Role of FDI on Indian Stock Market

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ABSTRACT

In recent years, emerging market economies (EMEs) are increasingly becoming a source of foreign investment for rest of the world. It is not only a sign of their increasing participation in the global economy but also of their increasing competence. More importantly, a growing impetus for change today is coming from developing countries and economies in transition, where a number of private as well as state-owned enterprises are increasingly undertaking outward expansion through foreign direct investments (FDI). Companies are expanding their business operations by investing overseas with a view to acquiring a regional and global reach. The Indian government recently opened the gates for foreign individual investors to invest directly into Indian stock markets.

A recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. The sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, the US and the UK were among the leading sources of FDI.

The current paper makes an attempt to study the relationship and impact of FDI on Indian stock market using statistical measures correlation coefficient. Sensex and Nifty were considered as the representative of stock market as they are the most popular Indian stock market indices.

Key words - FDI, Sensex, Nifty, Impact, sectors

INTRODUCTION

Unprecedented globalizations have witnessed double digit economic growth resulting in fierce competition and accelerated pace of innovation. As a result inflow of Foreign Direct investments has become a striking measure of economic development in both developed and developing countries. Any investment that flows from one country into another is known as foreign investment. Investments in listed/unlisted companies other than through stock exchanges are referred as Foreign Direct Investment. In other words FDI refers to an investment made by a company based in one country, into a company based in another country, companies making such direct investments have a significant degree of influence and control over the company into which the investment is made.

FDI is preferred over FII investments as it is considered to be the most beneficial form of foreign investment for the economy as a whole. Direct investment targets a specific enterprise, with the aim of increasing its capacity/productivity or changing its management control. FDI tends to be much more stable than FII inflows. Moreover, FDI brings not just capital but also better management and governance practices and, often, technology transfer.

Foreign Direct Investment in Indian stock market has allowed in increasing competition amongst the investors in domestic market. Competition increased due to upgradation of technology and invention of technology in India which acted a major jolt for the Indian economy and has enhanced the chances of growth of Indian economy.

Foreign investment is also seen as an emerging measure of growing economic globalization. Investment has always been an issue for the developing economies such as India and so those countries have drafted measures to liberalize their policies for welcoming investment from countries which are abundant in capital resources. The countries which are developed are focusing on new markets where there is availability of abundant labors, scope for products, and high profits are achieved to fulfill their growth ambitions.
The 30-share index of the Bombay Stock Exchange (BSE), which had lost nearly 193 points in the past two sessions, shot up over 440 points supported by all blue chips, while 50-share National Stock Exchange Nifty touched a fresh high of 2012. India’s share in global FDI has increased considerably, but the pace of FDI inflows has been slower than China, Singapore, Brazil, and Russia. Indian economy is largely agriculture based and there is plenty of scope in food processing, agriculture services and agriculture machinery. FDI in this sector should be encouraged.

NEED FOR FDI IN INDIA

Growing India needs abundant foreign capital in the form of FDI for the development of basic infrastructure like Roads, Railways, Sea Ports, Warehouses, Banking Services and Insurance Services etc. Moreover, rapid industrialization since 1991 has further strengthened the need of foreign capital across various industries. Many developing countries suffer from severe scarcity of funds in highly capital intensive areas such as infrastructure. This problem can be diverted to the foreign capitalists by allowing them to invest. Other words, foreign capital are the panacea for the scarcity of all resources. The variations in the cost of capital are also one of the important factors resulting in attracting foreign capital in India. For example; Interest rates are high in India as compared to developed economies. In several countries the interest rates are as low as 1% to 3%, where as in some countries like India the interest rates are very high as 8% to 10% per annum. Thus, for enterprises in India, foreign capital is an easy route to reduce the cost of capital. Thus investors tend to invest in countries like India where they can gain maximum return on their investments. Gradual Integration of global financial markets ultimately results in explosive growth of FDI around the globe.

The need for larger FDI exists because India is at a stage where it needs not only US investments, but also technology, and management policies to sustain and enhance its economic growth. The need for larger FDI calls for major issues and areas to be taken into consideration, such as:

- Market potential and accessibility
- Political stability
- Market infrastructure
- Easy currency conversion

India is the ideal country to make Foreign Direct investments in because of its features like:

- Developing economy
- Low salaried employees
- Low wage workers
- Abundant human resources
- Big private economy

OBJECTIVES OF THE STUDY

- To study the trends and patterns of foreign capital flow in to India in the form of FDI.
- To study the impact of Foreign Direct Investment (FDI) on Indian stock market.
- To find the Sectors that which attracts more FDI.
- To find the countries that contributes more investment in India.
- To find the reasons of decline in SENSEX during the year 2008-09.
- To study the reasons of decline in FDI Inflow during the year 2009-10 to 2010-2011.

SCOPE OF THE STUDY

The present study takes 10 years data into consideration. To study the impact of FDI on Indian stock market, Sensex was a natural choice to be considered in the study, as it is the most popular stock market indices and widely used by market participants for benchmarking.
DATA COLLECTION

This study is based on secondary data. The required data related to FDI have been collected from various sources i.e. Bulletins of Reserve Bank of India, publications from Ministry of Commerce, Govt. of India. The BSE Sensex and CNX Nifty data is downloaded from the websites of bseindia and nseindia respectively. Daily closing index value are taken and averaged to get the index value for each year, which is considered as more representative figure of index for the entire year rather any one day’s/month’s closing figure of the index. The present study considers 11 years data starting from 2001 to 2011.

DATA ANALYSIS

The following table presents the amount of flow of FDI in India in terms of US$ million. The flow of FDIs has shown an increasing trend during the considered period except during the years i.e. 2001 to 2004 and the year 2010-11.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FDI(US $ MILLION)</th>
<th>BSE SENSEX</th>
<th>CNX Nifty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-01</td>
<td>4029</td>
<td>4269.68</td>
<td>1334.76</td>
</tr>
<tr>
<td>2001-02</td>
<td>6130</td>
<td>3331.94</td>
<td>1077.02</td>
</tr>
<tr>
<td>2002-03</td>
<td>5035</td>
<td>3206.28</td>
<td>1037.22</td>
</tr>
<tr>
<td>2003-04</td>
<td>4322</td>
<td>4493.53</td>
<td>1427.5</td>
</tr>
<tr>
<td>2004-05</td>
<td>6051</td>
<td>5740.98</td>
<td>1805.26</td>
</tr>
<tr>
<td>2005-06</td>
<td>8961</td>
<td>8280.08</td>
<td>2513.44</td>
</tr>
<tr>
<td>2006-07</td>
<td>22826</td>
<td>12277.32</td>
<td>3572.44</td>
</tr>
<tr>
<td>2007-08</td>
<td>34835</td>
<td>16568.88</td>
<td>4896.59</td>
</tr>
<tr>
<td>2008-09</td>
<td>41874</td>
<td>12365.55</td>
<td>3731.02</td>
</tr>
<tr>
<td>2009-10</td>
<td>37745</td>
<td>15585.21</td>
<td>4657.76</td>
</tr>
<tr>
<td>2010-11</td>
<td>32901</td>
<td>18605.17</td>
<td>5583.54</td>
</tr>
</tbody>
</table>

Sources: FDI & FII from various reports of DIPP
BSE & NSE from bseindia and nseindia websites

Statistical Analysis Tools and Techniques

- Correlation co-efficient
- Simple Regression Analysis

In order to analyze the collected data the statistical tools such as correlation and Simple regression Analysis model is used. Correlation coefficient is a statistical measure that determines the degree to which two variable's movements are associated. Correlation coefficient value ranges from -1 to 1. Negative value of correlation indicates: if one variable increases in its values, the other variable decreases in its value and positive value indicates: if one variable increases in its values the other variable also increases in its value. In the current study to study the linear relationship between variables such as FDI and SENSEX & Nifty correlation is applied.

The simple regression analysis is a statistical technique used to evaluate the effects of independent variables on a dependent variable. In the current paper attempt is made to study the impact of FDI on SENSEX and Nifty. So FDI is considered as the independent variables the dependent variable for is SENSEX and Nifty.
ANALYSIS AND INTERPRETATION

Simple Regression Analysis is used to find the Impact of flow of FDIs on BSE SENSEX,

Regression equation gives the value of the dependent variable corresponding to any specified value of the independent variable. In this study FDI is considering as the Independent Variable i.e X and SENSEX is considered as the dependent variable i.e Y.

\[
Y = 0.316X + 3250
\]

Interpretation

From the above table it is interpreted that if the inflow of FDI is 1 million US $ then the expected SENSEX will be increased by 3890.31.

Calculation of correlation coefficient between FDI and BSE Sensex

Correlation is applied to study the statistical relationship between the variables FDI and BSE SENSEX and FDI & CNX Nifty. The following table presents the output, when correlation is run to the 11 years data considered. Based on the results it can be concluded that there is a very strong positive correlation between FDI & SENSEX and FDI & Nifty.

<table>
<thead>
<tr>
<th>Correlation Co-efficient</th>
<th>BSE SENSEX</th>
<th>CNX Nifty</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI (US $ Million)</td>
<td>0.907</td>
<td>0.907</td>
</tr>
</tbody>
</table>

Interpretation

From the above table it is interpreted that the correlation between FID inflow and BSE SENSEX and FDI and NIFTY is 0.907. It shows that, there is a positive linear relationship between inflow of FDI and BSE SENSEX and CNX Nifty.

Top 10 countries invested in India during the year 2011

Countries including Mauritius, Singapore, the U.S., the U.K., the Netherlands, Japan, Germany and UAE are the major investors in India.

<table>
<thead>
<tr>
<th>Countries</th>
<th>FDI inflow in US $ millions in the year 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritius</td>
<td>55,203</td>
</tr>
<tr>
<td>Singapore</td>
<td>13,070</td>
</tr>
<tr>
<td>U.S.A</td>
<td>9,529</td>
</tr>
<tr>
<td>U.K</td>
<td>6,643</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5,739</td>
</tr>
<tr>
<td>Japan</td>
<td>5,511</td>
</tr>
<tr>
<td>Cyprus</td>
<td>4,982</td>
</tr>
<tr>
<td>Germany</td>
<td>3,051</td>
</tr>
<tr>
<td>France</td>
<td>2,484</td>
</tr>
<tr>
<td>U.A.E</td>
<td>1,910</td>
</tr>
</tbody>
</table>
Sectors that attracts FDI in India during the year 2011

<table>
<thead>
<tr>
<th>Sectors</th>
<th>FDI inflow in US $ millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services sector</td>
<td>27,668</td>
</tr>
<tr>
<td>Computer</td>
<td>10,821</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>10,611</td>
</tr>
<tr>
<td>Housing and real estate</td>
<td>9,655</td>
</tr>
<tr>
<td>Construction</td>
<td>9,491</td>
</tr>
<tr>
<td>Automobile industry</td>
<td>6,199</td>
</tr>
<tr>
<td>Power</td>
<td>6,156</td>
</tr>
<tr>
<td>Metallurgical Industries</td>
<td>4,286</td>
</tr>
<tr>
<td>Petroleum &amp; Natural Gas</td>
<td>3,159</td>
</tr>
<tr>
<td>Chemicals</td>
<td>2,927</td>
</tr>
</tbody>
</table>

![FDI inflow in $ millions in 2011](image)

![Sector that attracts FDI in India](image)
Findings
1. The FDI flows have shown an increasing trend during the considered period of study except in the recent past two years and during 2002 to 2004.
2. There is a strong positive correlation between FDI & SENSEX and FDI & nifty.
3. Flow of FDIs into India and BSE SENSEX trend are dependent.
4. Flow of FDIs into India and CNX Nifty trend are dependent.
5. It was found that during the year 2008-2009 even though there was an increase in FDI inflows the SENSEX has dropped to 12,365.55 points from 16568.88 points. The reason behind this is stock market crisis in 2008-2009 due to global recession.
6. It was found that the inflow of FDI starts to decline even though there is recovery in stock market.
7. The country received maximum investment from countries like Mauritius, the US, the UK, Singapore, the Netherlands and Japan.
8. The sectors which attracted foreign investment, included services, telecommunication, construction activities and computer software and hardware.

Reasons for decrease in FDI inflow
The important factors that impede these flows are
- Delays in framing a new land acquisition act, which would ease availability of land for industry, have also hurt FDI flows into infrastructure and other sectors
- Lack of infrastructure,
- Restrictive labor laws,
- Absence of centre–state coordination,
- A dormant Special Economic Zone policy and a lack of institutional reform.
- Cost and time overruns due to contractual and institutional failures are also major obstacles, and are often caused by a lack of coordination among central and state government departments on land acquisition and environmental clearances.

SUMMARY & CONCLUSION
The flow of FDI accelerated the Indian economy and also gave opportunities to Indian industry for technological up-gradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and global competitive advantage with greater efficiency. Most importantly FDI is central for India’s integration into global production chains which involves production by MNCs spread across locations all over the world. From the current study it is evident that there is a strong positive correlation between FDI & SENSEX and FDI & nifty. Hence it can be concluded that the impact of flow of FDI on Indian stock market is significant.

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