A STUDY ON THE DETERMINANTS OF FOREIGN INSTITUTIONAL INVESTMENT INFLOWS INTO INDIA

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Abstract

FII is an investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds. This study intends to evaluate the trends and patterns of FII inflows into India. It also studies the relationship between the selected macro-economic variables and the FII inflows of India. The study is based on the secondary time series data collected for fifteen years ranging from FY 2000-01 to 2014-15. Index of Industrial Production, exchange rate, inflation, foreign exchange reserves and returns of BSE SENSEX are taken as the determinants of FII inflows for the purpose of this study. The collected data was analysed using Pearson’s correlation analysis, linear regression analysis and compounded annual growth rate. The results revealed that FII inflows exhibited a mixed pattern of inflows and high volatility. The established trend line shows an upward trend for FII inflows. IIP, REER and FER were found to be the determinants of FII inflows, whereas BSE returns and inflation were insignificant determinants. Favourable measures should be taken by the policy makers to improve these variables under study which will result in increased foreign institutional investment inflows.
1. INTRODUCTION

Foreign investment refers to the investments made by the residents of a country in the financial assets and production process of another country. The foreign investment is necessary for all developing nations as well as developed nations but the reasons and the importance may differ from country to country. The developing economies need these foreign investments for boosting up the entire development of the nation and for more intensive economic growth. The developed economies need foreign investments to support sustainable development.

India is one of the fastest growing economies since last few years and it has witnessed a large amount of foreign investment in various sectors. The government has formulated its policy aiming towards attracting more and more funds considering the domestic business concerns simultaneously.

2. FOREIGN INSTITUTIONAL INVESTMENTS

FII is an investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds.

Foreign institutional investors (FIIs) are those institutional investors which invest in the assets belonging to a different country other than that where these organizations are based.

According to SEBI "Foreign Institutional Investor" means an institution established or incorporated outside India, registered under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995; which proposes to make investment in India in securities

2.1 Determinants of FII inflows

The FII, given its short-term nature, might affect the returns of the domestic financial markets like money market, stock market, foreign exchange market, etc. Hence, understanding the determinants of FII is very important for any emerging economy as it would have larger impact on the domestic financial markets in the short run and real impact in the long run.

Determinants of FII can be put into two groups: economic determinants and policy/regulatory determinants. Economic determinants are not directly linked to policies aimed at attracting
foreign portfolio flows. Instead, they are a reflection of the general health of the economy, the potential for the firms operating in such a business environment to earn profits, and to obtain a satisfactory return on fixed income investment. Investors will typically focus on the following factors:

- High economic growth rate
- Exchange rate stability
- Macroeconomic stability
- Level of foreign exchange reserves
- Health of domestic banking system
- Stock and bond market liquidity
- Real interest rates

Some of the above factors will be of more importance to equity investors and others to fixed income investors. For example, high economic growth rates and the liquidity of the stock market will be of particular importance to portfolio managers specializing in equity investments. On the other hand, the degree of bond market liquidity and the level of real interest rates will be of particular importance for fixed income investors.

The other set of determinants of which foreign investors pay particular attention includes policy and regulatory frameworks in individual emerging markets. These are the factors over which domestic governments have a direct influence. The main determinants in this group are the following:

- Ease of repatriating dividends and capital
- Domestic capital gains tax
- Stock and bond market regulation
- Quality of domestic accounting disclosure standards
- Speed and reliability of settlement system
- Availability of domestic custodians and brokers
- Degree of investor rights protection

It is not possible to isolate any single factor as being the most important, although some tend to carry more weight than others. For example, the degree of investor rights protection and the ease of repatriating dividends and capital are often cited as being closely watched by potential investors.
2.2 Advantages of FII

1. Enhanced Flow of Equity Capital: FIIs have a greater appetite for equity than debt in their asset structure. The opening up the economy to FIIs has been in line with the accepted preference for non-debt creating foreign inflows over foreign debt. Enhanced flow of equity capital helps improve capital structures and contributes towards building the investment gap.

2. Managing Uncertainty and Controlling Risk: FIIs promote financial innovation and development of hedging instruments. These because of their interest in hedging risks, are known to have contributed to the development of zero-coupon bonds and index futures. FIIs not only enhance competition in financial markets, but also improve the alignment of asset prices to fundamentals. FIIs in particular are known to have good information and low transaction costs. By aligning asset prices closer to fundamentals, they stabilize markets.

3. Improving Capital Markets: FIIs as professional bodies of asset managers and financial analysts’ enhance competition and efficiency of financial markets. By increasing the availability of riskier long term capital for projects, and increasing firm’s incentives to supply more information about them, the FIIs can help in the process of economic development.

4. Improved Corporate Governance: FIIs constitute professional bodies of asset managers and financial analysts, who, by contributing to better understanding of firms’ operations, improve corporate governance.

2.3 Disadvantages of FII inflows

1. Potential Capital Outflows: Hot money refers to funds that are controlled by investors who actively seek short-term returns. Hot money can have economic and financial repercussions on countries and banks. When money is injected in a country, the exchange rate for the country receiving the money strengthens, while the exchange rate for the country investing the money weakens. If money is withdrawn on short notice, the banking institution of the recipient country will experience shortage of funds.
2. Inflation: Huge amounts of FII inflow into the country creates a lot of demand for rupee and the RBI pumps the amount of Rupee in the market to meet the demand created. This situation leads to excess money flow in the economy thereby leading to inflation where too much money chases too few goods.

3. Problem to Small Investors: The FII profits from investing in emerging financial stock markets. If the cap on FII is high then they can bring in huge amounts of funds into the country's stock markets and thus have great influence on the way the stock markets behaves. The FII buying pushes the stocks up and their selling pushes stock market on the downward path. This creates problems for the small investor, whose fortunes get driven by the actions of the large FIIs.

4. Adverse Impact on Exports: FII flows leading to appreciation of the currency may lead to the exports industry becoming uncompetitive due to the appreciation of the rupee.

2.4 FII in India

Emerging economies like India, which offer relatively higher growth than the developed economies, have become favourable among investors as attractive investment destinations for foreign institutional investors (FIIs). Investors are optimistic on India and sentiments are favourable following government’s announcement of a series of reform measures in recent months. A poll conducted by Bank of America Merrill Lynch (BofA-ML) recently, in which 50 investors participated, revealed that India was the most favourite equity market for the global investors for the year 2015 at 43 per cent, followed by China at 26 per cent.

FII’s net investments in Indian equities and debt have touched record highs in the past financial year, backed by expectations of an economic recovery, falling interest rates and improving earnings outlook. FIIs have invested a net of US$ 89.5 billion in 2014-15 which is expected to be their highest investment in any fiscal year. India continues to be a preferred market for foreign investors.
2.5 Who can invest in FII in India?

Foreign Institutional Investors (FIIs) registered with SEBI are eligible to purchase shares, convertible debentures and warrants issued by Indian companies under the Portfolio Investment Scheme (PIS). SEBI approved sub accounts of FIIs (sub accounts) have general permission to invest under the PIS.

The following entities, established or incorporated abroad, are eligible to be registered as FIIs:

- Pension Funds
- Mutual Funds
- University Funds
- Insurance Companies
- Investment Trusts
- Banks
- Endowments
- Foundations
- Charitable Trusts / Charitable Societies
- Asset Management Companies
- Institutional Portfolio Managers
- Trustees
- Power of Attorney Holders

2.6 Investment in listed Indian companies

FIIs can invest up to a maximum of 10 per cent of the total paid-up capital or 10 per cent of the paid-up value of each series of convertible debentures issued by the Indian company.

2.7 Prohibition on investments by FIIs

FIIs are not permitted to invest in the capital of a company in Defence Industry subject to Industrial license under the Industries (Development & Regulation) Act, 1951

FIIs are not allowed to invest in any company which is engaged or proposes to engage in the following activities:

- Business of chit fund, or
• Nidhi company, or
• Agricultural or plantation activities, or
• Real estate business or construction of farm houses, or
• Trading in Transferable Development Rights (TDRs).

3. REVIEW OF LITERATURE

Rajesh Chakrabarti (2001), “FII Flows to India: Nature and Causes”. Since the beginning of liberalisation, FII flows to India have steadily grown. The researcher analyses the flows of FII and their relationship with other economic variables. The period of study is from January 1993 to December 1999. Granger causality test has been applied and arrived at the following major conclusions: While the flows are highly correlated with equity returns in India, they are more likely to be the effect than the cause of these returns; The FIIs do not seem to be at an informational asymmetry in India compared to the local investors; The Asian Crisis marked a regime shift in the determinants of FII flows to India with the domestic equity returns becoming the sole driver of these flows since the crisis.

Suchismita Bose, Dipankor Coondoo (2004), “The Impact of FII Regulations in India: A Time-Series Intervention Analysis of Equity Flows”, the authors have studied the impact of the FII policy reforms on FII portfolio flows into the Indian stock markets. Assessment of several policy revisions related to FII investment and its impact on FII flows during the period January 1999 to January 2004 is done through a multivariate GARCH regression model. The results strongly suggest that liberalisation policies have had the desired expansionary effect and have either increased the mean level of FII inflows and/or the sensitivity of these flows to a change in BSE return and/or the inertia of these flows. On the other hand, the restrictive measures aimed at achieving greater control over FII flows also do not show any significant negative impact on the net inflows; it is found that these policies mostly render FII investments more sensitive to the domestic market returns and raise the inertia of the FII flows.

Ravi Saraogi (2008), “Determinants of FII Inflows: India”, the researcher has attempted to identify the important determinants of foreign institutional investments (FII) into India. The issue is extremely important for contemporary policy making since managing the large foreign inflows into India in recent times has come to haunt both the RBI and the Government. For the purpose of this study, monthly time series data ranging from January
2001 to December 2007 has been analysed using OLS regression model. The results indicated that a positive relationship between the variables and FII inflows into India were observed. It appears from the analysis that to control FII inflows into India, the best policy would be to curb foreign inflows into Indian equity markets.

Manjinder Kaur Sharanjit S. Dhillon (2010), “Determinants of Foreign Institutional Investors’ Investment in India”, the study aims at exploring the determinants of Foreign Institutional Investors’ (FIIs) investment in India. Results reveal that the returns on Indian stock market have positive impact whereas US stock market returns have no significant influence on FIIs investment to India. Stock market risk has negative influence on FIIs inflows to India. Market capitalization and stock market turnover of India have significant positive influence only in short-run. Among macroeconomic determinants, economic growth of India has positive impact on FII investment both in long-run and shortrun. But all other macroeconomic factors have significant influence only in long-run like inflation in US has positive influence whereas inflation in India has negative influence on FIIs investment. Further, US interest rate has adverse impact on FIIs investment while liberalization policies of India exhibited significant contribution to FIIs inflows. Study concludes that FIIs inflows in India are determined by both stock market characteristics and macroeconomic factors.

Dr. Mamta Jain, Priyanka Lakshmi Meena, T N Mathur (2013), “Role of Foreign Direct Investment and Foreign Institutional Investment in Indian Economy”. The authors have studied about the correlation between foreign institutional investments or foreign direct investment and the real economic growth in India over a period 2000-01 to 2009-10. GDP at factor cost has been taken as the proxy variable for real economic growth. They have concluded saying that the FII and FDI are influencing the economic development to a greater extent. FDI is preferred over FII investments since it is considered to be the most beneficial form of foreign investment for the economy as a whole.

Srinivasan P, Kalaivani M (2013), “Determinants of Foreign Institutional Investment in India: An Empirical Analysis”, the intention of the researchers is to explore the determinants of foreign institutional investments in India through the Autoregressive Distributed Lag (ARDL) bounds testing approach. Quarterly time series data has been used and the empirical analysis has been carried out for the period from January 2004 to December 2011. The result shows that exchange rate has significant negative impact on FII inflows both in the short-run and long-run, implying that depreciation of currency adversely affects the FII
flows into India. Moreover, the Indian equity market returns has negative short-run and positive long-run effects on FII inflows to India. This confirms the evidence of positive and negative feedback trading hypothesis in the short-run and long-run, respectively. The US equity market returns has positive and significant influence on FII flows in the long-run but positive and insignificant influence on FII flows in the short-run. It is concluded that FII inflows to India are essentially determined by exchange rate, domestic inflation, domestic equity market returns, returns and risk associated with US equity market.

Amita (2014), “Determinants of FIIs: Evidence from India”, the present paper is aimed to identify the determinants of Foreign Institutional Investment and to establish a relationship between them. The economic variables used are Foreign Exchange Rates, BSE Sensex, Exchange Rates, and Inflation. Secondary data has been used for a period of 12 years from 2001-02 to 2012-13. The data was obtained on monthly basis. Econometric tools like Augmented Dicker Fuller test and Granger Causality Test are used to analyse the data. The correlation coefficient between FIIs and Sensex, FIIs and FERs, FERs and Sensex, and WPI and Sensex were found positive. However, exchange rates and Inflation was found having negative relationship with FIIs. The results of Granger Causality Model indicated bi-directional causality between FII and Sensex, and FII and Exchange rate. However, no causality was found between FII and Foreign Exchange Reserves.

T Mohanasundaram, P Karthikeyan, V Krishnamoorthy (2015), “Macroeconomic Dynamics of Foreign Institutional Investments in India”, the authors study the determinants of Foreign Institutional Investments (FII) in India using monthly time series data for the period from April 2001 to March 2014. The secondary data have been collected from officially published websites. Correlation and Autoregressive Distributed lag (ARDL) bounds testing approach have been used. The authors have found that FII flows are having positive relationship with Exchange Rate, Producer Price Index of USA, Return on S&P 500, Return on Nifty, and Market Capitalization of NSE and having negative relationship with Wholesale Price Index of India. The result of ARDL model shows that the US 3-month T-bill rate (USTBR) representing foreign interest rate has significant and negative impact on FIIs investment in host (Indian) stock market and Producer Price Index (PPI) of USA has significant and positive influence on FIIs flows in the Indian stock market at long run. It is concluded that FII inflows to India are primarily determined by macroeconomic factors.
4. RESEARCH DESIGN

4.1 Statement of the Problem

Liberalisation and the globalisation of the Indian markets have attracted foreign investments into India in the past two decades. But the flow of foreign investments into India is found to be fluctuating highly. FDI and FII are predominant and vital factors influencing the economic development of a host nation. Initiatives like Make in India, favourable changes in the policy regimes and robust business environment has caused an upsurge in the foreign capital inflows. But events like global financial crisis and the ongoing economic slowdown in China will have an effect on the global capital market. In this backdrop the researcher aims to study the trends and patterns of FII inflows into India and examine the determinants of FII flows and to understand whether India can attain the position of an attractive investment destination in the global scenario.

4.2 Objectives of the Study

1. To study the trend and pattern of Foreign Institutional Investment inflows into India.
2. To examine the influence of BSE SENSEX returns, Index of Industrial Production, Real Effective Exchange Rate, Foreign Exchange Reserves and Inflation on the FII inflows of India each individually and collectively.

4.3 Hypotheses

To fulfil the objectives of this study, the following hypotheses have been set:

1. $H_0$: There is no significant relationship between the FII inflows and IIP of India  
   $H_1$: There is a significant relationship between the FII inflows and IIP of India
2. $H_0$: There is no significant relationship between the FII inflows and REER of India  
   $H_1$: There is a significant relationship between the FII inflows and REER of India
3. $H_0$: There is no significant relationship between the FII inflows and FER of India  
   $H_1$: There is a significant relationship between the FII inflows and FER of India
4. $H_0$: There is no significant relationship between the FII inflows and BSE Returns of India.  
   $H_1$: There is a significant relationship between the FII inflows and BSE Returns of India
5. $H_0$: There is no significant relationship between the FII inflows and CPI of India.
H$_1$: There is a significant relationship between the FII inflows and CPI of India

4.4 Research Methodology

4.4.1 Type of Research: This is an analytical research as it aims to study the relationship between the selected variables and FII inflows.

4.4.2 Type of data: The objectives of this study are satisfied by collecting and analyzing the secondary time series data from various sources.

4.4.3 Sources of data: The data for this study has been collected from various secondary sources like Handbook of Statistics on the Indian economy published by RBI, DIPP, SEBI, Ministry of Commerce, Ministry of Statistics and Programme Implementation, CSO, BSE India, World Development Indicators report and other online publications.

4.4.4 Statistical Tools used: Descriptive Statistics, CAGR, Correlation analysis, Regression Analysis

4.4.5 Period of the study: The study is conducted for a period of fifteen financial years starting from 2000-01 to 2014-15.

4.5 Variables used in this study:
4.5.1 Foreign Institutional Investment inflows (FII)
4.5.2 Index of Industrial Production (IIP)
4.5.3 Inflation (CPI)
4.5.4 Real Effective Exchange Rate (REER)
4.5.5 Foreign Exchange Reserves (FER)
4.5.6 BSE SENSEX Returns (BSE Returns)

5. ANALYSIS AND INTERPRETATION

5.1 To Study the Trend and Pattern of Foreign Institutional Investment Inflows into India.

Table 5.1.1: Net Foreign Institutional Investment Inflows into India (in INR Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>FII</th>
<th>Increase / Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-01</td>
<td>118.20</td>
<td></td>
</tr>
<tr>
<td>2001-02</td>
<td>92.90</td>
<td>-21.40%</td>
</tr>
<tr>
<td>2002-03</td>
<td>45.04</td>
<td>-51.52%</td>
</tr>
<tr>
<td>2003-04</td>
<td>518.98</td>
<td>1052.26%</td>
</tr>
<tr>
<td>Year</td>
<td>Value</td>
<td>% Change</td>
</tr>
<tr>
<td>--------</td>
<td>--------</td>
<td>----------</td>
</tr>
<tr>
<td>2004-05</td>
<td>413.12</td>
<td>-20.40%</td>
</tr>
<tr>
<td>2005-06</td>
<td>553.57</td>
<td>34.00%</td>
</tr>
<tr>
<td>2006-07</td>
<td>318.81</td>
<td>-42.41%</td>
</tr>
<tr>
<td>2007-08</td>
<td>1106.19</td>
<td>246.97%</td>
</tr>
<tr>
<td>2008-09</td>
<td>-650.45</td>
<td>-158.80%</td>
</tr>
<tr>
<td>2009-10</td>
<td>1539.67</td>
<td>336.71%</td>
</tr>
<tr>
<td>2010-11</td>
<td>1393.81</td>
<td>-9.47%</td>
</tr>
<tr>
<td>2011-12</td>
<td>855.71</td>
<td>-38.61%</td>
</tr>
<tr>
<td>2012-13</td>
<td>1464.67</td>
<td>71.16%</td>
</tr>
<tr>
<td>2013-14</td>
<td>296.80</td>
<td>-79.74%</td>
</tr>
<tr>
<td>2014-15</td>
<td>2499.45</td>
<td>742.13%</td>
</tr>
<tr>
<td>CAGR</td>
<td></td>
<td>24.35%</td>
</tr>
</tbody>
</table>

From the above table, it is seen that the Foreign Institutional Investment inflows into India has increased from Rs.118.20 billion in 2000-01 to Rs.2499.45 billion in 2014-15. From the observation made by the researcher, there is no particular pattern found in the FII inflows. There is mixed trend in the FII inflows From the calculated % of increase or decrease, it is seen that the highest increase % is in the year 2003-04 at 1052.26% and the lowest decrease % is in the year 2008-09 at 158.80 %.

Compounded Annual Growth Rate is calculated to be 24.35% for the period under study. This means the FII inflows have increased on an average of 24.35% year after year for fifteen years. On the whole there is a gradual increase in the FII inflows into India.

**Chart 5.1.1: Foreign Institutional Investment Inflows into India**
The above graph shows the Net Foreign Institutional Investments into India which are found to be highly volatile for the period under study. The FII inflows are observed to have increased in one year followed by a decrease in the next year. FY 2008-09 has a negative FII flow which means Foreign Institutional Investments made by India is more than the Foreign Institutional Investments received by India. This dip in the FII inflows is the effect of the global financial crisis. India has received the highest FII flows in the FY 2014-15. From the established trend line in the graph it is seen that there is an overall increasing trend in the FII inflows of India.

Table 5.1.2: Summary of descriptive statistics for FII and its determinants

<table>
<thead>
<tr>
<th></th>
<th>Maximum</th>
<th>Minimum</th>
<th>Mean</th>
<th>Std Deviation</th>
<th>Co-efficient of Variation</th>
</tr>
</thead>
<tbody>
<tr>
<td>FII</td>
<td>2499.45</td>
<td>-650.45</td>
<td>704.4313</td>
<td>783.8657</td>
<td>1.112764</td>
</tr>
<tr>
<td>IIP</td>
<td>176.8667</td>
<td>77.02511</td>
<td>130.4822</td>
<td>37.89773</td>
<td>0.290444</td>
</tr>
<tr>
<td>REER</td>
<td>115.02</td>
<td>97.65005</td>
<td>104.609</td>
<td>5.564566</td>
<td>0.053194</td>
</tr>
<tr>
<td>FER</td>
<td>21376.47</td>
<td>1972.04</td>
<td>10453.1</td>
<td>5980.925</td>
<td>0.572168</td>
</tr>
<tr>
<td>BSE Returns</td>
<td>46.60916</td>
<td>-27.8243</td>
<td>15.1145</td>
<td>24.78884</td>
<td>1.640071</td>
</tr>
<tr>
<td>CPI</td>
<td>12.4</td>
<td>3.8</td>
<td>6.92</td>
<td>2.930188</td>
<td>0.423438</td>
</tr>
</tbody>
</table>

The above table shows that the average FII inflow into India for the period of study is Rs.704.4313 billion. The Coefficient of variation for FII inflows and BSE Returns are found to be the highest and hence it is more volatile or inconsistent than the other variables under study.

5.2 To examine the influence of BSE SENSEX returns, Index of Industrial Production, Real Effective Exchange Rate, Foreign Exchange Reserves and Inflation on the FII inflows of India each individually and collectively.

5.2.1 Correlation Analysis: Correlation analysis has been done for testing of hypotheses.

Table 5.2.1: Correlation coefficients of FII and its determinants

<table>
<thead>
<tr>
<th></th>
<th>FII</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>IIP</td>
<td>0.569</td>
<td>0.019</td>
</tr>
<tr>
<td>REER</td>
<td>0.748</td>
<td>0.001</td>
</tr>
<tr>
<td>FER</td>
<td>0.617</td>
<td>0.014</td>
</tr>
<tr>
<td>BSE returns</td>
<td>0.465</td>
<td>0.081</td>
</tr>
<tr>
<td>CPI</td>
<td>0.362</td>
<td>0.185</td>
</tr>
</tbody>
</table>
The above table shows that the \( p \) value of all IIP, REER and FER are less than 0.05, \( p < 0.05 \), therefore the hypotheses set for these variables are rejected at 0.05 level of significance and a significant relationship is found between FII inflows and these variables; whereas for BSE returns and CPI, \( p > 0.05 \), therefore the null hypotheses is accepted. There is a strong positive correlation between FII and REER, whereas a moderate positive correlation is found between FII and IIP; and FII and FER.

5.2.2 Regression Analysis: to further verify the relationship and to predict the FII flows, regression analysis has been used.

Table 5.2.2: Regression Equations of FII and its determinants

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>Equation</th>
<th>R square</th>
</tr>
</thead>
<tbody>
<tr>
<td>FII</td>
<td>- 904.122 + 12.328 (IIP)</td>
<td>0.355</td>
</tr>
<tr>
<td>FII</td>
<td>- 10316.344 + 105.352 (REER)</td>
<td>0.559</td>
</tr>
<tr>
<td>FII</td>
<td>-141.327 + 0.081 (FER)</td>
<td>0.381</td>
</tr>
<tr>
<td>FII</td>
<td>482.303 + 14.696 (BSE Returns)</td>
<td>0.216</td>
</tr>
<tr>
<td>FII</td>
<td>33.912 + 96.869 (CPI)</td>
<td>0.131</td>
</tr>
</tbody>
</table>

The above regression equation evolved is of good fit for independent variables IIP, REER and FER and its the \( R^2 \) values seems to be significant in explaining the variations in the dependent variable FII. Using the above equations, FII inflows can be predicted with the help of independent variables. The equation formulated for independent variables CPI and BSE returns are not of good fit.

5.2.3: Multiple regression analysis

Table 5.2.3: Regression Equations of FII and its determinants

<table>
<thead>
<tr>
<th>Dependent variable</th>
<th>Equation</th>
<th>R square</th>
</tr>
</thead>
<tbody>
<tr>
<td>FII</td>
<td>- 11780.010 + 0.299 (FER) + 11.865 (BSE Returns) – 64.609 (IIP) + 155.630 (REER) + 191.681 (CPI)</td>
<td>0.808</td>
</tr>
</tbody>
</table>

In the above table \( R^2 = 0.808 \), which means the independent variables CPI, BSE Returns, REER, FER, IIP can explain 80.8 % of the variations in the dependent variable which is FII inflows. From the above equation FII can be predicted with the help of FER, BSE Returns, IIP, REER and CPI.
6. SUMMARY OF FINDINGS AND SUGGESTIONS

6.1 Findings

- The Foreign institutional investments inflows into India are found to be volatile for the study period. Though the FII inflows are found to be volatile, the trend line indicates an increasing trend in the FII inflows into India.

- The CAGR for FII inflows is worked out to be 24.35%, which means the FII inflows have increased at the rate of 24.35% approximately year after year for the past fifteen years.

- Index of Industrial Production, Real Effective Exchange Rate and Foreign Exchange Reserves moderately influence the Foreign Institutional Investment inflows into India. They tend to move in the same direction.

- There is no significant association found between returns of BSE SENSEX and FII; inflation level and FII inflows in India.

- Simple linear regression model formulated for FII and IIP, FII and REER, FII and FER were found to be of good fit to statistically significantly predict the FII inflows, where as models formulated for FII and BSE SENSEX returns and FII and CPI were not of good fit.

- Multiple Regression model formulated for dependent variable FII and the selected independent variables (IIP, REER, FER, BSE returns, CPI)is found to be of good fit with $R^2 = 0.808$, which means the independent variables can explain 80.8% of the variations in the dependent variable.

6.2 Suggestions

- Exchange rate of INR is found to influence the FII inflows, therefore the policy makers should bring about policy changes to appreciate the INR which will lead to increased FII inflows.

- The FII inflows into India are very inconsistent and this will affect the Indian economy, therefore factors influencing the FII inflows have to be kept in mind and measures should be taken to curb the volatility in the FII inflows.

- Government of India should increase its foreign exchange reserves to build confidence and attract more foreign institutional investors investing in India.
• The policy makers should consider improving the index of industrial production by providing incentives and attractive benefits for the lacking industries in the economy because IIP has a bearing on the foreign capital inflows.

• The volatility of Indian stock markets will affect the investors’ returns and confidence as a result the capital formation will be affected. Therefore the government has to take measures to accelerate the indices of stock exchanges.

• The government should be prudent while pursuing policies and it should exercise stringent control over inefficient bureaucracy, red-tapism, and the widespread corruption, so that India can gain the investor’s confidence and attract more foreign capital inflows to India

6.3 Conclusion

Foreign capital is considered to be a vital component for the economic growth of a developing country. Since 1990’s to this date the Government of India has eased its foreign capital policies and norms and many initiatives to attract foreign capital has been implemented. It is found that the FII inflows have increased for the period under study and exhibits an upward trend. FII inflows of India were found to be influenced by IIP, exchange rate and foreign exchange reserves, whereas inflation and returns of BSE Sensex were found to be insignificant. The policy decisions taken by the government should have a favourable effect on the exchange rates, forex reserves and the industrial production in order to increase the inward FII flow into India.

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