

## Portfolio Investment: An Examination of Trends in India

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### Abstract

Arena of foreign investments and their impact on host country has received much attention of researchers due to its rising importance in the economic development. Not only does it enhance financial stability of firms, it also brings in expertise which can help to achieve efficiency in business. Hence, the growth of foreign investment is important to track. This is the primary objective of this study. We examine the trend of FII and FDI growth in India over a period of eighteen years from 2000-01 to 2018-19. Results are encouraging as we witness an increasing trend in FDI over the period under consideration. On the contrary, flows of FII seem to follow a random pattern. Results also provide an indication towards a positive net investment figure over the years. However, there seems no fixed proportion of total foreign portfolio investment when we segregate it into equity and debt component.

### Introduction

In this era of globalization, the driving forces for the growth of any economy have gone through a complete turnaround. The capital flow across nations has emerged as a catalyst for the development of both the host countries. Liberalization has opened and widened the horizon of growth across distinct spheres of financial movements. The flow of capital is acting as one of the ingredients of capital accumulation model of various nations. With an extensive dependency on foreign capital, a nation has to resort upon the continuous inflows of capital. 1992 was the year of transformation in financial streams of Indian economy; where the government, after a long time, accepted approaches of foreign investors to invest in the country. The liberalization policy strengthened its roots inside the grounds of world's second largest economy. This policy changed the way one can ever think about investments, capital inflow, stock markets and gains made out of these.

Positive fundamentals combined with fast growing markets have made Indian markets a preferred destination for foreign institutional investors (Prasanna, 2008). The win-win situation has helped both the host nation and foreign investors. Late 90's was the period, when India started off as the industrial and manufacturing hub to touch the skies of growth and with its levels of inputs, it gained maximum profits. Indian economy is an economy which in spite being in the list of developing nations, gives huge profits to investors as compared to the developed nations. Thus, it turned out to be the most favored investing destination for investors all over the world. Various investment schemes promoted by the Indian government have turned up optimism in foreign investors and they are increasingly looking forward to the investment process.

The decade prior to global financial crisis (1998-2008) witnessed an exponential increase in International Capital Movements, specifically in the emerging markets. India was not left unaffected by this phenomenon. The fusion of economic liberalization and globalization lead to a large increase in the portfolio inflows. Some commonly observed effects of the capital included real exchange rate appreciation, stock market and real estate boom, reserve accumulation, monetary expansion as well as effect on production and consumption (Goudarzi & Ramanarayanan, 2011). The study of FIIs in the host country has broadly been classified into two strands. First strand discusses the factors determining the level of FIIs in the host country. The second strand of discussion highlights the impact of FIIs on the economic performance of the host country. The subsequent section discusses these two important aspects.

Capital markets are less developed in emerging and transition economies (Douma et al., 2006). This is a complex situation where nations are not equipped with the required resources to fulfill demands. However, India gains advantage in two important aspects: First, being a labor abundant nation, the money flow is more in terms of wage payment. This causes an increased velocity of money in the manufacturing sector. Second, India has developed stock markets which have transparent indexes as their performance indicators. All public information is easily available to the investor in a structured way and is reflected in the stock prices quickly. The favorable demographic characteristics like growth potential, scope of diversification and economic policies also influenced India's share in capital flows among Emerging Market Economies (EMEs) (Mohan, 2004). This resulted in the Indian financial markets getting increasingly integrated with the global financial markets. Literature provides evidence of various factors that have an impact on foreign inflow of capital in the host

country. The levels of FDI were found to be largely driven by natural resources and large market size in South Africa (Asiedu, 2005). Foreign outward investment was found to have a significant relationship with political risk, cultural proximity, geographic proximity and market size of the host country (Buckley et al., 2007). Financial market openness and transparency were found to be significant determinants of foreign investments in Vietnam (Batten & Vinh, 2015).

Securities and Exchange Board of India (SEBI) monitors each and every step made into the dynamic world of stocks, shares, derivative and everything associated with the capital flows within India. It acts as the lifeline in the registration of FIIs. Reserve Bank of India (RBI) has granted permission to SEBI registered FIIs to invest in India under the Portfolio Investment Scheme (PIS). FIIs can invest in equity (primary and secondary market), dated government bonds, corporate bonds, mutual funds, and derivatives traded on a recognized stock exchange, subject to investment limits. There are strict guidelines by SEBI which are to be followed by these foreign investors in order to invest.

Foreign Institutional Investments (FIIs) include the foreign based investment categories such as Pension Funds, Mutual Funds, Investment Trust, Insurance or Reinsurance companies, Investment Trusts, Banks, Endowments, University Funds, Foundations, Charitable Trusts or Charitable Societies. The entities proposing to invest on behalf of broad based funds are also eligible to be registered as FIIs. These may include Asset Management Companies, Institutional Portfolio Managers, Trustees, Power of Attorney Holders, and the following Financial Instruments available as FII: Securities in primary and secondary markets including shares, debentures and warrants of companies, unlisted, listed or to be listed on a recognized stock exchange in India; Units of mutual funds; Dated Government Securities; Derivatives traded on a recognized stock exchange; Commercial papers.

The role of FII in an economy is undisputable. This raises curiosity among researchers, theoreticians, and economists to further explore the growth patterns of FII in a nation. With this primary objective, this study tends to examine the growth pattern of FII in India over a period of eighteen years from 2001 through 2018-19. Interesting insights have been gained from the examination, which have been reported in further sections of this study. The remainder of the paper is structured as follows. Section 2 contains linkages with the existing literature. Section 3 contains an examination of FII movements across the period of study. The study concludes in section 4, with challenges and authors’ annotations on the future of FIIs in India.

**Review of Literature**

There is no scarcity of literature analyzing factors affecting flows of FII in a country. Nor there is any deficit of studies examining the impact of FII in a nation’s growth.. Various authors have reported varied results with respect to factors affecting FII levels and their impact on nation’s growth. A summary of this vast literature has been highlighted in table 1.

**Table 1:** Studies examining factors determining FII levels in a country

S. No.	Author	Year	Variables	Results
1	Chakrabarti	2001	FII, Exchange rate and Gold rate	FII determines market returns
2	Apte	2001	Stock market and Nominal Exchange rate	Volatile relationship in stock indices and market return
3	Kumar et al.	2001	ADRS,GDRS and DII	Negative relationship between Indian investors and Stock returns
4	Khanna	2002	Rate of savings, foreign currency assets and money supply	Neutral relationship of FII and growth of Indian Capital market
5	Mukherjee et. al.	2002	FII, exchange rates, short term interest rates and index of industrial production	FII positively affected market and past returns as well.
6	Rai & Bhanumurthy	2004	Return, risk and inflation	Positive relation between FII and BSE stock returns

7	Chakrabarti	2005	FII and stock returns	Positive relation
8	Wong et al.	2005	FII and stock returns of India and other foreign markets US,UK and Japan	Positive short term and long term relationship
9	Karmakar	2006	Stock returns and FII	Long term volatility between S&P CNX nifty and FII
10	Sethi & Patnaik	2007	Foreign exchange reserves, Money supply, and Foreign exchange rates	Foreign Institutional Investment (FII) is affecting the economy but not as much as FDI
11	Sethi & Sucharita	2009	FII and economic growth (IIP as proxy of GDP) and FINV and Exchange Rate (EXR)	FII negatively affecting economic growth
12	Joo & Mir	2014	FII and stock returns of Nifty and Sensex	Significant relationship between FIIs capital flows and stock market volatility
13	Ryakala	2015	FII and Indian stock market(BSE & NSE) returns	FII's are influencing the price changes in the Indian stock market
14	Singh & Singh	2016	FII and Financial stress in Indian capital market	Increase in financial stress, the inflow of FII reduced

**Source:** Authors' compilation based on literature review.

**Data and Methodology**

The current study encompasses a descriptive analysis and examines the trends of foreign portfolio in India over a period of eighteen years. The time period for which the data has been sourced is 2000-01 through 2018-19. Annual financial year end values of the variables under consideration have been extracted from various sources. Data set comprises secondary data which has been sourced from various online platforms which contain details pertaining to FII and FDI levels in India. Major contributors of data include handbook of statistics, SEBI, NSDL and CDLS websites. Trends and patterns in foreign portfolio investment in India have been depicted with the help of tables and charts using trend lines. Utmost care has been taken while extracting the data required for study. It has been ensured that only reliable online platforms are considered to make certain that the secondary data is authentic. Subsequent section examines the patterns of FII and FDI in India over the period under examination.

**Research Objective**

The Main Objective of this Paper is to Analyze the Trends and Pattern In FII over a period of 18 years i.e from 2000-01 to 2018-19

**An Examination of Trends**

Till the early 1990s, the flow of foreign capital was restricted by many countries including India, under the policy of protectionism. At that time, there was huge dependence upon external financial aid and official development assistance. However, gradually, when hard pressed by the economic needs of their countries, the economies of most of the developing countries were opened by way of dismantling the so called capital

controls. One of the main objectives for opening up of these economies was also to attract foreign capital, which, if accompanied by domestic capital would speed up the process of domestic growth, higher productivity and enormous output. Since then, portfolio flows from FIIs have emerged as the major source of capital for many emerging market economies (EMEs) like China, India, South Africa and Brazil.

It is a well established fact that economic growth of a country is a function of multiple developments like amount of total investment, speed of industrialization, process of capital formation and so on. It has been empirically experienced that FII flows do not create any financial liability. Rather, they are a good source of non-debt capital for the economy and the flexible investment norms and regulations along with fiscal advantages have been playing a positive role in enhancing FII flows amongst nations. India is the one of the largest democracy which has received highest amount of FII and FDI inflow in the last two decades. A snapshot of the FII and FDI coming to India from 2000-01 to 2018-19 has been depicted in table 2.

**Table 2: Total Foreign Investment in India from 2000-01 to 2018-19**

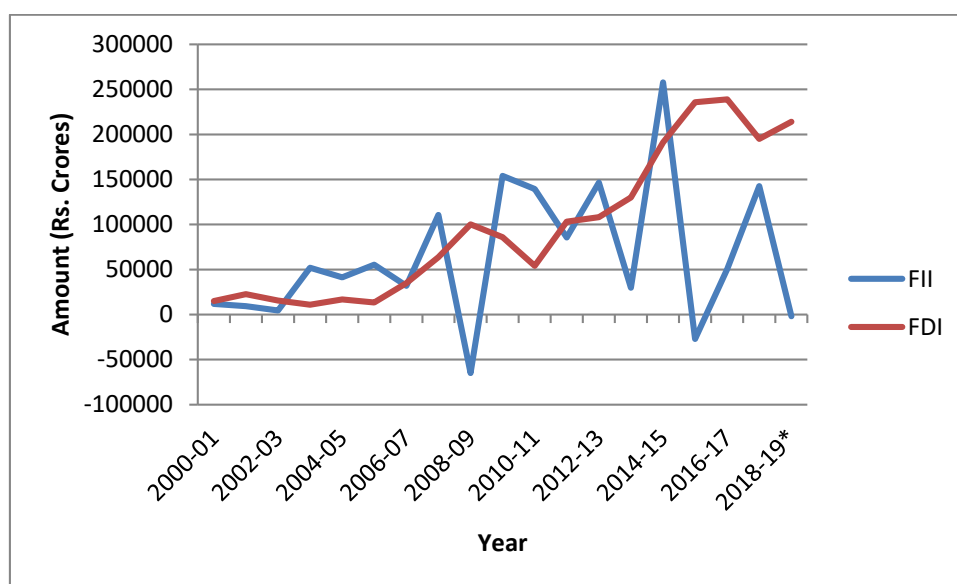
Year	FII	FDI
2000-01	11,820	14,924
2001-02	9,290	22,630
2002-03	4,504	15,594
2003-04	51,898	10,944
2004-05	41,312	16,745
2005-06	55,357	13,425
2006-07	31,881	34,910
2007-08	1,10,619	63,776
2008-09	-65,045	1,00,106
2009-10	1,53,967	85,983
2010-11	1,39,381	54,101
2011-12	85,571	1,03,167
2012-13	1,46,467	1,08,186
2013-14	29,680	1,29,969
2014-15	2,57,853	1,91,219
2015-16	-27,203	2,35,782
2016-17	50,482	2,38,913
2017-18	1,42,632	1,95,052
2018-19*	-1,857	2,14,036

**Source:** Handbook of Statistics 2018. All amounts are in Rs. Crores. \*Figures were taken in the month of October.

Table 2 indicates a substantial increase in foreign portfolio flows and direct investment since early 21<sup>st</sup> century till date. It is attributable to factors like greater integration amongst major global financial markets, more advancement in information technology and growing interest amongst FIIs to invest into Emerging Market Economies (EMEs) through various investment alternatives such as hedge funds, private equity funds etc. Figure 1 highlights the trends of FDI and FII in India over a period of eighteen years. As clearly reflected by the trend lines, there has been a consistent growth in FDI over the years under examination. However, the movement in FII over the years has been random. There is no fixed pattern observed in case of FII in India. This needs further examination as to why a disorderly movement has been observed in FII levels of the time period

under consideration. Nonetheless, detection of reasons of such disorderly movement is not under the preview of the current study.

**Figure 1:** Trends of FII and FDI in India from 2000-01 to 2018-19



**Source:** Authors’ own based on examination of secondary data.

We further examine the break-up of portfolios in terms of gross purchases and gross sales made during the period of 2010-11 to 2017-18. Details pertaining to such break up have been provided in table 3. There has been a positive net investment throughout except in the year 2015-16.

**Table 3: Breakup of Total Portfolio Investment**

Year	Gross Purchases*	Gross Sales*	Net Investment*	Net Investment (US \$ Million)#
2010-11	9,92,596	8,46,158	1,46,438	32,226
2011-12	9,21,285	8,27,562	93,725	18,923
2012-13	9,04,845	7,36,481	1,68,364	31,047
2013-14	10,21,010	9,69,361	51,649	8,876
2014-15	15,21,346	12,43,886	2,77,460	45,698
2015-16	13,24,418	13,42,593	-18,175	-2,523
2016-17	15,07,028	14,58,617	48,411	7,600
2017-18	17,28,360	15,83,679	1,44,681	22,466

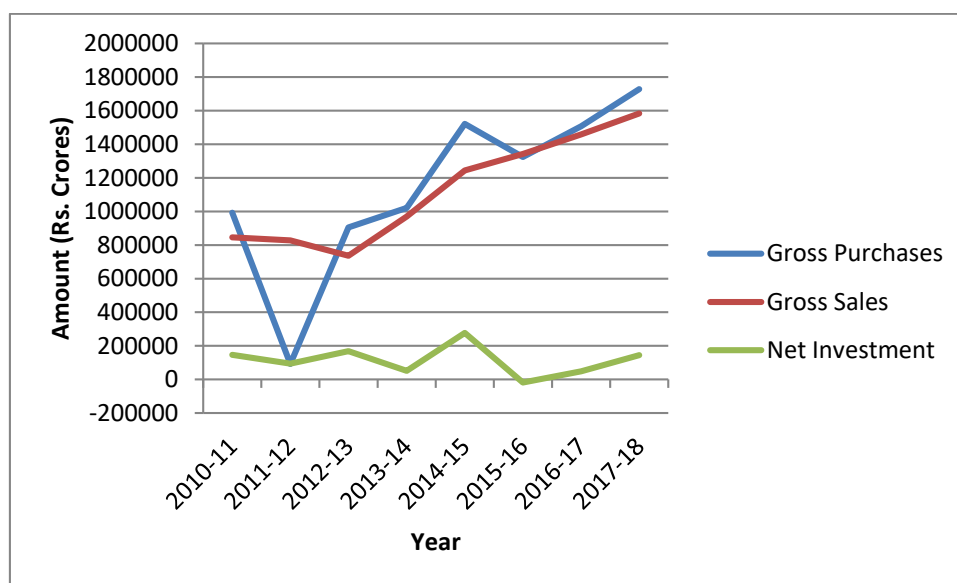
**Source:** SEBI, NSDL & CDSL. \* Amounts are in Rs. Crores.

**Note:**

1. With the commencement of FPI Regime from June 1, 2014, the erstwhile FIIs, Sub Accounts and QFIs are merged into a new investor class termed as “Foreign Portfolio Investors (FPIs)”. All existing FIIs and SAs are deemed to be FPIs till the expiry of their registration.

2. # Conversion rate: The daily RBI reference rate as on the trading day has been adopted. (If the trading day is a bank holiday, immediately preceding day's reference rate has been used).

**Figure 2: Trends in Portfolio Investment**



**Source:** Authors' own based on examination of secondary data.

An examination of portfolio trends offers useful insights. It would be interesting to examine the channel through which the foreign investment gets infused in the organizations in India. We further sub divide the foreign portfolio investment on the basis of a component of capital structure of firms.

**Table 4: Foreign Portfolio Investment in Equity, Debt and Hybrid Segment**

Year	Equity	Debt	Hybrid	Total
2010-11	1,10,121	36,317	NA	1,46,438
2011-12	43,737	49,988	NA	93,725
2012-13	1,40,031	28,333	NA	1,68,364
2013-14	79,709	28,060	NA	51,649
2014-15	1,11,333	1,66,127	NA	2,77,460
2015-16	-14,172	-4,004	NA	18,176
2016-17	55,703	-7,292	NA	48,411
2017-18	25,635	1,19,036	11	1,44,681

**Source:** SEBI, NSDL & CDSL. All amounts in Rs. Crores.

**Note:**

1. With the commencement of FPI Regime from June 1, 2014, the erstwhile FIIs, Sub Accounts and QFIs are merged into a new investor class termed as "Foreign Portfolio Investors (FPIs)". All existing FIIs and SAs are deemed to be FPIs till the expiry of their registration.

2. A new category of reporting FPI investments in "Hybrid securities" came into effect from December 2017.

A large number of domestic and global factors have affected and have been affecting FII flows in the developing countries including India. The empirical studies on FII flows have classified these factors into two broad categories namely: pull (domestic) factors and push (global) factors. Pull or domestic factors are those which attract FII whereas push or global factors are those which compel the FIIs to move around across the countries with an object to invest their funds and earn better returns.

There have been also many pull or domestic factors which have been affecting FII flows in India. Some of the major factors amongst the same include return in the Indian share market, ER, economic reading of the Indian economy, risk in the Indian share market, home biasness on the part of FIIs, credit rating of the country, price-earnings ratio of the companies in the domestic country, domestically available infrastructure facility, country risk and many other economic factors like industrial growth, inflation, FERs etc (Kaur & Dhillon, 2010). In addition to this, some other factors which fall under the same category include politically and economically stable environment in the country, potential for growth opportunities, supportive policies of the host government towards FIIs, overall orientation philosophy towards privatization, congenial taxation policies, a supportive and enabling investment environment such as good governance practices, an effective legal system, better administrative machinery, a suitable regulatory regime and ultimately a positive investment climate (French & Petorba, 1991).

The various push or global factors which have been affecting FII flows in India include performance of other countries, global liquidity, interest rates in global market, tax heaven countries, the drivers in the global market, probability of global crisis, herding mentality of FIIs and so on (Bose, 2002). It has been surprisingly observed that the FII flows which have been pulled by domestic factors have been found more sustainable as compared to the FII flows pushed by global factors. Moreover, in the earlier case, sustainability of FII flows have depended more on the economic and political stability of the host country along with its continuous regime for economic reforms in foreign investment.

## Conclusion

The nature of FII flows has been very dynamic over the past years which make it difficult to analyze the exact behavior of foreign portfolio investment. This has probably been one of the underlying reasons that comparatively less number of research studies has been undertaken on the same subject till date. However, rising figures of FII and FDI in India gives an indication of improved investor confidence in terms of their outlook towards Indian economy. Positive net investments also point towards a positive sentiment of investors when it comes to evaluating India as an investment destination. This will not only contribute towards strengthening the foreign exchange reserve position of our country, but will also help in giving supremacy to Indian currency as it will become more stable. Not only does an increased level of FII and FDI result in additional foreign exchange, it also tends to improve the technical knowhow for the firms in which such investment happens. The results of our study are in line with many others like French & Petorba (1991) who argued that increased levels of FDI and FII are results of good governance practices and a positive investment climate. A positive outlook of the Indian economy based on rising levels of FII points towards a bright future of India corporations when it comes to sourcing funds by way of foreign investments.

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## Web-links

- [http://www.arthapedia.in/index.php?title=Foreign\\_Institutional\\_Investor\\_\(FII\)lows\\_and\\_the\\_Indian\\_Economy\\_in\\_the\\_1990s](http://www.arthapedia.in/index.php?title=Foreign_Institutional_Investor_(FII)lows_and_the_Indian_Economy_in_the_1990s)
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