An Analysis of impact of Select Variables on Foreign Institutional Investment: A Review of Literature

Dr Pravin Kumar Agrawal, Assistant Professor, School of Business Management, CSJM University, Kanpur. Email: drpravinagrawal@csjmu.ac.in
Dr Tanu Jain, Independent Researcher, Nagpur, Email: agarwaltanu87@gmail.com
Dr Sanjeev Kumar Singh, Assistant Professor, School of Business Management, CSJM University, Kanpur. Email: drsanjeevksingh@csjmu.ac.in
Dr Mohit Kumar , Assistant Professor, School of Business Management, CSJM University Kanpur.
Email: drmohitkumar@csjmu.ac.in

Abstract

Foreign Institutional Investors (FIIs) were invited, on a guideline issued by Government of India in 1992. This inculcated a sea -change in entire gamut of financial market, not thought of before. This research attempts to examine its relevance in the current context and impact on Indian economy and financial market. On establishing the relationship of several macroeconomic variables with FIIs' flow of fund in India, broadly three sections have been drawn with the two variables each. First, in external variables; current account deficit and foreign direct investment, second, in domestic macroeconomic variables; index of industrial production and fiscal deficit, third, in domestic financial market variables; Sensex and mutual fund investment, have been included in the study.

Keywords: Foreign Institutional Investors (FIIs), current account deficit, foreign direct investment, index of industrial production and fiscal deficit.

1. Introduction

As per Clause 2(f) of the Securities and Exchange Board of India (SEBI) (FIIs)Regulations, 1995, Foreign Institutional Investor (FII) means "an institution established or incorporated outside India which proposes to make investment in India in securities."Chapter 2, Clause 2.2, Sub-Clause 2.1.14 of Consolidated FDI Policy (2015) defines the FII as "an entity established or incorporated outside India which proposes to make investment in India and which is registered as a FII in accordance with the SEBI (FIIs) Regulations, 1995."Institutions include any artificial juridical person. FIIs are regulated by an appropriate foreign regulatory authority: provided that University Fund, Endowment, Foundation, Charitable Societies may not be regulated by any such foreign regulatory authority. There is a simultaneous approval for registration of FIIs in SEBI and by RBI under Foreign Exchange Management Act (FEMA) [SEBI (FIIs) Regulations, 1995].

FIIs brought in foreign currency on the strength of Indian economy and stability of Rupee conversion value. Rupee value in the international market was normally dependent on current account deficit, India had been facing the devaluation crisis largely since eruption of Sub-Prime crisis. FIIs' inflows could offset losses on current account deficit. In first, pre Sub-Prime duration, there was a multiple increase in current account deficit of `136.89 billion in fourth quarter of 2007-08 against a deficit of`19.86 billion in first quarter of 2003-04. In post Sub-Prime duration, there has been a continuous surge in current account deficit from `142 billion in first quarter of 2003-04 to Rs. 984 billion in fourth quarter of 2012-13 respectively. FIIs continued to be in withdrawal mode from last quarter of 2007-08 to last quarter 2008-09 showing revival in inflows from 2009-10 to 2012-13

Focus of the study herein, is to study the impact of select variable on FIIs in Indian context, being influenced and affected by several macro-economic and financial parameters.

2. Objective of the Study

The main focus of this paper is to review the literature related to the impact of macroeconomic variable on FIIs Investment in an organized manner. This is an attempt to better understand the behavior of macroeconomic variable and FIIs Investment. A summary of all the select previous studies with special reference to India will add value to all researchers, investors, and practitioners,

3. Data and Methodology

The present paper covers research studies from reputed national and international journals based on macroeconomic variable and FIIs Investment from various countries of the world. Some more papers were available, but we have concentrated on those papers which fulfill the objective of our study.

4. Review of Literature

4.1 Foreign Exchange Reserve

FIIs have proven to be the carrier of globalization over its inception in 1992, as they keep on balancing the liquidity, the rate of return across the world. FIIs' hot money always searches for a greener pasture across the political boundaries. Several external variables such as, foreign exchange reserve, current account deficit, exchange rate and foreign direct investment do influence FIIs investment decision.

There exists short and long run relationship between foreign exchange reserve and private foreign capital inflows in India (Sethi, 2012). FIIs have played a significant role in building up a strong Balance of Payment position of the Country (Morgan, 2002 as cited by Shukla, Upadhyaya and Jain, 2011).

4.2 Current Account Deficit

The factor such as current account deficit is affected by negative movement of exchange rate and that narrows down foreign investments also. Outflow of FIIs lead the depreciation of Rupee against US Dollar that adversely affects current account deficit on increasing import bills. Widening current account deficit creates a pressure for outflow of foreign funds (Omkar and Pillai, 2013). A weak Balance of Payment status could lose the confidence of FIIs in economy as happened in case of Mexico in 1994 and Thailand in 1997. FIIs started withdrawing fund from Thailand stock market due to the current account deficit and depreciation of Baht (Samal, 1997).

4.3 Exchange Rate

FIIs consider exchange rate as an important determinant for infusing capital in India (Dua and Garg, 2013; Kumar, 2011). FIIs put an effect on exchange value of Rupee against US Dollar. Inflow of foreign capital causes exchange rate appreciation that ultimately leads to an increase in net import of goods and services (Rakshit, 2006).

4.4 Foreign Direct Investment

Foreign direct investment is the foremost external variable that contributes towards the development of economy. Continuous inflow of foreign direct investment provides opportunity to Indian corporate towards technological up gradation, hiring global managerial skills and practices, utilization of human and natural resources and attaining global competitive advantage, on improving efficiency followed up with return. FIIs and foreign direct investment both are positively associated with stock market. Foreign direct investment is more preferred form of foreign investment than FIIs for economy as a whole (Jain, Meena and Mathur, 2013).

4.5 Fiscal Deficit

Fiscal deficit represents the excess of government expenditure over income. On eruption of Sub-Prime financial crisis 2007 in USA, several developing economies started experiencing increase in fiscal deficit that were consequently imposed with risk of loss of foreign capital (Bose and Jha, 2011). A government may initiate several measures to reduce fiscal deficit. One of the measures is to attract and encourage infusion of foreign capital. Foreign capital helps in improving the economic stability with fall in fiscal deficit and surge in forex flow. A narrowed fiscal deficit strengthens the economy that boosts the confidence of FIIs.

4.6 Wholesale Price Index

Inflation and risk condition in the domestic economy and a higher return in the foreign Country adversely affect the FIIs' flows in home Country and vice-versa (Rai and Bhanumurthy, 2004). Domestic inflation rate poses negative and significant influence on FIIs' flows in short run (Srinivasan and Kalaivani, 2013).

5. Research Gaps

i. A systematic analysis of trend of FIIs' investment in India separately in two durations that is before the occurrence of Sub-Prime crisis in 2008 and thereafter have not been comprehended together.

ii. Little effort has been made to study the relationship between FIIs' investment and Index of Industrial Production as it signifies the potential of investment in domestic industries.

iii. On adopting a top-down approach, in an as an emerging economy, higher fiscal deficit amounts to influence corporate return adversely. There is a need to examine the relationship between FIIs' investment and fiscal deficit.

6. Conclusion

Current account deficit remained subsidiary to FIIs' net investment, though loss of Current Account in Balance of Payment statement is off-set with inflows of FIIs' investment in Capital Account. India should review its basket of import, like crude oil and gold in terms of trimming its burden on trade balance. Any curb on non-essential and non-productive import could improve current account deficit favourably and thereby dependence on FIIs' inflow as a foreign exchange earner shall fall. That would lead to Rupee to improve, cost of import to fall and current account deficit automatically to narrow down and encourage FIIs' investment in India. Foreign direct investment used to influence net investment by FIIs in pre Sub-Prime duration but inter-dependence of foreign direct investment and FIIs' net investment evaporated in post Sub-Prime and full durations that long term investment of FDI later on converged into a non-influencing factor to India's FII-inflows scenario. An economy depends largely on long term investment either in manufacturing or services that pays off to national income and finally in employment generation. FIIs' inflow could not prove to be a facilitator to foreign direct investment along with Special focus on development should be drawn to facilitate larger foreign direct investment inflows to India and not wholly depending upon FIIs as an alternative capital investor. Health of a national economy is reflected in quantum of fiscal deficit, a Country is striving for. Macro economy of a Country besides others, derives liquidity, investment and interest rate determination, out of budgetary provisions and its fiscal deficit. Like index of industrial production in pre Sub-Prime duration, fiscal deficit also drove FIIs' net investment and in post Sub-Prime duration, it was the turn of net investment by FIIs to influence fiscal deficit and in full duration, both found to be mutually dependent. Interest rate differential between India and other developed countries induce FIIs' plan for investment across the globe. Higher fiscal deficit leads to larger federal borrowings, pulling up interest rate that amounts to impact cost of capital and profitability of investee-companies adversely. Loss of revenue on unproductive expenses if curtailed, larger investment made in infrastructure, reducing gestation period thereby enhancing output, could lead better management of fiscal deficit attracting FIIs' in India.

References

Bose, S. (2012, September).Mutual Fund Investments, FII Investments and Stock Market Returns in India.*ICRA Bulletin, Money & Finance*, 89-110.

Dua, P. and Garg, R. (2013, February).*Foreign Portfolio Investment Flows to India-Determinants and Analysis* (No. 225). Retrieved from http://www.cdedse.org/pdf/work225.pdf

Jain, D., Meena, P. L. and Mathur, D. R. T. N. (2013, March).Role of Foreign Direct Investment and Foreign Institutional Investment in Indian Economy.*Asian Journal of Multidimensional Research*, 2(3), 6-22

Kumar, R. (2011, October). Determinants of FIIs in India: Evidence from Granger Causality Test. *South Asian Journal of Marketing and Management Research*, 1(1), 61-68.

Morgan, S. (2002). FII's influence on Stock Market.*Journal of Impact of Institutional Investors on ISM*, 17. Publisher: Emerald Group Publishing Limited.

Omkar, K. and Pillai, S. (2013). *Relationship between the Current Account Deficit, Indian Rupee and Foreign Investments: A Periodic Study*. Retrieved fromhttp://investorsareidiots.com/wp-content/uploads/2013/08/Internship-Final-Report-Omkar-and-Shweta.pdf

Rai, K. and Bhanumurthy, N. R. (2004, December). Determinants of Foreign Institutional Investment in India: The Role of Return, Risk and Inflation. *The Developing Economies*, 42(4), 479-493.
Rakshit, M. (2006).On Liberalizing Foreign Institutional Investments.*Economic and Political weekly*, 991-1000.
Samal, K. C. (1997). Emerging Equity Market in India: Role of Foreign Institutional Investors.*Economic and Political Weekly*, 2729-2732.
Sethi, N. (2012). Inflows and their Macroeconomic Impact in India a VAR Analysis. *The Romanian Economic Journal*, 15(46), 93-142.
Shukla, R. K., Upadhyaya, A. and Jain, S. (2011). *FII Equity Investment and Indian Capital Market - An Empirical Investigation*. Retrieved June 18, 2014, from http://www.pbr.co.in/Brochure/008.pdf
Srinivasan, P. and Kalaivani, M. (2013). Determinants of Foreign Institutional Investment in India: An Empirical Analysis, *MPRA, Paper No. 43778.* Retrieved from http://mpra.ub.uni-muenchen.de/43778/1/MPRA_paper_43778.pdf