



## **Impact of FDI on India share market**

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### **Abstract**

FDI has become the tool of economic simulation and integration and a criteria to development. Domestic economic growth tends to rise when foreign investments are promoted. Foreign investments certainly influences the share market in positive manner. It also boosts various sector which creates the chances of more employment.

FDI provides long-term investment which brings the stability in the economy of a country. To continue the flow of economy, developed countries do some investment in developing countries managing a treaty. On the other hand, developing countries need foreign investment to grow their economy.

The current paper highlights the impact of foreign direct investment on Indian share market.

**Keywords:** Share, FDI, Investment

### **Introduction**

FDI plays a major role in the basic infra-structure such as roads, buildings, communication networks etc. Most of the developing countries can't afford the budget to develop their basic infrastructure. In that case, they need foreign investments so as to develop infrastructure and be competitive.

Industrialization in developing countries like India has also opened the window for foreign investment. India also favors the high interest rate of about 8 to 10% per annum which also motivates the foreign investors to invest here.

In this way, the investors get maximum return if they invest in India which certainly lowers the capital cost. FDI boosts every emerging sector to grow and creates many opportunities for the government as well. The level of employment also increases if foreign investments are brought to the market.

FDI also boosts stock market. It is observed that the share of particular sector ; on which some foreign investments are done ; tends to raise due to the fact that the local investors show more faith in these kind of sectors.

Any investment that flows from one country into another is known as foreign investment. Inflow of investment from other countries is encouraged since it complements and stimulates domestic investments in capital-scarce economies of developing countries. Since 1991 Foreign investments in the country are allowed to take the form of investments (thru stock market) in listed companies referred as FII investments and 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.

Direct investment in order to create or augment capacity ensures that the capital inflow gets translated into additional production. In the case of FII investment that flows into the secondary market, the effect is to increase capital availability in general, rather than availability of capital to a particular enterprise. Translating an FII inflow into increased production depends on production decisions of the local investor who has to explore and design production plans drawn upon the additional capital made available via FII inflows to augment production. For instance, when FDI flows into an enterprise for mere acquisition an existing asset, no addition to production capacity takes place as the direct effect of FDI inflow.

### **Research Study**

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. Prominently, the know-how that gets transferred along with FDI is often more crucial and significant than the capital itself! Though no such irreplaceable benefits accrue in the case of FII inflows, the search by FIIs for credible investment options has improved accounting and governance practices among many listed Indian companies.

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.

Growing India needs abundant Foreign capital in the form of FDI & FII 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.

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.

FDI and FII thus have become instrumental for international economic integration and stimulation. Fast growing economies like Singapore, China, and Korea etc. have registered incredible growth at onset of FDI. Though US captures most of the FDI inflows, developing countries still account for significant growth of FDI and rise in FII. FDI not only gives access to foreign capital but also provides domestic countries with cutting edge technology, desired skill sets, tools of innovation and other complementary skills. Apart from helping in creating additional economic activity and generating employment, foreign investment also facilitates flow of sophisticated technology into the country and helps the industry to march into advanced technology.

India is a developing country, like many other developing countries, international capital flows has significant potential benefit on the Indian economy. Under the liberalized foreign exchange transactions regime, the results were dramatic. The liberalization of the portfolio investment led to a surge in inflow of capital for investment.

### **Discussion**

The foreign capital is freely available and unpredictable too therefore they (FIIs) are always on the lookout for profits. Foreign capital frequently moves investments, and those swings can be expected to bring severe price fluctuations resulting in increased volatility. Foreign capital increased depth and breadth of the market. It plays a major role in expanding securities business. Foreign investor's policy on focusing on fundamentals of the shares had caused efficient pricing of shares. These impacts made the Indian stock market more attractive to FIIs and domestic investors, which involve the other major player MF (Mutual Funds). The impact of FIIs is so high that whenever FIIs tend to withdraw the money from market, the domestic investors become fearful and they withdraw from market.

With the FDI policies becoming more liberalized since the last many years, Mergers, Acquisitions deals are growing at a good rate. The list of past and anticipated mergers and acquisitions in India covers every size and variety of business providing platforms for the small companies being acquired

by bigger ones. India companies merge with some big foreign companies as well as the some big foreign companies merge with India companies for getting the advantage of large Indian market.

Merger & Acquisitions are increasingly been recognized as a business tool. The most widely practiced business strategy i.e. organic growth story - involving steps that a company would take to augment its human resource, clients, infrastructure resources etc thus resulting in organic growth of its revenues and profits. The M&A route interchangeably used as inorganic growth story would provide immediate extension of company's human resource, clientele, infrastructure thus catalyzing the growth.

The flow of FDI & FII 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.

It is observed that foreign investors invested more in companies with a higher volume of shares owned by the general public. The promoters' holdings and the foreign investments are inversely related. Foreign investors choose such companies where family shareholding of promoters is not very substantial. The financial performance variables which influenced the financial decisions of FII include share returns and earnings per share.

### **Significance of the Study**

Liberalizing foreign direct investment regulations was important part of India's reforms, driven by the belief that this will increase the total volume of investment in the economy, improve production technology, and increase access to world markets. The policy now allows 100 percent foreign ownership in a large number of industries and majority ownership in all except banks, insurance companies, telecommunications and airlines. Procedures for obtaining permission were greatly simplified by listing industries that are eligible for automatic approval up to specified levels of foreign equity (100 percent, 74 percent and 51 percent).

Potential foreign investors investing within these limits only need to register with the Reserve Bank of India, for investments in other industries, or for a higher share of equity than is automatically permitted in listed industries, applications are considered by a Foreign Investment Promotion Board that has established a track record of speedy decisions. In 1993, foreign institutional investors were allowed to purchase shares of listed Indian companies in the stock market, opening a window for portfolio investment in existing companies.

### **Conclusion**

Reforms in Indian economy have created a very different competitive environment for India's industry than existed in 1991, which has led to significant changes.

Indian companies have upgraded their technology and expanded to more efficient scales of production. They have

also restructured through mergers and acquisitions and refocused their activities to concentrate on areas of competence. New dynamic firms have displaced older and less dynamic ones: of the top 100 companies ranked by market capitalization in 1991, about half are no longer in this group. Foreign investment inflows increased from virtually nothing in 1991 to about 0.5 percent of GDP.

Although this figure remains much below the levels of foreign direct investment in many emerging market countries (not to mention 4 percent of GDP in China), the change from the pre-reform situation is impressive. The presence of foreign-owned firms and their products in the domestic market is evident and has added greatly to the pressure to improve quality.

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