

An Empirical Analysis into Relationship between Foreign Institutional Investments (FIIs) and Stock Market

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Abstract

This paper makes an attempt to understand the relationship between FII and the Stock markets with the help of an empirical analysis. For the purpose of the study 5 stock market indices of the Bombay Stock Exchange have been considered which includes BSE Bankex, BSE Teck, BSE Healthcare, BSE IT, BSE Auto and BSE Oil and Gas. The six sectors were reported to have attracted the maximum FIIs in the recent years. The period selected for the study is 10 years from 1st January 2006 - 31st December 2015. Johansen's co-integration test revealed that FII and all of the six selected indices of BSE had a long these indices and FII move together. There is a unidirectional causal relationship flowing from BSE Auto, BSE Bankex, BSE IT, BSE Teck and BSE Oil & Gas to FII and there is no causal relationship flowing either from the Healthcare index to FII or from FII to Healthcare index. The results revealed a positive correlation between all the stock market indices and Foreign Institutional Investments.

I. Introduction

FOREIGN INSTITUTIONAL INVESTMENTS involves flow of funds across the countries. This flow of funds helps the capital scarce countries to mobilize the resources and gives a momentum to the growth process. While the flow of foreign institutional investments gives a boost to the stock market activity, their withdrawal creates a havoc causing losses to our retail investors. Thus the growing importance of FIIs for the developing economies has caught the attention of researchers and academicians. A number of researches are being undertaken in this area to understand the nuances of FII.

This paper attempts to understand the relationship between FII and the stock market through an empirical analysis. The study was undertaken for

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Healthcare index does not cause FII returns which means that there is no causal relationship flowing either from the Healthcare index to FII or from FII to Healthcare index.

This is a very comprehensive study involving 6 Indices. Hence the result of the study would help in gauging the significant impact FII would have on Indian Stock Markets.

5.1 Policy Implications

The understanding of relationship between the indices which have been attracting foreign capital flows is very important for the policy makers so that they can take essential steps to attract the foreign investments in our country. It is seen that FII flows are greatly influenced by movements in the stock market. It is necessary to stabilise BSE Auto, BSE Bankex, BSE IT, BSE Teck and BSE Oil and Gas Indices as they give good returns to Foreign Institutional Investors. By bringing out the correlation and the co-integration and the causality between FII and the selected stock indices, the market regulators would be able to focus their attention on the indices which can pull the FIIs into the Stock Market. This will help in increasing the liquidity which would trigger the economic development of our country.

This study can be carried out further by analysing the extent of impact FII exerts on these indices in order to take meaningful decisions.

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