

Determinants of Foreign Institutional Investment Inflows in India

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Abstract

The present study aim at exploring the determinant of foreign institutional investment in India through autoregressive distribution lag (ARDL) bound test approach using monthly time series data, the empirical analysis was carried out for the period of April 2003 to March 2013. The empirical results indicate that movement of Sensex, volatility associated with foreign institutional investment inflows, turnover in Indian capital market, market capitalization of publicly traded company and numbers of listed companies in Indian capital market are important factors in attracting foreign institutional investment during post-reform period.

International portfolio investors are attracted by economic fundamental of Indian Capital Market and well behaved economic fundamental are determined by the major determinants of foreign portfolio investments.

I. Introduction

WITH THE ONSET of globalization, there has been a massive foreign portfolio investment inflow in the emerging countries. Foreign equity investment has been the principal vehicle for easier capital for startup companies as well as for existing companies. With the participation of foreign investor, there is an increase in the liquidity for the local market, this makes the base of investor broader, increase risk sharing and thus lowers the cost for investors. Higher investment from the foreign investment need better rules and regulation in local markets. These rules primarily relate to quality information and higher accounting standard. Hence financial market becomes highly regulated through the participation of foreigners, leading to better allocation of resources and healthier financial market. The foreign portfolio investor may stabilize and smother the local market if they tend to follow negative feedback trading strategies i.e. investor buy when prices are low and sell after prices increase. Conversely

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Number of listed companies is also considered as a determinant of FII inflows in Indian capital market which shows the negative impact of FII inflows, but significant in long run and insignificant in short run. Negative and significant effect of number of listed company reveals that increase in number of listed companies do not have any effect on FII inflows in Indian capital market this is due to the fair market value of company is not good and market capturing power of the most of companies in Indian stock market is low.

Moreover, for the policy maker to sustain the inflows of foreign portfolio investment or foreign institutional investment in India, they should look towards the well functioning of stock market which promotes economic development. International portfolio investors are attracted by the economic fundamental of Indian capital market and well behaved economic fundamental are determined by major determinants of foreign portfolio investment.

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