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The Role of Foreign Institutional Investors (FIIs) in the Economic Development of India

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Abstract: *Foreign Institutional Investors (FIIs) have been one of the most consequential and most contested actors in India's post-liberalisation growth story. Opened to foreign portfolio capital on 14 September 1992, the Indian securities market absorbed cumulative net FII/FPI investment running into several lakh crore rupees over the following quarter-century, while simultaneously enduring some of the sharpest reversals witnessed by any large emerging market of the period. This article synthesises secondary data, from the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), the Department for Promotion of Industry and Internal Trade (DPIIT, Office of the Economic Adviser), the Bombay Stock Exchange (BSE), and the National Stock Exchange (NSE) to examine three interlocking questions: the trend and phase-wise pattern of FII inflows between 1992 and 2018; the empirical relationship between FII activity and the growth, depth and volatility of Indian capital markets up to 2018; and the transmission channels through which portfolio capital contributed to investment, industrial growth and employment over this period. Using descriptive statistics, correlation analysis, and a review of GARCH-based volatility studies published up to 2018, the article documents a strong positive association between monthly net FII flows and Sensex/Nifty returns, an asymmetric 'leverage effect' whereby FII selling raised volatility more than equivalent buying lowered it, and the beginnings of a domestic shock-absorption mechanism in which Domestic Institutional Investors (DIIs) cushioned the January 2008 global-crisis outflow and, a decade later, the February 2018 and September-October 2018 outflows triggered by the reintroduction of Long-Term Capital Gains (LTCG) tax and the IL&FS liquidity crisis. The article further shows that FII's contribution to Gross Fixed Capital Formation over this period was indirect rather than direct, operating chiefly by lowering the cost of equity capital, and that its employment effect was diffused through corporate capital-expenditure cycles rather than immediate job creation. The article concludes with policy recommendations, framed as of 2018, on deepening the domestic institutional base, widening the debt-FPI route, and strengthening SEBI-RBI macro-prudential surveillance of 'hot money' reversals.*

Keywords: Foreign Institutional Investors; Foreign Portfolio Investors; Indian capital market; capital flows; market volatility; Domestic Institutional Investors; economic development.