 122 FIIs have registered with SEBI during the year 2009-10 taking the total number of FIIs in India to 1713 on March 31, 2010.

India has attracted FIIs from more than 30 countries including Canada, UAE, Japan, Australia, Taiwan, and Singapore and the majority of these FIIs are from US and Europe. The US accounts 45% , UK 20% and Western Europe 11% of total FIIs registered with SEBI. It shows the role of FIIs in the Indian capital market. These trends have been on account of the rapid economic growth, strong economic fundamentals, attractive valuation of companies, high quality of corporate governance, efficient market mechanism for

settlement and clearing, availability of active derivative market and high rate of return with diversified risk management and more transparency in the stock market.

Conclusion

FII's have played a dominant role in the Indian stock market in the post-liberalized period and their investment has been growing steadily since their arrival in Indian market. This year, the FII inflow have already reached \$ 24.48 billion. Of this, FII pumped 6.11 billion, about 25 percent of the total inflows so far in October 2010 alone. The current levels of capital inflows, which exceeded the financing requirements on the current account deficit, have put pressure on the rupee, resulting in its appreciation in the last months. The upward movement of rupee against the U.S dollar was sharp in recent weeks as the Indian currency had climbed about 5.6 percent since the beginning of September 2010 due to sustained capital inflows. Union Finance Minister Pranab Mukherjee said on Tuesday 26th October 2010 that with FII inflows and forex reserves, we will be able to contain the current account deficit at around 3 percent of GDP this fiscal. It was around 3.6 percent of GDP in the first quarter of 2010-11. Addressing a meeting of the Indo-US CEOs' Forum in the backdrop of U.S. President, Barack Obama's on going visit, Finance Minister said on Monday, November 8th 2010; "Economic policy, finance and trade constitute important planks of our bilateral relations. This apart, the bilateral investment treaty being negotiated with the U.S. would improve flow of investment to India. We are now negotiating a bilateral investment treaty [with the U.S] that will contribute to creating a more conducive environment for investment flows.

Portfolio investment, flavoured by highly intensive research and diversification, is now an emerging activity providing institutional character to the capital market. But the excessive dominance may have negative impact as well. That is why government is sometimes thinking of putting cap on FII inflows in the equity market. Union Finance Minister, Pranab Mukherjee on Tuesday, 26th Oct, 2010 ruled out putting any curb on FII inflows into the equity market but at the same time indicated that the RBI might intervene to check the rupee appreciation if needed. FII may become a very strong entity controlling not only the resource and manufacturing facilities of the country but also influencing the political system as well. This requires a critical assessment of their role in the Indian stock market.

Mr. Pranab Mukharjee noted that some steps have already been proposed in the budget for 2011-12. According to him "...while allocating a major share of public resources, about 48.5 percent of gross budgetary support to the central plan, for the development of infrastructure, FII investment limits in corporate bonds have been liberalized and 'special vehicles' in the form of notified infrastructure debt funds with certain tax concessions have been announced to improve the flow of resources to this sector[Infrastructure]."

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