

IMPACT OF DOMESTIC INSTITUTIONAL INVESTORS ON FOREIGN INSTITUTIONAL INVESTORS IN INDIA: AN ANALYSIS

Tanu Jain*
Satyendra P. Singh**

ABSTRACT

Foreign institutional investors (FIIs) play a vital role in the stock market of a country and Indian stock markets are no exception to this. FIIs bring liquidity, buoyancy and growth in stock markets but at the same time they also enhance the level of volatility and instability. Over past few years the stock markets in India have shown an impressive growth. The stock market indices are making new strides and increasing number of shares are making new highs. Following India's impressive growth story, increasing corporate profitability and competitiveness, and better integration with the world economy, the investment by foreign institutional investors (FIIs) in the stock markets of India has gone up tremendously.

Investment decisions of foreign institutional investors in India are affected by so many factors. Investment behavior of domestic institutional investors (DIIs) is one such important factor. This research paper is an attempt to analyze the impact of domestic institutional investors on the investment decision of foreign institutional investors in India. In other words, this study explores whether Domestic Institutional Investors affect the investment decisions of Foreign Institutional Investors in India or not. For this purpose, researchers have used regression analysis. Mutual fund investments have been taken as proxy for investment by DIIs. Investment patterns of FIIs and DIIs have been divided into eight variables i.e. FII Equity Purchases, FII Equity Sales, FII Debt Purchases, FII Debt Sales, MF Equity Purchases, MF Equity Sales, MF Debt Purchases and MF Debt Sales respectively. The study reveals that investment decisions of DIIs affect the investment decisions of FIIs.

Keywords: *FIIs, DIIs, Investment Decision, Equity Purchases and Sales, Debt Purchases and Sales*

***Independent Researcher & Free Lance Professional, Brahmपुरi, Raipur, C.G.,
E-mail: tanuagarwal2105@gmail.com**

****Professor, Alliance School of Business, Alliance University, Chandapura-Anekal Main Road, Anekal, Bengaluru. www.alliance.edu.in. E-mail: satyendras.14@gmail.com**

1. INTRODUCTION

Indian economy faced the balance of payment crisis in 1990-91 because of which government of India introduced the liberalization policy in 1991-92. During this era, on 14th September 1992, for the first time FIIs were permitted to invest in all the listed securities of Indian capital market to reduce country's dependence on debt-creating capital flows, correct the balance of payment position and develop the capital and security markets (Gordon and Gupta, 2003; Dhamija, 2008; Kaur and Dhillon, 2010; Loomba, 2012). Along with that, the new economic policy introduced large number of policy changes in India to integrate domestic financial market with global markets which would permit free flow of capital from developed to developing economies, resulting into higher rate of return, increased productivity and capital efficiency at global level (Chakraborty, 2007; Bekaert and Harvey, 2000).

Foreign capital plays a significant role in the development of every national economy (Goudarzi and Ramanarayanan, 2011). Apart from foreign investment, domestic investment also contributes towards the growth and development of capital market of the country. There are two major categories of institutional investors in Indian financial market namely Foreign Institutional Investors and Domestic Institutional Investors (primarily Mutual Funds). Ever since the new economic policy started, FII net investments have been positive in India every year except 1998-99, 2007-08 and 2008-09. Country has received large amount of FII flows after 2003 (SEBI). At the end of March 2018, FIIs' cumulative net investment has reached \$253539.04 million as compared to \$15939.4 million in March 2003 (NSDL, 2019). At the end of fourth quarter of 2017-18, mutual funds' net Investment resulted into an inflow of Rs. 128232.22 crore in comparison to Rs. 13645.43 crore through FII investments (SEBI, 2018). At the end of same quarter, the number of FPIs registered with SEBI has increased to 9227 (SEBI, 2018).

Stock market returns are determined by the combination of domestic as well as foreign investments. Domestic or local investors seize greater knowledge about Indian financial markets than that of foreign investors who belong to some other country (Chakraborty, 2007). Over the last few years, FIIs and MFs both have contributed in the subsequent increase in the stock prices of Indian capital market (Mukherjee and Roy, 2011). Every investor has a similar objective of investment such as maximum returns, risk exposure, favorable economic and liquidity condition of the investing country (Anuradha and Rajendran, 2012). Stock market provides investors with large number of scrips with varying degree of risk, return and liquidity.

This research paper is an attempt to analyze the impact of domestic institutional investors on the investment decisions of foreign institutional investors in India. The remaining paper progresses in the following manner: section two deals with the review of literature, while section three talks about objectives of this study. Section four entails database and methodology, describing the nature of data and sources from which relevant data has been collected, the tools and techniques employed in the study, followed by data analysis and interpretation in section five. Lastly, Section six deals with conclusion and discussion.

2. LITERATURE REVIEW

2.1 Determinants and Implications of FIIs in Indian Stock Market

The term FIIs has been conceptually and empirically explained by various researchers to illustrate its effectiveness in the Indian capital market. Rao, Murthy, and Ranganathan (1999) observed that only few FIIs are active on the Indian stock market. They further observed that US-based India specific funds suggested a close resemblance between FII investment profile and trading pattern at the BSE. Chakraborty (2007) detected the direction of causality between FII flows and Indian stock market returns and described that the causality between FII flows and stock returns are highly model specific.

However, Srikanth and Kishore (2012) observed that there was bi-directional causality between net FII inflows and the Sensex which mutually reinforced each other.

Jalota (2017) conducted a study on the behavioural aspects of FIIs and DIIs in order to study the relationship between the two. The study shows a high negative correlation between FIIs and DIIs. Salar (2016) conducted a study to judge the impact of DIIs on Indian stock market. He examined the relationship between DIIs and Sensex (representative of India stock market). The causality between the investments made by Domestic Institutional Investors and movement of Sensex were analyzed using Granger causality test. The data from 2009 to 2016 was analyzed by taking the net investments made by DIIs and closing values of Sensex. Periyasami and Kumar (2016) conducted a study to judge the impact of institutional Investors on Indian Stock Market. The study was conducted using the movement of Nifty with the contribution of DII and FII transactions from January 2007 to August 2015. The study shows that there is a positive correlation between Institutional investments and market movement over the period.

Srinivas (2016) conducted a study to find out the impact of FIIs on Indian Stock Market. The study covers statistical analysis of FII flows and its impact on the Sensex from 2008 to 2013, where the focus is Global financial crisis of 2008 and Euro zone crisis of 2011. The study shows positive correlation between the FII flows and the movement of Sensex. The study also reveals that FIIs are the dominant player in Indian stock market. Bhattacharje and Upadhyay (2014) concluded that there exists high degree of positive correlation ship between Sensex and FII inflows trends. FIIs have positive impact on BSE Sensex and Nifty. However, there are other major factors that influence the bourses in the stock market but FIIs definitely is one of the factors. This signifies that market rise with increase in FII's and collapse when FII's are withdrawn from the market.

Prasanna (2008) highlighted about the contribution of FIIs particularly among the companies in the sensitivity index of the BSE. He also examined the relationship between FIIs' investment and firm specific characteristics in terms of ownership structure, financial performance and stock performance. They pointed out that foreign investments are more in companies which have high volume of publicly held shares. They further found that in financial performance variables, share returns and earnings per share are more influencing variables on the investment decision. However, Gupta (2011) provided evidence which shows that Indian Stock Market and FIIs both influence each other but their timing of influence is different.

Sehgal and Tripathi (2009) concluded that both the domestic foreign institutional investors (DFIIs) or MFs and FIIs follow a positive feedback trading mechanism chasing stock market returns and FIIs seem to be reacting faster compared to DFIIs in the case of the equity market. Saha (2009) found that Indian market offers reasonable safe returns in the emerging market space. Bansal and Pasricha (2009) explained that there is no significant change in the Indian stock market average returns after the opening up of the stock market for the FIIs. According to Bohra and Dutt (2011) the behavior of FII in last decade was opportunistic whereas Profit accumulation was prime objective behind the portfolio investments in India.

Mukherjee and Roy (2011) compared the nature and determinants of MF decisions to that of the FIIs. Author s found that MFs influence the decision of FIIs when they invest in equity and FIIs do exactly opposite to what MFs do. MFs are more cautious when they invest in debt compared to equity. Jain, Meena, and Mathur (2012) observed that FIIs are influencing the Sensex movement to a greater extent. Sensex has increased when there are positive inflows of FIIs and vice-versa. Siddiqui and Azad (2012) found that FIIs have a significant influence on the Indian financial market indices. Loomba (2012) provided the evidence of significant positive correlation between FII activity and effects on Indian

Capital Market.

Bose (2012) explored the interaction between the investment flows of FIIs and MFs of the post crisis period from April 1, 2008 to March 31, 2012 on daily basis. The author found strong negative relationship between them. Domestic MFs determined their investment flows on the basis of their own previous investments, FII investments and market returns.

Dasgupta (2012) aimed to investigate the impact of and relationship between FII and MF net flows in Indian stock market from April 2007 to March 2012 using monthly data. The study found no short term as well as long term relationship between them.

Hence, most of the researchers (Rao, Murthy, and Ranganathan, 1999; Chakraborty, 2007; Kumar, N.A; Saha, 2009; Bansal and Pasricha, 2009; Gupta, 2011; Srikanth and Kishore, 2012; Loomba, 2012) have given their emphasis about its relation with Indian stock market along with the amount of volatility to be involved in it. There are rich literature in which Micro economic variables and Firm level characteristics are considered to be important determinants of FII Investment (Rao, Murthy, and Ranganathan, 1999; Prasanna, 2008; Tripathi, 2008; Dhamija 2008; Saha, 2009; Bansal and Pasricha, 2009; Kaur and Dhillon, 2010; Lakshmi, 2011; Bohra and Dutt, 2011; Mukherjee and Roy, 2011; Jain, Meena, and Mathur, 2012; Siddiqui and Azad, 2012; Anuradha and Rajendran, 2012; Srikanth and Kishore, 2012).

Vast literature has been found that defines the cause and effect relationship between variables by employing Granger Causality Test (Chakraborty, 2007; Sehgal and Tripathi, 2009a; Ray, 2009; Sehgal and Tripathi, 2009b; Mishra, Das, and Pradhan, 2010; Mukherjee and Roy, 2011; Srikanth and Kishore, 2012).

2.2 Determinants and Implications of FIIs in Global Stock Market

The significance of FII flows has been observed all over the world. Various researchers have provided an evidence regarding the importance of FIIs in Global Stock Markets. The researchers particularly Aggarwal, Klapper, and Wysocki (2005); Chen, Wang, and Lin (2008); Ting, Yen, and Chiu (2008); Burnie and Ridder (2009); Kim, Sul, and Kang (2010); Lee and Fang (2011); Bredin and Liu (2011); Boubakri, Hamza, and Kooli (2011); Abdioglu, Khurshed, and Stathopoulos (2012) have observed about the market behavior of US, Taiwan, China, Sweden and Korea market.

Aggarwal, Klapper, and Wysocki (2005) examined that at the country level, US Mutual funds invest more in open emerging markets with stronger accounting standards, shareholder rights, and legal frameworks. At the firm level, US funds are found to invest more in firms that adopt discretionary policies such as greater accounting transparency and the issuance of an ADR. Stepanyan (2011) examined the role of institutional investors in accelerating the development of capital markets and economies abroad, the determinants of their investment, both in the domestic and foreign markets. Abdioglu, Khurshed, and Stathopoulos (2012) observed the investment preferences of foreign institutional investors investing in the U.S. market. The study analyzed both firm and country-level determinants that influence the foreign Institutional investors' allocation choices.

However, In the Global context the researchers have given more emphasis to Corporate Governance Practices (Chen, Wang, and Lin, 2008; Kim, Sul, and Kang, 2010; Bredin and Liu, 2011; Stepanyan, 2011; Abdioglu, Khurshed, and Stathopoulos, 2012) which is an important determinant attracting more FII inflows into the stock market.

3. OBJECTIVES OF STUDY

The study has been conducted keeping in minds the following objectives:

1. To evaluate the impact of inflow and outflow decision of domestic institutional investors on foreign institutional investors' inflow and outflow decision in India
2. To find out whether there is any contrast relationship between purchase and sales decisions of foreign and domestic institutional investors in India or not

4. METHODOLOGICAL FRAMEWORK

4.1. Sample and Data Collection

The time series data have been taken in the study that is quantitative and secondary in nature. Mutual fund investment has been taken as proxy for domestic institutional investors (DIIs). To address the objective and gather the relationship between the FIIs and DIIs inflow and outflow decisions, their investment patterns have been divided into eight variables namely FII Equity Purchase, FII Equity Sales, FII Debt Purchase, FII Debt Sales, MF Equity Purchase, MF Equity Sales, MF Debt Purchase and MF Debt Sales respectively. Inflow and outflow of funds by both these investors class have been segregated into their equity and debt investment in order to conduct in depth study. Required data has been collected from the website of Securities and Exchange Board of India (SEBI) and National Securities Depository Limited (NSDL). Acronyms have been used for all the variables. The description of the variables along with the sources from which the data has been collected is presented in the Table 1.

Table 1: Description of Variables and Sources of Data

Variables	Acronyms	Sources
FII Equity Purchase	FEP	SEBI and NSDL
FII Equity Sales	FES	SEBI and NSDL
FII Debt Purchase	FDP	SEBI and NSDL
FII Debt Sales	FDS	SEBI and NSDL
MF Equity Purchase	MEP	SEBI
MF Equity Sales	MES	SEBI
MF Debt Purchase	MDP	SEBI
MF Debt Sales	MDS	SEBI

The time frame for the study has been taken from financial year 2001-02 to 2016-17 and the data has been collected on monthly basis.

4.2. Statistical Tools and Techniques

Collected data has been analyzed by applying relevant statistical tools such as Correlation and Linear Regression Analysis to address the objectives of the study. SPSS 16.0 version is used to analyze the collected data.

4.3. Model/ Hypotheses Framing

Dependence of one variable on other variable (s) could be predicted through Regression analysis.

It requires formulation of regression models to determine relationship among the variables. In the study, FII is considered as dependent whereas MF as independent variable. The study also deals with the contrast relationship between FIIs equity and debt purchase and sales decision with MFs equity and debt purchase and sales decision. Total eight models have been framed to test the relationship between these two investor classes. Hypotheses behind the models are shown in the Table 2.

Table 2: Description of Hypotheses

H.No.	Null Hypothesis	H.No.	Alternate Hypothesis
H01	MEP does not affect the investment decision of FEP in India	H1	MEP affects the investment decision of FEP in India
H02	MES does not affect the investment decision of FES in India	H2	MES affects the investment decision of FES in India
H03	MDP does not affect the investment decision of FDP in India	H3	MDP affectsthe investment decision of FDP in India
H04	MDS does not affect the investment decision of FDS in India	H4	MDS affectsthe investment decision of FDS in India
H05	MES does not affect the investment decision of FEP in India	H5	MES affectsthe investment decision of FEP in India
H06	MEP does not affect the investment decision of FES in India	H6	MEP affects the investment decision of FES in India
H07	MDS does not affect the investment decision of FDP in India	H7	MDS affects the investment decision of FDP in India
H08	MDP does not affect the investment decision of FDS in India	H8	MDP affects the investment decision of FDS in India

To test the above hypotheses, eight regression equations have formulated and presented in Table 3.

Table 3: Description of Models

S.No.	Dependent Variable	Independent Variable	Equation
1.	FEP	MEP	$FEP_t = C + MEP + e$
2.	FES	MES	$FES_t = C + MES + e$
3.	FDP	MDP	$FDP_t = C + MDP + e$
4.	FDS	MDS	$FDS_t = C + MDS + e$
5.	FEP	MES	$FEP_t = C + MES + e$
6.	FES	MEP	$FES_t = C + MEP + e$
7.	FDP	MDS	$FDP_t = C + MDS + e$
8.	FDS	MDP	$FDS_t = C + MDP + e$

Where, t = for a given period C = Constant

5. DATA ANALYSIS AND INTERPRETATION

5.1 Correlation Analysis: Results and Interpretation

Correlation analysis describes the degree and strength of relationship among the variables. It does not deal with the causality and only defines whether the relationship between the variables exists or not? Table 4, shows the bivariate relationship among all the variables. The values depict high degree of positive and strong association among the variables in the study. All the variables are found to be significant at 0.1% significance level. The result indicates that these two investor classes are highly associated with each other and could influence the decision of each other in India. Hence, their patterns of investments are strongly correlated in Indian capital market.

Table 4: Correlation Table

	MEP
FEP	.868*
	MES
FES	.880*
	MDP
FDP	.843*
	MDS
FDS	.836*
	MES
FEP	.901*
	MEP
FES	.906*
	MDS
FDP	.836*
	MDP
FDS	.825*
Note: *p<0.001	

5.2 Regression Analysis: Results and Interpretation

Model summary (Table 5) describes the acceptability of the models. To check the validation of the models, R, R-square and adjusted R-square values are considered. R represents the multiple correlation coefficients between dependent and independent variable(s). In this study, linear regression analysis has been applied and therefore the value of R is same as that of the value of correlation coefficients (Table 4). R-Square is a squared value of R and defines the explanatory power of the model. Explanatory power of the model would increase with the higher R-square value (Hair, et al., 2013). Values of R-Square are 0.753, 0.774, 0.710, 0.699, 0.812, 0.821, 0.698 and 0.681

respectively for all the eight models, indicating that 75.3%, 77.4%, 71%, 69.9%, 81.2%, 82.1%, 69.8% and 68.1% of the variance in dependent variable (FIIs) can be predicted through independent variable(s) (MFs). For better acceptability of model, value of adjusted R square should be close to the value of R square (Ghosh, et al., 2012). In the given table values of adjusted R square is 0.751, 0.773, 0.709, 0.698, 0.811, 0.820, 0.696 and 0.679 satisfying the required criteria.

Table 5: Model Summary

Model	R	R-Square	Adjusted R-Square	Std. Error of the Estimate
1	0.868	0.753	0.751	16490.29874
2	0.880	0.774	0.773	14881.84143
3	0.843	0.710	0.709	6238.37367
4	0.836	0.699	0.698	5493.91407
5	0.901	0.812	0.811	14385.34937
6	0.906	0.821	0.820	13255.62569
7	0.836	0.698	0.696	6367.47869
8	0.825	0.681	0.679	5661.86229
Note:	Model 1	: Predictor (Constant) MEP	Dependent Variable: FEP	
	Model 2	: Predictor (Constant) MES	Dependent Variable: FES	
	Model 3	: Predictor (Constant) MDP	Dependent Variable: FDP	
	Model 4	: Predictor (Constant) MDS	Dependent Variable: FDS	
	Model 5	: Predictor (Constant) MES	Dependent Variable: FEP	
	Model 6	: Predictor (Constant) MEP	Dependent Variable: FES	
	Model 7	: Predictor (Constant) MDS	Dependent Variable: FDP	
	Model 8	: Predictor (Constant) MDP	Dependent Variable: FDS	

Statistical acceptability of the model can be estimated through the ANOVA table 6. It provides F-value that defines whether the model is statistically significant or not. The values of F (578.009, 651.99, 465.676, 441.886, 819.213, 871.262, 439.311 and 404.955) for all the models are found to be highly significant at 0.1% level of significance indicating the statistical significance of the models.

Table 7: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	10749.089	2033.867		5.285	.000
MEP	3.306	.138	.868	24.042*	.000
2 (Constant)	3841.917	1975.789		1.944	.053
MES	3.742	.147	.880	25.534*	.000
3 (Constant)	1113.043	648.689		1.716	.088
MDP	.169	.008	.843	21.578*	.000
4 (Constant)	1036.502	570.146		1.818	.071
MDS	.204	.010	.836	21.021*	.000
5 (Constant)	4519.509	1909.872		2.366	.019
MES	4.054	.142	.901	28.622*	.000
6 (Constant)	7053.440	1634.912		4.314	.000
MEP	3.263	.111	.906	29.517*	.000
7 (Constant)	1237.610	660.802		1.873	.063
MDS	.236	.011	.836	20.960*	.000
8 (Constant)	1119.591	588.741		1.902	.059
MDP	.143	.007	.825	20.123*	.000
<p><i>Note: Dependent Variable: Model 1 : FEP</i> <i>Model 2 : FES</i> <i>Model 3 : FDP</i> <i>Model 4 : FDS</i> <i>Model 5 : FEP</i> <i>Model 6 : FES</i> <i>Model 7 : FDP</i> <i>Model 8 : FDS</i> <i>*p<0.001</i></p>					

6. HYPOTHESIS TESTING

Table 6 depicts the p-value of all the independent variable(s) for all the models. The results show that the p-value of all the models are 0.000 which is less than $p < 0.001$. Thus, all the null hypotheses i.e. H01, H02, H03, H04, H05, H06, H07, and H08 have been rejected, whereas alternate hypotheses H1, H2, H3, H4, H5, H6, H7, and H8 have been accepted. Hence it is concluded that MEP, MES, MDP, MDS significantly affect the investment decisions of FEP, FES, FDP and FDS. In the contrast relationship MEP, MES, MDP and MDS affect the investment decision of FES, FEP, FDS and FDP (Table 8).

Table 8: Hypotheses Testing

H.No.	Null Hypothesis	Decision	H.No.	Alternate Hypothesis	Decision
H01	MEP does not affect the investment decision of FEP in India	Reject	H1	MEP affects the investment decision of FEP in India	Accept
H02	MES does not affect the investment decision of FES in India	Reject	H2	MES affects the investment decision of FES in India	Accept
H03	MDP does not affect the investment decision of FDP in India	Reject	H3	MDP affects the investment decision of FDP in India	Accept
H04	MDS does not affect the investment decision of FDS in India	Reject	H4	MDS affects the investment decision of FDS in India	Accept
H05	MEP does not affect the investment decision of FES in India	Reject	H5	MEP affects the investment decision of FES in India	Accept
H06	MES does not affect the investment decision of FIEP in India	Reject	H6	MES affects the investment decision of FEP in India	Accept
H07	MDP does not affect the investment decision of FDS in India	Reject	H7	MDP affects the investment decision of FDS in India	Accept
H08	MDS does not affect the investment decision of FDP in India	Reject	H8	MDS affects the investment decision of FDP in India	Accept

7. CONCLUSION AND DISCUSSION

There are two major investor classes in Indian stock market i.e. domestic and foreign. Both of them play a vital role in the development and expansion of economy. They are like two wheels in the vehicle. As without one wheel the vehicle cannot move properly, similarly the market with single investor class may not be in a position to move smoothly. But, at the same time, their investment patterns are different from each other. As per the data released by Securities and Exchange Board of India for the duration of 2001-02 to 2016-17, consistently MFs have registered lower amount in their equity investment than debt investment, while FIIs have shown opposite pattern with higher amount of investment in equity than debt. On one hand, MFs believe in safe investment by investing large amount in debt than equity investment, while on the other hand FIIs follow the pattern of risk return trade off by investing more in equity than debt. (See figures 1.1, 1.2, 1.3, 1.4, 1.5, 1.6, 1.7 and 1.8).

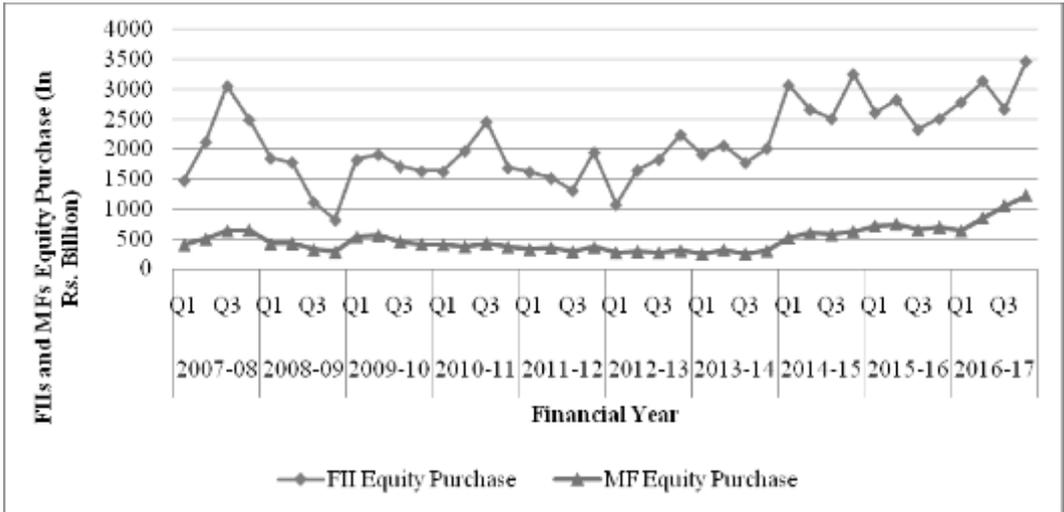


Figure 1.1: FII and MF Equity Purchase: Relationship

Source: Constructed through the data compiled from SEBI and NSDL

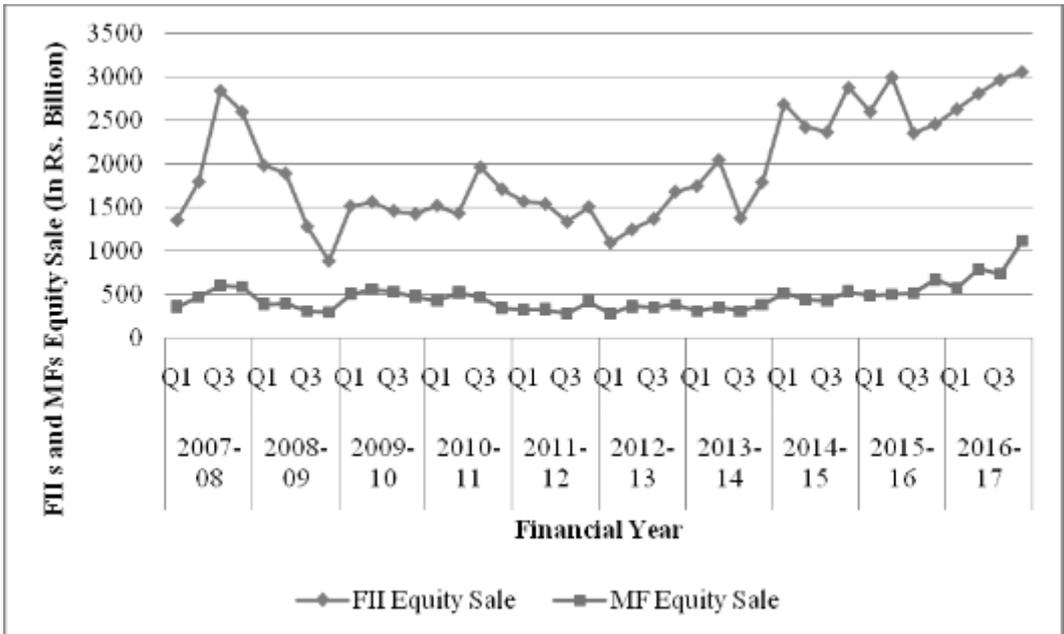


Figure 1.2: FII and MF Equity Sale: Relationship

Source: Constructed through the data compiled from SEBI

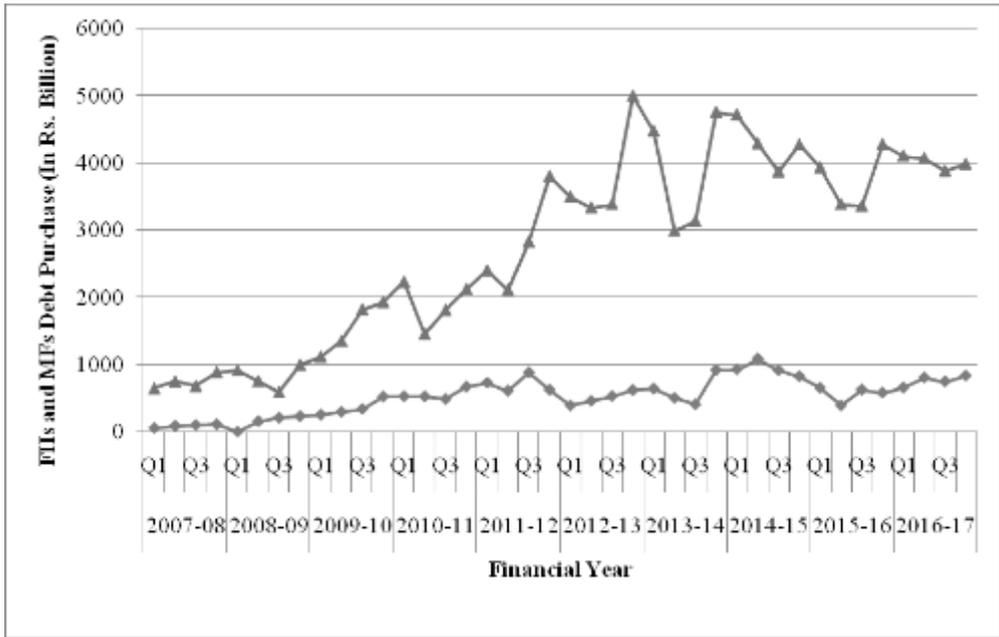


Figure 1.3: FII and MF Debt Purchase: Relationship

Source: Constructed through the data compiled from SEBI and NSDL

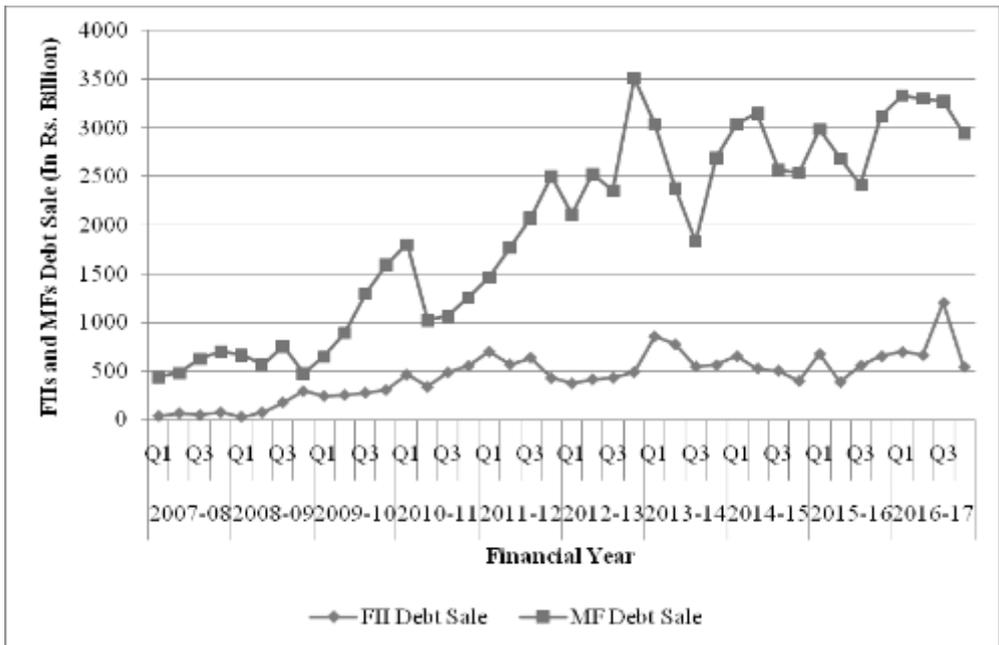


Figure 1.4: FII and MF Debt Sale: Relationship

Source: Constructed through the data compiled from SEBI

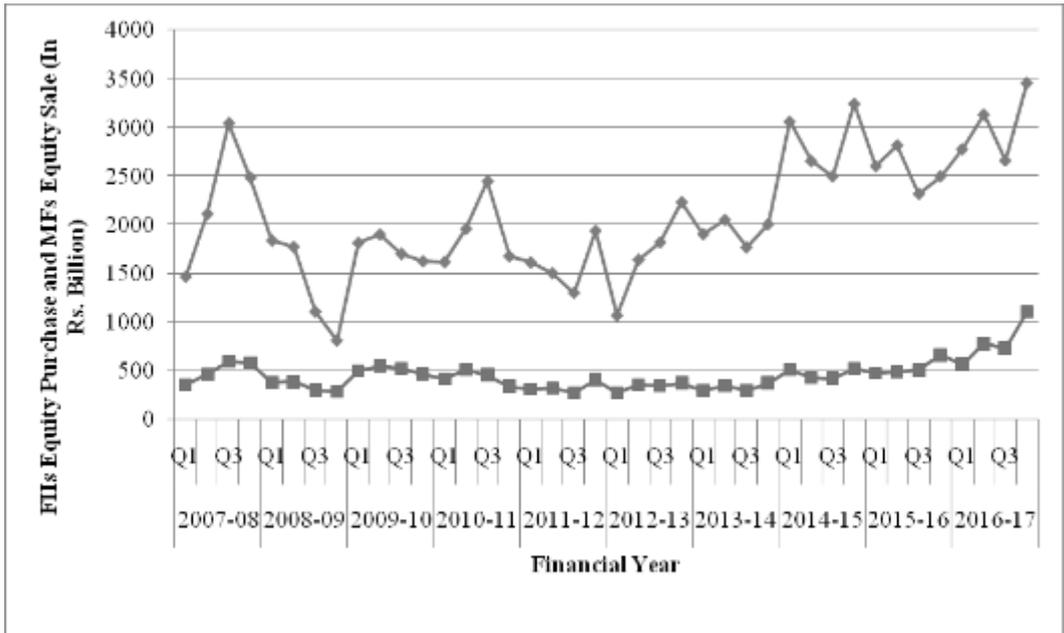


Figure 1.5: FII Equity Purchase and MF Equity Sale: Relationship

Source: Constructed through the data compiled from SEBI

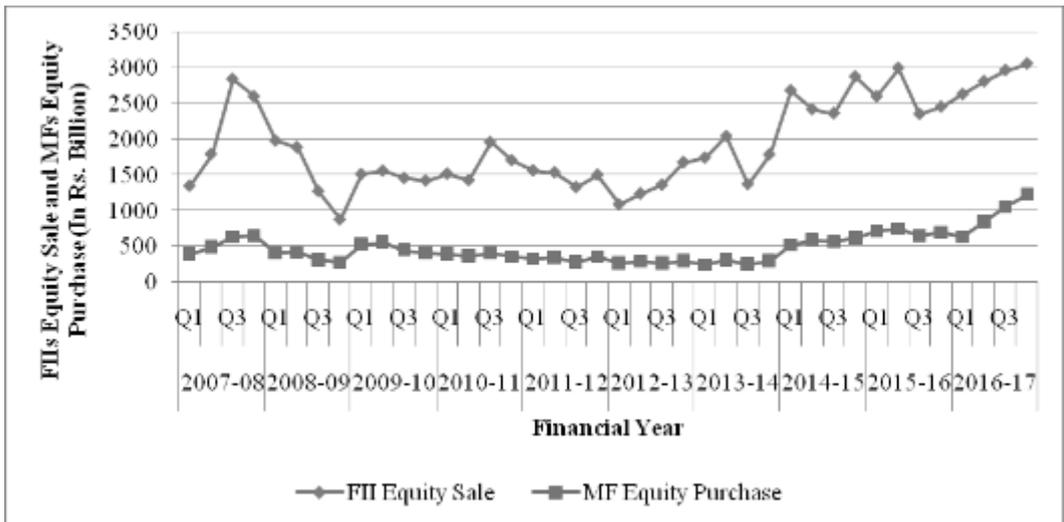


Figure 1.6: FII Equity Sale and MF Equity Purchase: Relationship

Source: Constructed through the data compiled from SEBI



Figure 1.7: FII Debt Purchase and MF Debt Sale: Relationship

Source: Constructed through the data compiled from SEBI

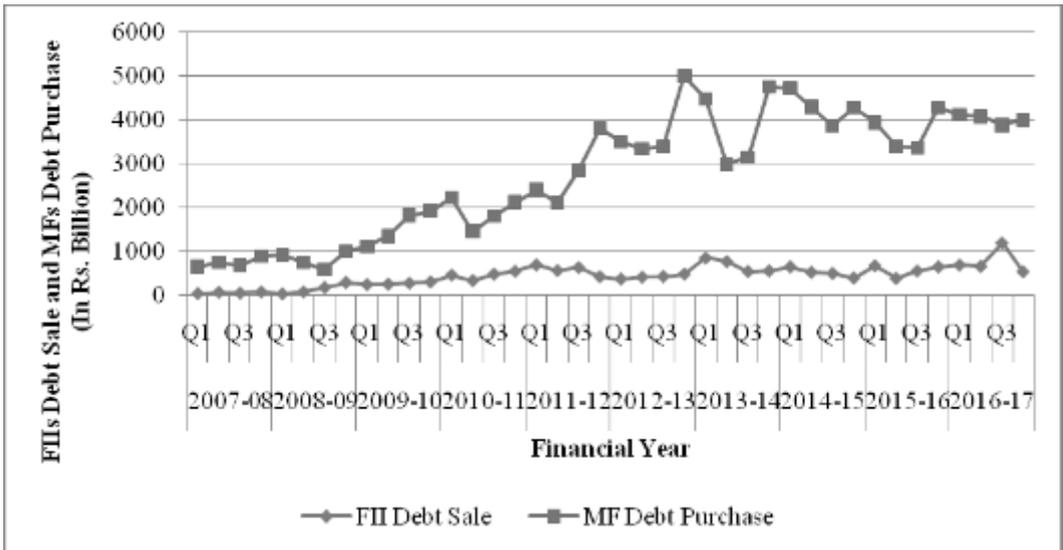


Figure 1.8: FII Debt Sale and MF Debt Purchase: Relationship

Source: Constructed through the data compiled from SEBI

On applying regression analysis, it is concluded that inflow and outflow decisions of DIIs significantly affect the inflow and outflow decision of FIIs to invest money in capital market. Investment by DIIs presents internal stability of the market in front of macro-economy that enhances the confidence of FIIs to invest in Indian market. Hence, the decision of domestic investors has an impact on the investment decision of FIIs.

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