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Growth and sustainability of FII in India: A post reform analysis

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In a developing country like India greater emphasis has been given to the foreign capital. It not only increases the productivity and the efficiency of labour but also helps to maintain adequate foreign exchange reserve which results in facing the trade deficit. After the globalisation of Indian economy, foreign investments in India have grown enormously. Indian economy has emerged most favourable foreign investment which results in issues like minimisations of trade barriers, flexible exchange rate etc. It also results in strengthening the external position of the domestic economy.

This article purports about the recent development in FII in the Indian economy. Here a brief idea has given regarding the various policy changes and development which have taken place in the field of FII. With these various aspects in this article attempt has made to analysis of FII in the post reform era with the help of net Investments by FIIs in Equity and Debt, trends in FII investment.

Introduction

Foreign Institutional Investor [FII] is defined as an institution organized outside of India for the purpose of making investments into the Indian securities market under the regulations prescribed by SEBI and it can invest its own funds as well as invest on behalf of their overseas clients registered as such with SEBI. Generally, FIIs include overseas pension funds, mutual funds, investment trust, asset management company, nominee company, bank, institutional portfolio manager, university funds, endowments, foundations, charitable trusts, charitable societies, a trustee or power of attorney holder incorporated or established outside India proposing to make proprietary investments or investments on behalf of a broad-based fund. These client accounts, known as 'sub-accounts', are managed by FII. A domestic portfolio manager can also register itself as an FII to manage the funds of sub-accounts. Foreign institutional Investor means an entity established or incorporated outside India which proposes to make investment in India. In this paper an attempt has made to analysis the FII in India in the post reform period i.e., 2000-2010.

Review of Literature

Foreign Institutional Investor [FII] is used to denote an investor - mostly of the form of an institution or entity, which invests money in the financial markets of a country different from the one where in the institution or entity was originally incorporated. There are various relevant literatures which give an overall idea about the significance of FII in India.

Hassan Reshi (2012) in his article expressed his opinion regarding the potentiality and challenges of FDI in the country during the post globalisation era. He also explains government of India has taken many initiatives to attract FDI and FII inflows, to boost the Indian economy since economic liberalization. **Bohra and Dutt (2011)** in their article explain the behavioural pattern of FII in India and figure out the reason for indifferent responses of BSE sensex due to FII inflows in India. **Saha (2009)** in his paper attempts to find out the participation of foreign institutional Investor in relation to the Indian stock market. He also point out foreign capital which is playing a major role in transforming the dull economy into a dynamic one and minimise the entire trade barrier to other countries.

Research Methodology

The present study has been undertaken with a conduct of empirical analysis of status of FII in India and made some policy recommendation to boost up the flow of FII to India. The present study is of analytical nature and makes use of secondary data between 2000-2010. The relevant secondary data are collected from various publications of Government of India; Reserve Bank of India. Trend analysis has been conducted to have an empirical idea about the status of FII in India.

Objective of the study

FII has been recognized as an important driver for economic growth and development. One of the most striking developments during the last two decades is the spectacular

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growth of FII in the global economic landscape. In this study, an attempt has been made to find out the development in respect with

- To depict the post reform scenario of FII inflows in India.
- To study the changing trends in India due to FII inflows from the year 2001-2010.

Foreign Institutional Investment (FII) in India

From the early 1990s, India has developed a framework through which foreign investors can participate in the Indian securities market. Since 1990-91, the Government of India embarked on liberalization and economic reforms to bring rapid and substantial economic growth and move towards globalization of the economy. In reforms process the Government under its New Industrial Policy, changes its foreign investment policy drastically realizing the growing importance of foreign investment in Indian economy. Portfolio investments from abroad by foreign institutional investors were permitted in the Indian capital market for first time by Indian government through this process. The entry of FIIs was allowed by the Narsimhan Committee Report on Financial System; but the Committee did not elaborate on the objectives of the suggested policy. The committee only suggested that the capital market should be gradually opened up to foreign portfolio investments.

From September 14, 1992 with suitable restrictions, Foreign Institutional Investors were permitted to invest in all the securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India. While presenting the Budget for 1992-93, the then Finance Minister Dr. Manmohan Singh had announced a proposal to allow reputed foreign investors, such as Pension Funds etc., to invest in Indian capital market.

A few large FII issue derivative instruments called 'participatory notes' that are registered and traded overseas, backed by FII holdings of Indian securities. This has raised some concerns in regulatory circles since it makes difficult to trace out the ultimate beneficiary of funds and may be used to bring in "unclean funds' into the Indian markets. December 2005, the number of FIIs and sub-accounts stood at 823 and 2,273 respectively.

Portfolio investment spreads risk for foreign investors and has certain macro economic implications. While contributing to build up foreign exchange reserves, portfolio investment would influence the exchange rate and could lead to artificial appreciation of local currency. This could hurt competitiveness of the economy. The portfolio investments are amenable to sudden withdrawals and, therefore, these have the potential to disturb any economy. The global opportunities and flows considerably influence portfolio volatility.

Number of Foreign Institutional Investors (FIIs)

India has generated a high level of interest among FIIs on account of its deep and liquid stock market and relatively high returns. Total investment of FIIs has increased from US$ 35.93 billion in 2005 to US$ 45.11 billion in 2006. The number of FIIs registered with SEBI has increased from 685 during 2005 to 882 during 2006 and further reached 1059 by January, 2007. The net addition in SEBI registered FIIs failed to keep up the momentum seen in 2007-08 and 2008-09 wherein there was addition of 322 and 316 FIIs respectively. There was a net addition of 78 SEBI registered FIIs in 2009-10 which took their total number to 1,713 at end March 2010 compared to that of 1,635 at the end of March.

Table 1: SEBI Registered FIIs in India

Year	FII at end of March	Net Additions of FIIs during the year
2000-01	527	21
2001-02	490	-37
2002-03	502	12
2003-04	540	18
2004-05	685	38
2005-06	882	145
2006-07	997	197
2007-08	1,319	115
2008-09	1,635	322
2009-10	1,713	316

Source: SEBI. www.nseindia.com

Policy Developments for Foreign Institutional Investments

Allocation of Government debt and corporate debt investment limits to FIIs SEBI, vide its circular dated November 26, 2010 has made the following decisions:

Increased investment limit for FIIs in Government and Corporate debt

In an attempt to enhance FII investment in debt securities, government has increased the current limit of its investment in Government Securities by US $ 5 billion raising the cap to US $ 10 billion. Similarly, the current limit of FII investment in corporate bonds has also been increased by US $ 5 billion raising the cap to US $ 20 billion. This incremental limit shall be invested in corporate bonds with residual maturity of over five years issued by companies in the infrastructure sector. The market regulator SEBI announced this vide its circular dated November 26, 2010.

Time period for utilization of the debt limits

In July 2008, some changes pertaining to the methodology for the allocation of debt limit had been specified. In continuation of the same, SEBI has decided that the time period for utilization of the corporate debt limits allocated through bidding process (for both old and long term infra limit) shall be 90 days. However, time period for utilization of the government debt limits allocated through bidding process shall remain 45 days. Moreover, the time period for utilization of the corporate debt limits allocated through first come first serve process shall be 22 working days while that for the government debt limits shall remain unchanged at 11 working days. Further, it was decided to grant a period of up to 15 working days for replacement of the disposed off/ matured debt instrument/ position for corporate debt while that for Government debt will continue to be at 5 working days.

Government debt long terms

SEBI, vide its circular dated February 2009, had decided that no single entity shall be allocated more than 10,000 crore of the investment limit. In a partial amendment to this, SEBI, vide its circular dated November 26, 2010, has decided that no single entity shall be allocated more than 2000 crore of the investment limit. Where a single entity bids on behalf of multiple entities, then such bid would be limited to 2,000 crore for every such single entity. Further, the minimum amount which can be bid for has been made 200 crore and the minimum tick size has been made 100 crore.

Corporate debt – Old limit

SEBI has decided that no single entity shall be allocated more than 600 crore of the investment limits. Where a single entity bids on behalf of multiple entities, then such bid would be limited to 600 crore for every such single entity. Further, the least amount which can be bid for has been made 100 crore and the minimum tick size has been made 50 crore.

Multiple bid order from single entity

SEBI has allowed the bidder to bid for more than one entity in the bidding process.

- It provides due authorization to act in that capacity by those entities
- It provides the stock exchanges, the allocation of the limits interest for the entities it has bid for to exchange with 15 minutes of close of bidding session.

Timely Change in Policy Initiatives of FII

In order to encourage the Flow of Foreign investment in India in due course of time government of India formulated various policies to maintain self sufficiency in an economy. Following are the major policy initiative taken by India government in view of FII in India.

- **September 1992**: FIIs allowed investing by the Government Guidelines in all securities in both primary and secondary markets and schemes floated by mutual funds. Single FIIs to invest 5 per cent and all FIIs allowed investing 24 per cent of a company's issued capital. Broad based funds to have 50 investors with no one holding more than 5 per cent. The objective was to have reputed foreign investors, such as, pension funds, mutual fund or investment trusts and other broad based institutional investors in the capital market.
- **April 1997:** Aggregated limit for all FIIs increased to 30 per cent subject to special procedure and resolution. The objective was to increase the participation by FIIs.
- **April 1998:** FIIs permitted to invest in dated Government securities subject to a ceiling. Consistent with the Government policy to limit the short-term debt, a ceiling of US $ 1 billion was assigned which was increased to US $ 1.75 billion in 2004.
- **June 1998:** Aggregate portfolio investment limit of FIIs and NRIs/PIOs/OCBs enhanced from 5 per cent to 10 per cent and the ceilings made mutually exclusive. Common ceilings would have negated the permission to FIIs. Therefore, separate ceilings were prescribed.
- **June 1998:** Forward cover allowed in equity.
- **February 2000:** Foreign firms and high net-worth individuals permitted to invest as sub-accounts of FIIs. Domestic portfolio manager allowed to be registered as FIIs to manage the funds of sub accounts. The objective was to allow operational flexibility and also give access to domestic asset management capability.
- **March 2001:** FII ceiling under special procedure enhanced to 49 per cent. The objective was to increase FII participation.
- **September 2001:** FII ceiling under special procedure rose to sectoral cap.
- **December 2003:** FII dual approval process of SEBI and RBI changed to single approval process of SEBI. The objective was to streamline the registration process and reduce the time taken for registration.
- **November 2004:** Outstanding corporate debt limit of USD 0.5 billion prescribed. The objective was to limit Short term debt flows.
- **April 2006:** Outstanding corporate debt limit increased to USD 1.5 billion prescribed. The limit on investment in Government securities was enhanced to USD 2 bn. This

was an announcement in the Budget of 2006-07.

- **November 2006:** FII investment up to 23% permitted in infrastructure companies in the securities markets, viz. stock exchanges, depositories and clearing corporations. This is a decision taken by Government Following the mandating of demutualization and corporatization of stock exchanges.
- **January and October 2007:** FIIs allowed to invest USD 3.2 billion in Government Securities (limits were raised from USD 2 billion in two phases of USD 0.6 billion each in January and October).
- **June 2008:** While reviewing the External Commercial Borrowing policy, the Government increased the cumulative debt investment limits from US $3.2 billion to US $5 billion and US $1.5 billion to US $3 billion for FII investments in Government Securities and Corporate Debt, respectively.
- **October 2008:** Removal of regulation for FIIs pertaining to restriction of 70:30 ratio of investment in equity and debt respectively.
- **October 2008:** Removal of Restrictions on Overseas Derivatives Instruments (ODIs) Disapproval of FIIs lending shares abroad.
- **April 2010:** FIIs allowed offering domestic Government Securities and foreign sovereign securities with AAA rating, as collateral to the recognized stock exchanges in India, in addition to cash, for their transactions in the cash segment of the market.
- **November 2010:** Investment cap for FIIs increased by US $ 5 billion each in Government securities and corporate bonds to US $ 10 billion and US $ 20 billion respectively.

As is evident from the above, the evolution of FII policy in India has displayed a steady and cautious approach to liberalization of a system of quantitative restrictions (QRs). The policy liberalization has taken the form of (i) relaxation of investment limits for FIIs; (ii) relaxation of eligibility conditions; and (iii) liberalization of investment instruments accessible for FIIs.

Evaluation of trend and prospect of FII in India

Foreign investments in India have been increasing significantly after opening of our economy into the world economy. To get more insight into the emerging trend of foreign investment in case of FII in India, net Investments by FIIs in Equity and Debt, trends in FII investment are the major instrument which guide and regulate the flow of foreign trade in India.

Net Investments by FIIs in Equity and Debt

After the reform period how FII has worked in India can be highlighted by the investment by FII in equity and debt (Table 2).

Table 2: Net Investments by FIIs in Equity and Debt

Year	Net Investment in Equity (in million)	Net Investment in Debt (in million)
2001-02	80,670	6,850
2002-03	25,280	600
2003-04	399,600	58,050
2004-05	441,230	17,590
2005-06	488,010	-73,340
2006-07	252,360	56,050
2007-08	534,040	127,750
2008-09	-477,060	18,950
2009-10	1,102,200	324,380

Source: SEBI. www.nseindia.com

Above table shows that after the net outflow of 477,070 million in equity instruments in 2008-09, FII investment in 2009-10 is 1,102,200 million. Similarly, the net investment by FIIs in the debt segment was 18,950 in 2008-09 which booms to 324,380 in the year 2009-10. Here it is also found that for two consecutive years in 2004-05 and 2005-06, net investment in equity showed year-on-year increase of 10%.

Trends in FII investment

Trends in FII are also helpful to analysis the post reform FII status in India (Table 3). From table 3 it is found out that the net in FII shows some negative move in the year 2008-09. But the trend in 2009-10 has the positive mark which indicates the growth of Indian economy. The FII investment has an increasing trend through-out the years.

Table 3: Trends in FII investment

Year	Purchases (mn.)	Sales (mn.)	Net investment (mn.)	Net investment (US $ mn.)	Cumulative Net investment (US $ mn.)
2000-01	740,506	641,164	99,342	2,159	13,532
2001-02	499,199	411,650	87,549	1,839	15,372
2002-03	470,601	443,710	26,891	566	15,937
2003-04	1,448,575	990,940	457,635	10,005	25,943
2004-05	2,169,530	1,710,730	458,800	9,363	36,294
2005-06	3,449,780	3,055,120	394,660	9,863	45,657
2006-07	5,205,090	4,896,680	308,410	6,821	52,478
2007-08	9,480,196	8,389,304	1,090,892	16,442	68,919
2008-09	6,145,810	6,603,920	-458,110	-9,837	59,082
2009-10	8,464,400	7,037,810	1,426,580	30,253	89,333

Source: SEBI. www.nseindia.com

Findings and conclusion

Since the inception of liberalization and globalisation (1991) FII flows to India have steadily grown in significantly, any economy in the world is major affected by the foreign investment and the movement of its capital market, as an indicator of performance of its various companies in a particular industry. In this article it signify that during the post reform period the flow of FII in India has augmented and foreign investor are anxious to make investment India which shows every year the registration of foreign investor in India are increasing. This article suggests no doubt government made many initiative but the policy implication that the authorities can focus on domestic economic policies to accelerate the growth and sustainability of foreign investment in India.

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