Executive Summary of the Minor Project

conducted by

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A Critical Evaluation of the Foreign Institutional Investment in the Indian Stock Market and Its Impact on the Volatility of Market Index

The Foreign Institutional Investors (FIIs) have emerged as important players in the Indian equity market in the recent past. The Indian stock market is touching new highs and there is a notion that there is a positive correlation between FII investment and stock market Index. During the fifteen year period from 2000, FIIs invested Rs. 749857.8 crores in the Indian equity market and Rs. 281831.2 crores in the debt market. During the review period from 1st April 2009 to 31st March 2014, FIIs made a gross purchase of Rs. 37,97,337.70 and gross sales of Rs. 32,84,745.60 resulting in a net purchase of Rs. 5,18,797.40 crores in the Indian equity market in 1235 trading days. The present study is an attempt to evaluate whether FII investment cause market fluctuations.

A detailed analysis was done to assess whether the FII investment has influenced the Sensex and the resultant changes thereof if any, on the same day and on the succeeding day. For this, net investment or withdrawal by the FIIs above Rs. 1000 crores intraday and its impact was assessed. There were 1235 trading days during the review period.

The objectives of the study are as follows:

- To analyze the amount of money invested by the Foreign Institutional Investors in India during the review period.
- To study the scope and trading mechanism of Foreign Institutional investors in India.
- To analyze whether the volatility in the Indian stock market is exclusively dependent on the purchase and sales activity done by FIIs.
- To analyse the intraday net investment above Rs. 1000 crores and its impact on Sensex

For the purpose of analysis, the following hypothesis was formulated.

- HO: The volatility in the Indian stock market is not fully dependent on the FII activity ($r=0$)
- H1: The volatility in the Indian stock market is fully dependent on the FII activity ($r\neq0$)

Major Findings of the study

From the above analysis it may be concluded that the index movements are not directly correlated to the FII investment. There is a unidirectional causality from Sensex to FII which means that FII does not cause fluctuations in Sensex movements. But Sensex movements cause FII to fluctuate and hence the first hypothesis that the volatility in the Indian stock market is not fully dependent on the FII activity is to be accepted.

The long run relationship between FII and Sensex cannot be determined precisely as the ARDL model suggests an inconclusive result for cointegration.

It is evident that the index movements are not directly correlated to the FII investment. A number of factors may influence the market; this may be economic factors, political factors or even social factors. The positive or negative news relating to the above factors may influence the price of stocks and will ultimately be reflected in the stock market index.

Likewise the Sensex is the index composed of 30 stocks from 12 different sectors of the Indian industry. More than 6000 shares were listed in the Bombay stock exchange. FII investment need not be in the component stocks of Sensex and if their investment is in other stocks it may not affect directly in the Sensex or may affect only partially to the Sensex.

The movement in the Indian capital market is not fully dependent on the investment or withdrawal of money by the Foreign Institutional Investors, an investor has to consider other factors which influence the market before investing.