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ROLE OF FOREIGN INSTITUTIONAL INVESTORS IN INDIAN INVESTMENT ARCADE GROWTH

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Abstract

A vital article of the growth of Investment Arcade in India in the past 10 to 15 years has been the mounting contribution of Organized Stakeholders, together external organized stakeholders and the Indian mutual funds shared together, the total assets beneath their organization amounts to nearly 18% of the perfect arcade capitalization. This broadsheet scrutinizes the role of these stockholders in Indian speculation arcade growth and catches that the input to monetary constancy can be explicated by the way of the capitals tide from these stakeholders.

Key words: FII, SEBI, OTCEI, FDI, BSE, NSE, UTI, GST, DTC, GDP

Introduction

The Union Government permitted the entrance of FIIs in order to inspire the investment arcade and invite external capitals to India. Today, FIIs are permitted to participate in all securities traded on the primary and secondary arcades, comprising equity shares and other securities listed or to be listed on the stock exchanges. The original guidelines were delivered in September 1992. Subsequently, the Securities and Exchange Board of India (SEBI) notified the SEBI (Foreign Institutional Investors) Regulations, 1995 in November 1995.

Over the years, altered kinds of FIIs have been permitted to operate in Indian stock arcades. They nowadays comprise organizations such as pension funds, mutual funds, investment trusts, asset management companies, nominee companies, incorporated/organised portfolio managers, university funds, endowments, foundations and charitable trusts/societies with a track record. Proprietary funds have also been permitted to make investments through the FII route subject to certain environments.

The SEBI is the nodal agency for distributing with FIIs, and they have to obtain preliminary registration with SEBI. The registration fee is $10,000. For yielding registration to an FII, the SEBI takes into account the track record of the FII, its specialized capability, financial soundness, involvement and such other criteria as may be measured relevant by SEBI. Besides, FIIs seeking initial registration with SEBI will be required to hold a registration from an appropriate external regulatory authority in the country of domicile/incorporation of the FII. The broad based criteria for FII registration has recently been relaxed. An FII is now considered as broad based if it has at least 20 stakeholders with no investor holding more than 10 per cent of shares/units of the company/fund.

FIIs can invest in all securities traded on the primary and secondary arcades. Such investments comprise equity/debentures/warrants/other securities/instruments of companies unlisted, listed or to be listed on a stock exchange in India including the Over-the-Counter Exchange of India, derivatives traded on a recognized stock exchange and schemes floated by domestic mutual funds. A major feature of the guidelines is that there are no restrictions on the volume of investment - minimum or maximum - for the purpose of entry of FIIs. There is also no lock-in period prescribed for the purpose of such investments.

Further, FIIs can repatriate investment gains, dividends, incomes received by way of interest and any reward received towards sale/renouncement of rights offering of shares subject to payment of withholding tax at source. The net proceeds can be remitted at arcade rates of exchange.

All secondary arcade tasks would be only through the recognized intermediaries on the Indian stock exchanges, including OTCEI. Forward exchange cover can be provided to FIIs by authorized merchants both in respect of equity and debt instruments, subject to prescribed guidelines. Further, FIIs can lend securities through an approved intermediary in accordance with stock lending schemes of SEBI.

Objectives of the study

- To know the organized stakeholders involvement to Indian Capital Arcade growth.
- To study the scope and trading mechanism of External Organized stakeholders in India.
- To find the bond between the FIIs equity investment pattern and Indian stock indices.
- To analyze the impact of FIIs equity investment on specific industrial sector.

Indian Investment Arcade Growth

Indian capital arcades have done well in the last decade. Emerging arcades are flush and have witnessed a steady inflow of funds from FIIs. A steady growth rate of GDP coupled with a high savings and investment rate, coupled with improved governance and favourable regulatory environment has built the momentum and kept the financial arcades afloat.

The year 2010-11 witnessed a strong recovery of Indian capital arcades. This has set the pace for steady growth in the coming months. The vigour of the Indian capital arcades reflects strong investor confidence

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and an accumulative appetite for risk. Growth of the Indian economy was 8.6% during 2010-11, supporting the increased activity in the capital arcades in full measure.

Net capital inflows increased to US$123.2 billion in April 2011 as compared to US$92.1 billion reported in April 2010. The composition of these capital inflows was dominated by (Foreign Institutional Investor) FII investments and trade credits, inflows from External Direct Investment (FDI) being on the lower side.

In 2010-11, 40 new companies were listed on the exchange (NSE and BSE) at a consolidated value of 33,068 crore, as compared to 39 companies listed the previous year with a reported value of 24,696 crore. The amount of capital mobilised through private placement in 2010-11 as on November 30,2010 was 1,47,400 crore, as compared to 2,12, 635 crore in 2009-10.

Price appreciation has been reflected in the arcade capitalisation (of BSE) to GDP ratio and the traded value (of BSE and NSE together) to GDP ratio which increased from 55.4% and 69.1% respectively, in 2008-09 to 100% and 89.5% in 2009-10.
Resources mobilised through capital arcades was 57,555 crore during 2009-10, as against 16,220 crore mobilised in 2008-09.

Turnover in the currency futures segment of NSE was 17,82,608 crore during 2009-10 as against 1,62,563 crore during 2008-09.
Trading on the mutual fund front was 62,959 crores as of April 2011, with an inflow of 9,629 crore in equity and 1,01,333 crore in the debt segment. Outflow as of April 2011 was comparatively lower at `8,466 crore than 65,372 crore reported in April 2010.

FII investment in the Indian arcade has maintained its momentum, with funds continuing to flow into the domestic arcade. The number of SEBI-registered.

FIIs stood at 1,713 by end-March 2010 from 1,635 a year ago. Net purchase in equities by FIIs was US$ 23 billion in 2009-10 as against net sales of US$ 10 billion in 2008-09. This growth in mobilisation of resources has been spearheaded by a favourable macro-economic environment. A rise in savings and investment rate and steady growth in private consumption has created a favourable environment, giving a boost to the investment demand in the economy. The gross domestic savings rate currently stands at 33.7%, with the investment rate reported at 36.5%. The rate of saving in financial assets has also grown to 11.8% in 2009-10, a rise from 10.8% in 2008-09, reflected in the investment rate of the household sector at 11.7%.

Hypothesis

The main intension of this paper is to study the FIIs contribution to Indian capital arcade growth.

1. H1:- Is institutional investment results in capital arcade growth of the country.

2. H2:- Does India attract the FII's.

Compensations of FII's

FIIs contribute to the external exchange inflow as the funds from multilateral finance institutions and FDI (External direct investment) are inadequate. Following are the some compensation of FIIs.

• It lowers cost of capital, access to cheap global credit.

• It supplements domestic savings and investments.

• It leads to higher asset prices in the Indian arcade.

• And has also led to considerable amount of reforms in capital arcade and financial sector.

Investments by FII's

There are generally two ways to invest for FIIs.

• **Equity investment**

100% investments could be in equity related instruments or up to 30% could be invested in debt instruments i.e.70 (Equity Instruments): 30 (Debt Instruments)

• **100% Debit**

100% investment has to be made in debt securities only

Equity investment route:

In case of Equity route the FIIs can invest in the following instruments:

A. Securities in the primary and secondary arcade including shares which are unlisted, listed or to be listed on a recognized stock exchange in India.

B. Units of schemes floated by the Unit Trust of India and other domestic mutual funds, whether listed or not.

C. Warrants

100% Debit route: In case of Debt Route the FIIs can invest in the following instruments:

A. Debentures (Non Convertible Debentures, Partly Convertible Debentures etc.)

B. Bonds

C. Dated government securities

D. Treasury Bills

E. Other Debt Arcade Instruments

It should be noted that external companies and individuals are not be eligible to invest through the 100% debt route.

Impact of FII on stock arcade:

• They increased depth and breadth of the arcade.

• They played major role in expanding securities business.

• Their policy on focusing on fundamentals of share had caused efficient pricing of share.

These impacts made the Indian stock arcade more attractive to FII & also domestic stakeholders. The impact of FII is so high that whenever FII tend to withdraw the money from arcade, the domestic stakeholders fearful and they also withdraw from arcade.

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FII Investment 1992-93 to Nov 30 2012 (In INR Crores)

FY	Equity	Debt	Net Investment
92-93	13.40	0.00	13.40
93-94	5,126.50	0.00	5,126.50
94-95	4,796.30	0.00	4,796.30
95-96	6,942.00	0.00	6,942.00
96-97	8,545.60	28.90	8,574.50
97-98	5,267.00	691.05	5,958.05
98-99	-717.20	-867.00	-1,584.20
99-00	9,669.50	452.60	10,122.10
00-01	10,206.70	-273.30	9,933.40
01-02	8,072.20	690.40	8,762.60
02-03	2,527.20	162.10	2,689.30
03-04	39,959.70	5,805.00	45,764.70
04-05	44,122.70	1,758.60	45,881.30
05-06	48,800.50	-7,333.80	41,446.70
06-07	25,235.70	5,604.70	30,840.40
07-08	53,403.80	12,775.30	66,179.10
08-09	-47706.20	1,895.20	-45,811.00
09-10	1,10,220.60	32,437.70	1,42,658.30
10-11	1,10,120.80	36,317.30	1,46,438.10
11-12	43,737.60	49,987.90	93,725.50
12-13	59,322.00	13,887.00	73,209.00
Total	**4,88,344.40**	**1,54,019.65**	**7,01,686.05**

Note:- The data presented above is compiled on the basis of reports submitted to SEBI by custodians and constitutes trades conducted by FIIs on and up to the previous trading days.

Impact on rates

Along with the domestic mutual funds, the FIIs have started playing a critical role in the movement of stock prices. The assets under management of domestic mutual funds have crossed Rs. 100,000 crores. About half of these funds are income funds, and the remaining balanced funds and equity funds. Hence, the FIIs and the domestic mutual funds play an important part in the movement of stock prices. A few other developments have strengthened the role of the FIIs. The Unit Trust of India's share in mutual fund collection has been going down. In fact, the UTI today is more successful with its income funds rather than with equity funds. In recent months, privately managed domestic mutual funds have been the most successful in garnering fresh funds from the public. Not surprisingly a few of these external owned fund managers are also well known names among FIIs.

Another development during recent years has been the declining role of development financial institutions (DFIs) such as IDBI, ICICI and IFCI in the capital arcades. This is partly on account of their limited access to cheap funds and partly because of the withdrawls of the convertibility clause under which these DFIs managed to acquire equity shares of companies which were financed by them.

A positive contribution of the FIIs has been their role in improving the stock arcade infrastructure. The SEBI has no doubt contributed much in improving the stock exchange infrastructure. However, it is doubtful whether one would have witnessed such rapid developments in computerizing the operations of the stock arcades and introduction of paperless trading in the demat form if the FIIs had not built up pressure on the authorities to move in this direction.

The FIIs are playing an important role in bringing in funds needed by the equity arcade. Additionally, they are contributing to the external exchange inflow as the funds from multilateral finance institutions and FDI are insufficient. However, the fact remains that FII investments are volatile and arcade driven, but this risk has to be taken if the country has to ensure steady inflow of external funds.

FII Movement for preceding centuries

FII Activity is the year wise list of Gross Buy (in Crores) and Sell (in Crores) investments done by External Organised Stakeholders, their Net Investment Positions for those year as on that year in Crore with a break up of Investments made in Equity and Debt instruments.

Year	Gross purchase (Cr)	Gross sale (Cr)	Net Investment (Cr)
2012	669184.40	540823.90	128360.70
2011	611055.60	613770.80	-357.83
2010	766283.20	633017.10	29361.83
2009	624239.70	540814.70	17458.14
2008	721607.00	774594.30	-11974.30
2007	814877.90	743392.00	17655.80
2006	475624.90	439084.10	8107.00
2005	286021.40	238840.90	10706.30
2004	185672.00	146706.80	8669.80
2003	94412.00	63953.50	6627.60
2002	46479.10	42849.80	749.50
2001	51761.20	38651.00	2806.40
2000	74791.50	68421.60	1532.60

Improvement to Indian

India is considered to be the third most favored destination for investment after China and the US for major global companies, according to UNCTAD's World Investment Report 2012. The report anticipates that external investments in India could increase by over 20% in 2012-13. So, let's see what sets India apart:

- India has the second highest growth rate in the world. Its GDP is growing at 5.30% even in times of an economic slowdown, while developed countries like the US, Euro Area, UK & Germany stand at 2.50%, -0.60%, -0.10%, and 0.40%, respectively. Going forward, it is expected to continue its strong growth path on back of huge investment and favorable demographics. This growth differential between India and the developed countries seems to be working in favor of India.

- Another reason for attracting external investment is India's favorable economic development and change in consumer lifestyle over the last decade. Factors like India's young population (average age of 25 years) leading to a greater proportion of working-age population as compared to any other country, higher disposable income, growing urbanization, rural expansion, infrastructure development, increased participation of women in the workforce etc. promoting economic development, have built confidence among stakeholders about the future of India.
- Policy initiatives like the infrastructure sector investments being committed $1 trillion in the 2012-17 five-year plan, increase in FDI cap in the Aviation and Multi-brand retail sectors were announced recently. Also, the GST (Goods & Services Tax) and DTC (Direct Tax Code) are being contemplated to be introduced in India. These are positive signs of growth and development being envisaged, and implemented in India.

All the above factors will drive the GDP growth in future which would fuel the growth in the Indian equity arcade.

Propping up stocks

Investing in stocks with high FII interest can give good returns. For instance, the FII holding in HDFC has been 58-60% since 2008. Similarly, the FII holding in ICICI Bank has been 38-40% for years. Between March 2008 and 29 September 2011, HDFC Bank and ICICI Bank have risen 35% and 20%, respectively.

"Most banks have hit the FII investment limit, in which case there is always a buyer and a seller FII for the stock," says Parmar. At present, FIIs can hold up to 24% paid-up capital of an Indian company and 20% of a public sector bank. This can be raised after approval from the company's board.

The stocks-out of top 20 in BSE 500 on the basis of FII holding -that have seen a rise in FII interest since March 2008 include Yes Bank, Shriram Transport Finance, agriculture stocks such as Jain Irrigation and REI Agro, and United Spirits. Yes Bank and Shriram Transport Finance stocks have doubled in this period.

While you can gain by investing on the basis of what FIIs are doing, FII inflows can reverse any time and work against you. Out of the top 20 stocks with the highest FII holding in September 2011, real estate stocks such as India bulls Real Estate and IVRCL Infrastructure have seen a huge drop in FII interest. The FII holding in the former has fallen from 69% in December 2009 to 49%. The fall in case of IVRCL has been from 58% to 48%. IVRCL has lost 90% of its value since December 2009 while Indiabulls Real Estate is down 75%.

Reformed in 2011

FIIs have invested just $200 million until September 2011 compared with $30 billion in 2010. This has affected the performance of the Sensex, which has fallen 11% this year. "While the outflow this year has been 1% of that in 2008 ($12 billion), India funds have seen redemptions in 20 of the past 21 weeks," says Paulson.

There are a number of factors that influence FII investment. Generally, the most important are valuations and earning expectations. It's natural that relative valuations and earnings growth expectations come into play when somebody has an option of investing across countries.

"The other factors that have influenced FII investment are high inflation, aggressive tightening by RBI and escalation of corruption as an issue," says Paulson. Corporate governance has of late become very important.

What hurt in 2008 was not the performance of firms but the rapid outflow of Rs 55,000 crore as stakeholders fled risky assets."

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Investment constraints

Portfolio investments in primary or secondary arcades were initially subject to a ceiling of 24 per cent of issued and paid up share capital for the total holdings of all registered FIIs in any one company, taking into account the conversions arising out of the fully and partly convertible debentures issued by the company. Further, the maximum holding of 24 per cent, for all FII investments did not include portfolio investments by non-resident Indians (NRIs), NRI-OCBs (overseas corporate bodies), direct external investments, offshore single/regional funds, global depository receipts and euro convertibles. In the case of public sector banks, the overall limit is 20 per cent of the paid-up capital.

In 1997, it was decided to increase the limit of aggregate investment in a company by FIIs to 30 per cent of issued and paid-up share capital, subject to the condition that the board of directors of the company approved the limit and the general body of the company passed a special resolution in this behalf. Further, the Finance Minister in his budget speech in February this year announced that, subject to approval by the board of directors and a special resolution of the general body of the company, this limit of external portfolio investment was being increased to 40 per cent of issued and paid-up capital of a company.

The holdings of a single FII in any company are also subject to a ceiling of 10 per cent of total issued capital. For this purpose, the holdings of an FII group will be counted as holdings of a single FII.

In addition to FIIs, NRIs, OCBs and Persons of Indian Origin (PIOs) are allowed to invest in the primary and secondary capital arcades in India through the portfolio investment scheme (PIS). Under this scheme, NRIs/OCBs/PIOs can acquire shares/debentures of Indian companies through stock exchanges in India.

The ceiling on overall investment is 10 per cent for NRIs/OCBs/PIOs. This ceiling can be raised to 24 per cent, subject to the approval of the general body of the company passing a resolution to that effect. Further, the ceiling for FIIs is independent of the ceiling of 10/24 per cent for NRIs/OCBs/PIOs. If one adds the amount that can be raised by Indian companies in the form of FDI and euro issues, one realises that the external investment norms applicable to Indian companies have become liberal.

The RBI monitors the ceilings on FII/NRI/OCB/PIO investments in Indian companies on a daily basis. In order to prevent crossing of the ceilings, the RBI has fixed cut-off points that are two percentage points lower than the actual ceilings. The cut-off point, for instance, is fixed at 8 per cent for companies in which NRIs/OCBs/ PIOs can invest up to 10 per cent of the company's paid up capital. The cut-off limit for companies with 24 per cent ceiling is 22 per cent and for companies with 30 per cent ceiling, is 28 per cent. Similarly, the cut-off limit for public sector banks (including State Bank of India) is 18 per cent.

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FII in India

India is well placed to attract FII flows over the long term. With FIIs holding 16 per cent of equity of India's biggest 500 companies (Source: India Brand Equity Foundation) and as growth in the Indian economy accelerates, FII sentiment is expected to remain positive towards India.

Indian equities have attracted more external organised flows than any other Asian arcade so far in 2012 as portfolio investments resumed in July on renewed hopes of policy action by the government to revive the economic growth. External funds have poured close to $11 billion (Rs 55,000 crore) into Indian equities so far this year with the second highest being South Korea, which clocked flows worth $6.3 billion (Rs 31,500 crore) since January.

Outcomes and Deduction:

- Domestic sources of outside finance are restricted in many countries, particularly those with emerging arcades. Through capital arcade liberalization, external capital has become increasingly significant source of finance.
- Since India is a labour intensive country. Therefore, in developing countries like India external capital supports in snowballing the productivity of labour and to figure up external exchange reserves to meet the current account deficit. External Investment delivers a channel through which country can have access to external capital.
- It is requisite to understand when they withdraw their funds and when they pump in more money. Higher Sensex indices and high price earnings ratio are the country level factors attracting more external investment in India.
- This broadsheet empirically observed that the research that arcade performance is the strong basis for attracting more external investment for the individual companies in India. The external organised stakeholders with draw their money when the stock arcade performance starts sliding down.

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