

## Impact of Foreign Direct Investment in Indian Capital Market

**Shalendra Singh Rao<sup>1</sup>,**

Research Scholar

Department of EAFM

University of Rajasthan, Jaipur

**Dr.Manish Dadhich<sup>2</sup>**

Assistant Professor

Singhania University, Udaipur

**Abstract:** The inflow of capital in terms of foreign direct investment (FDI) has definitely impacted the economy as well as the capital markets. Foreign direct Investment has provided ample opportunities as far as technological up gradation is concerned. In addition to this India has also gained the global managerial skills which were required to sharpen the managerial skills for Indian industry. The flow of FDI boost the Indian economy and also gave opportunities to Indian industry to expand and grow, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources. This study depicted that there is a strong positive correlation between FDI & Sensex and FDI & CNX Nifty. In the first model Sensex as a dependent variable and FDI found to be significant predictor. Similar results were obtained for second model Nifty as a dependent variable along with flow of FDI. Hence it can be concluded that the impact of flow of FDI on Indian capital market is significant. Larger the inflow of FDI means bullish trend in the capital markets. The statistical tools such as coefficient of correlation as

well as regression have proved the significant impact of the inflow of FDI on capital market.

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**Keywords:** FDI, Sensex, CNX Nifty, FII, Capital market, Financial Indicators, GDP.

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### 1. Introduction

Any investment that flows from one country into another is known as foreign investment. Various countries are integrated in the present global competitive environment through FDI. 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. The impact of FDI on the Indian economy has been phenomenal as per the economic factors-GDP, Currency, Stock Market, Foreign Exchange Reserves, Interest Rate, Current Account, Exports, Imports, and Unemployment Rate. Our country is getting the top rank among three global investment destinations. It has a tremendous potential to adapt FDI and inflows of technology and skills Sharma & Singh (2016).

Thus, like in the case of FII inflows, in this case too, addition to production capacity does not merely result from the action of the foreign investor – but on designs and actions of the domestic seller who has to invest the proceeds of the sale in a manner that augments capacity or productivity for the foreign capital inflow to boost domestic production. There is a widespread notion that FII inflows are hot money that it comes and goes, creating volatility in the stock market and exchange rates. While this might be true of individual funds, cumulatively, FII inflows have only provided net inflows of capital.

## **2. Need of FDI**

Developing economies like India needs a large inflow of the capital in terms of FDI. This is required for the development of the basic infrastructure like roads, railways, warehouses, banking and insurance services etc. Many countries in the world may not be having appropriate infrastructure due to lack of the funds, now better infrastructure facilities can be easily created if a country allows the foreign giant to invest. We can say that foreign capital is a unique remedy for the scarcity of all resources. Moreover FDI may involve new technologies and expertise may not be available in the domestic economy.

## **3. Review of Literature**

Jayachandran and Sielan (2010) studied the relationship between trade, FDI and economic growth of India over the period 1970-2007. The tests showed that there is a casual relationship between the examined variables. The direction of casual relationship is from FDI to growth rate and there is no causality relationship from growth rate to FDI.

Kumar & dadhich (2014) concluded that in the time of global uncertainty investors prefer USD as a safe heaven and FIIs take U-turn from Indian stock market. This study reveals the perfect

negative correlation between the SENSEX and value of rupee/dollar. Moreover, volatility of rupee/dollar more will the unpredictability of SENSEX but a lot depends on the global economic outlook, oil prices, current account deficit, and the future of Euro zone that will help to determine the future of rupee.

Wang M et al (2010) found the relationship between the fluctuations in crude oil prices, gold price and exchange rate of US Dollar with various currencies on the stock price indices of the US, Germany, Japan and China for the period 2006 to 2009.

Mathiyazhagan (2005) analyzed sectoral level of the Indian economy and concluded that FDI has helped to raise the output, productivity and export in some sectors. However, it can be observed from the result of the PCONT that a very minimal relation in these variables (output, labour productivity and export) is established by the FDI inflows into the sectors. This may be due to the low flow of FDI into India both at the macro level as well as at the sectoral level.

#### **4. Objectives of the study**

- a. To study the trends and patterns of foreign capital flow in to India in the form of FDI
- b. To study the impact of foreign capital in the form of FDI on the stock market.

#### **5. Research Methodology**

- a. **Collection of data:** This study is based on secondary data. The required data related to FDI and FII 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 collected from [www.moneycontrol.com](http://www.moneycontrol.com). 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.
- b. **Tools of analysis:** The collected data recorded, analyzed and interpreted in the significant manner with the help of SPSS and excel sheet. The statistical tools used for the study is regression.
- c. **Sample size:** The present study considers data of 17 years from 2000 to 2016.

#### **6. Hypotheses**

H<sub>0</sub>1: Flow of FDIs in India and Sensex trend are independent.

H<sub>0</sub>2: Flow of FDIs in India and CNX Nifty trend are independent.

#### **7. Data Analysis and Interpretation**

Indian bourses both securities & commodities are amongst the favorite hunting spots for foreign investors betting on India's growth story. These businesses appeal to investors as they have long term horizons and signify bets on the country's growth. 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.

The following table 1 presents the amount of flow of FDI in India in terms of US\$ million, Sensex and CNX Nifty. The flow of FDIs has shown an increasing trend but real gain started from the year 2006-07 and kept moving upward 55457 USD in the year 2015. Similarly Sensex and CNX Nifty also delineated growing trend so it can be inferred that these three factors are positively correlated.

**Table 1**

Flow of FDI, Sensex and CNX Nifty

Year	FDI (USD Million)	Sensex	CNX Nifty
2000	4029	3972	1263
2001	6130	3262	1059
2002	5035	3377	1093
2003	4322	5838	1879
2004	6051	6602	2080
2005	8961	9397	2836
2006	22826	13786	3966
2007	34843	20286	6138
2008	41873	9647	2959
2009	37745	17464	5201
2010	34837	20509	6134
2011	46556	15454	4624
2012	34298	19426	5905
2013	36396	21170	6304
2014	45,148	27499	8282
2015	55,457	26117	7946
2016	48,032	26626	8185

Source: FDI from various reports of DIPP, [www.moneycontrol.com](http://www.moneycontrol.com)

In below table-2 R shows the correlation coefficient 0.879 and  $R^2$  0.772 is the coefficient of determination that shows the percentage of the total variation of dependent variable. R Square, the coefficient of determination, is the squared value of the multiple correlation coefficients. The value of  $R^2$  is 0.772 shows that the model explains 77.2% of the variation. In other words the independent variable FDI explained around 77% the variation of the dependent variable i.e. Sensex. Whereas adjusted  $R^2$  attempts to yield a more realistic picture of the fit of regression value to estimate the R square.

**Table 2**

## Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.879 <sup>a</sup>	.772	.757	4171.71594

a. Predictors: (Constant), FDI

**Table 3**ANOVA<sup>a</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	885409793.305	1	885409793.305	50.876	.000 <sup>b</sup>
Residual	261048208.224	15	17403213.882		
Total	1146458001.529	16			

a. Dependent Variable: Sensex

c. Predictors: (Constant), FDI

**Table 4**Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3365.787	1887.517		1.783	.095
FDI	.409	.057	.879	7.133	.000

a. Dependent Variable: Sensex

The ANOVA table 3, tests the acceptability of the model from a statistical perspective. The residual row displays information about the variation that has not been accounted by the model. The regression much is less than residual sums of squares, which indicates that around 77% of the variation in Sensex is explained by the model. However, F statistic is found significant, since the p value (0.000) less than 0.05. F-Value (50.876) can be calculated by dividing mean square regression by mean square of residual. The p-value associated with the F-value is very small (.000) that is why it can be inferred that independent variable explain variations in the dependent variable which is statistically significant.

**Table 5**

## Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.878 <sup>a</sup>	.771	.755	1254.73332

a. Predictors: (Constant), FDI

In above table-5 R shows the correlation coefficient 0.878 and  $R^2$  0.771 is the coefficient of determination that shows the percentage of the total variation of dependent variable. R Square, the coefficient of determination, is the squared value of the multiple correlation coefficients. The value of  $R^2$  is 0.771 shows that the model explains 77.1% of the variation. In other words the independent variable FDI explained around 77% the variation of the dependent variable i.e. CNX Nifty.

**Table 6**

**ANOVA<sup>a</sup>**

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	79287072.431		79287072.431	50.362	.000 <sup>b</sup>
Residual	23615335.569	15	1574355.705		
Total	102902408.000	16			

a. Dependent Variable: CNX Nifty

b. Predictors: (Constant), FDI

**Table 7**

**Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1060.912	567.711		1.869	.081
FDI	.122	.017	.878	7.097	.000

a. Dependent Variable: CNX Nifty

The ANOVA table 6, tests the acceptability of the model from a statistical perspective. The residual row displays information about the variation that has not been accounted by the model. The regression much is less than residual sums of squares, which indicates that around 77% of the variation in CNX Nifty is explained by the model. F-Value 25.741 can be calculated by dividing mean square regression by mean square of residual. The p-value related to FDI shown in table 7, is 0.00 which is less than 0.05. Thus, null Hypothesis is rejected and it can be concluded that flow of FDIs into India has a significant relationship with CNX Nifty.

## 8. Conclusion

The flow of FDI boost 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. This study depicted that there is a strong positive correlation between FDI & Sensex and FDI & CNX Nifty. In the first model Sensex as a dependent variable and FDI found to be significant predictor. Similar results were obtained for second model

Nifty as a dependent variable along with flow of FDI. Hence it can be concluded that the impact of flow of FDI on Indian capital market is significant. Larger the inflow of FDI means bullish trend in the capital markets. The statistical tools such as coefficient of correlation as well as regression analysis have proved the significant impact of the inflow of FDI on capital market.

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