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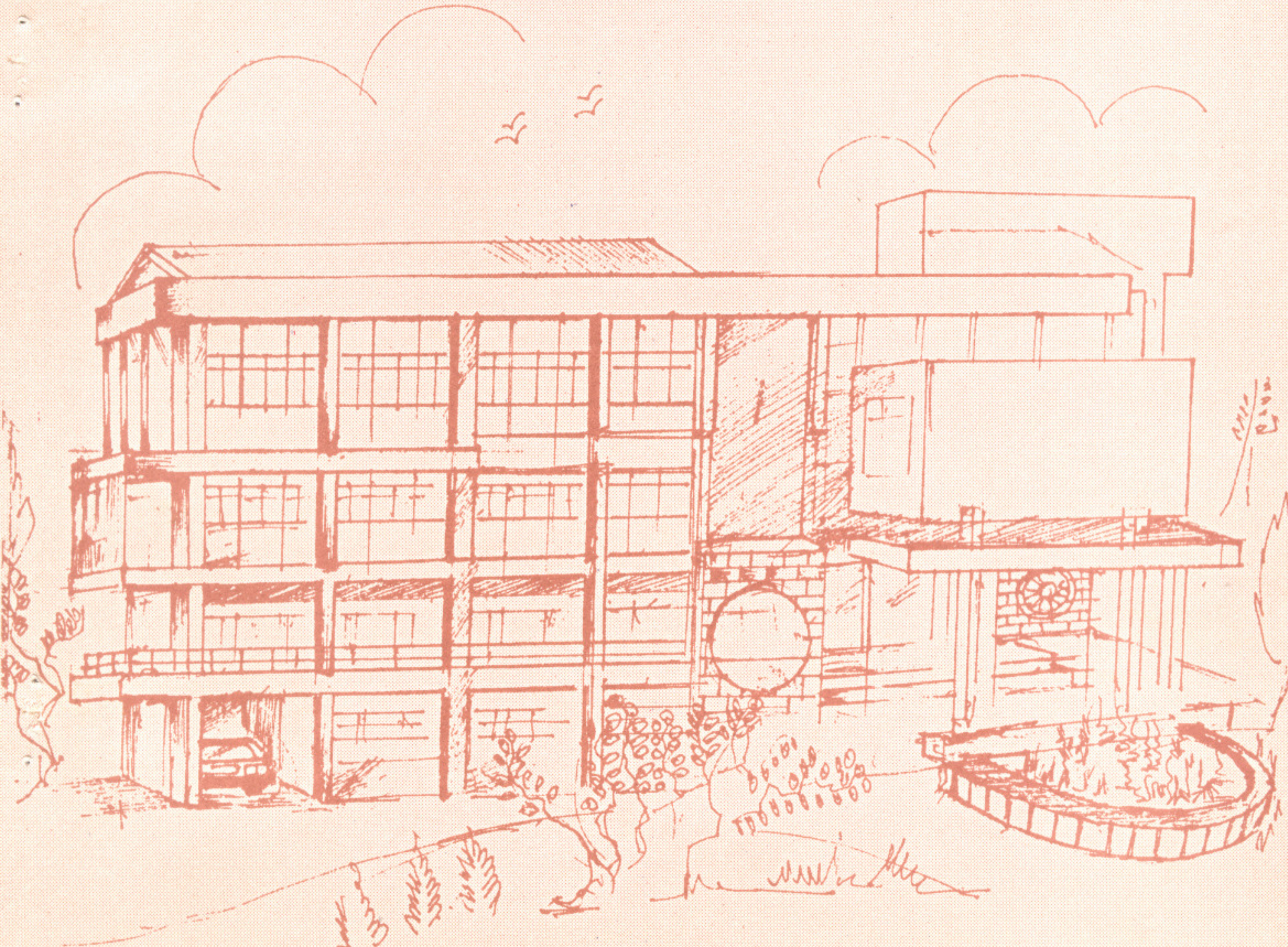
# Working Paper Series

# A Gap Analysis of FIIs Investments – An estimation of FIIs Investments Avenues in Indian Equity Market



# A Gap Analysis of FIIs Investments – An estimation of FIIs Investments Avenues in Indian Equity Market

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# A Gap Analysis of FIIs Investments – An estimation of FIIs Investments Avenues in Indian Equity Market

**Prof. Lakshmi Sharma***

India embarked on a programme of economic reforms in the early 1990s to tie over its balance of payment crisis and also as a step towards globalization. An important milestone in the history of Indian economic reforms happened on September 14, 1992, when the FIIs (Foreign Institutional Investors) were allowed to invest in all the securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the stock exchanges in India and in the schemes floated by domestic mutual funds. Initially, the holding of a single FII and of all FIIs, NRIs (Non-Resident Indians) and OCBs (Overseas Corporate Bodies) in any company were subject to a limit of 5% and 24% of the company's total issued capital respectively. In order to broad base the FII investment and to ensure that such an investment would not become a camouflage for individual investment in the nature of FDI (Foreign Direct Investment), a condition was laid down that the funds invested by FIIs had to have at least 50 participants with no one holding more than 5%.

Ever since this day, the regulations on FII investment have gone through enormous changes and have become more liberal over time. From November 1996, FIIs were allowed to make 100% investment in debt securities subject to specific approval from SEBI as a separate category of FIIs or sub-accounts as 100% debt funds. Such investments were, of course, subjected to the fund-specific ceiling prescribed by SEBI and had to be within an overall ceiling of US $ 1.5 billion. The investments were, however, restricted to the debt instruments of companies listed or to be listed on the stock exchanges. In 1997, the aggregate limit on investment by all FIIs was allowed to be raised from 24% to 30% by the Board of Directors of individual companies by passing a resolution in their meeting and by a special resolution to that effect in the company's

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General Body meeting. From the year 1998, the FII investments were also allowed in the dated government securities, treasury bills and money market instruments. In 2000, the foreign corporates and high net worth individuals were also allowed to invest as sub-accounts of SEBI-registered FIIs. FIIs were also permitted to seek SEBI registration in respect of sub-accounts. This was made more liberal to include the domestic portfolio managers or domestic asset management companies. 40% became the ceiling on aggregate FIIs portfolio investment in March 2000. This was subsequently raised to 49% on March 8, 2001 and to the specific sectoral cap in September 2001. As a move towards further liberalization, the Finance Minister announced in his budget speech on February 28, 2002 that, "Foreign Institutional Investors (FIIs) can invest in a company under the portfolio investment route beyond 24 per cent of the paid up capital of the company with the approval of the general body of the shareholders by a special resolution. I propose that now FII portfolio investments will not be subject to the sectoral limits for foreign direct investment except in specified sectors. Guidelines in this regard will be issued separately."

Accordingly, a committee was set up on March 13, 2002 to identify the sectors in which FIIs portfolio investments will not be subject to the sectoral limits for FDI, under the chairmanship of Dr. Rakesh Mohan. Later, on December 27, 2002 the committee was reconstituted and Dr. Ashok K. Lahiri became the chairman. The committee has come out with recommendations in June 2004. The committee has proposed that, 'In general, FII investment ceilings, if any, may be reckoned over and above prescribed FDI sectoral caps. The 24 per cent limit on FII investment imposed in 1992 when allowing FII inflows was exclusive of the FDI limit. The suggested measure will be in conformity with this original stipulation.' (pp.15-16). The committee also has recommended that the special procedure for raising FIIs investments beyond 24 per cent up to the FDI limit in a company may be dispensed with by amending the relevant regulations.

Meanwhile, the increase in investment ceiling for FIIs in debt funds from US $ 1 billion to US $ 1.75 billion has been notified in 2004. The SEBI also has reduced the turnaround time for processing of FIIs applications for registrations from 13 working days to 7 working days except in the case of banks and subsidiaries.

All these are indications for the country's continuous efforts to mobilize more foreign investment through portfolio investment by FIIs. The FII portfolio flows have also been on the rise since September 1992, when they were initially allowed to invest in Indian bourses. Their investments have always been net positive, but for 1998-99, when their sales were more than their purchases.

**Table 1**
**Trends in FII investment**

| Period | Gross purchases (Rs. Mn.) | Gross Sales (Rs. Mn.) | Net Investment (Rs. Mn.) | Net investment* (US $ mn.) | Cumulative Net Invetment* (US $ mn.) |
|---|---|---|---|---|---|
| 1993-94 | 55,925 | 4,663 | 51,262 | 1,634 | 1,638 |
| 1994-95 | 76,310 | 28,348 | 47,963 | 1,528 | 3,167 |
| 1995-96 | 96,935 | 27,517 | 69,420 | 2,036 | 5,202 |
| 1996-97 | 155,539 | 69,794 | 85,745 | 2,432 | 7,634 |
| 1997-98 | 186,947 | 127,372 | 59,575 | 1,649 | 9,284 |
| 1998-99 | 161,150 | 176,994 | -15,844 | -386 | 8,898 |
| 1999-2000 | 568,555 | 467,335 | 101,219 | 2,339 | 11,237 |
| 2000-01 | 740,506 | 641,164 | 99,340 | 2,160 | 13,396 |
| 2001-02 | 499,200 | 411,650 | 87,552 | 1,846 | 15,242 |
| 2002-03 | 470,601 | 443,710 | 26,889 | 562 | 15,804 |
| 2003-04 | 1,448,575 | 990,940 | 457,645 | 9,949 | 25,754 |

***** Net investment at US $ mn. at monthly exchange rate
Source : SEBI Bulletin, October 2004

It can be observed from the above table that the portfolio investment inflows have always been on the increase. But the years 2001-02 and 2002-03 saw some reversal in the trend. From a net inflow of US $ 2.1 billion in 2000-01, such inflows declined to US $ 1.8 billion in 2001-02, and further dropped to US $ 0.562 billion in 2002-03. The decline is because of the lower portfolio inflows, as a result of which the net investment has dropped in these years. However, this decline witnessed a sharp reversal in the year

2003-04. FIIs have made a net investment of US $ 9969 million during this year registering a growth of 1670% over the previous year, creating a record in the history of FII investment in India. Gross purchases in this year registered a growth rate of 208% compared to the year before in rupee terms. This trend continued in April 2004, only to suffer reversal again during May and June 2004, when the net investment became negative. This is because many Asian markets fell in May and also because of the news about the Indian general elections. For example, on Monday, the May 17$^{th}$ 2004, many Asian markets fell over 4 per cent. South Korea dropped by 5.14 per cent. Taiwan was down by 4.61 per cent. (Economic Survey 2003-2004) Fortunately, this year from July 2004 has been seeing a net positive portfolio flows by FIIs. As of September 2004, the net FII portfolio investment stands at US $ 27,637 million.

In general, the FIIs investment flows, if analysed for the country as a whole have increased over time and have always been a net positive figure for most of the months since 1992. But, when the question of how fruitful would the increase in FIIs investment cap could be answered only if this analysis is done at the companies' level. It should not be forgotten that these FIIs investment flows are portfolio flows in nature and are made in the stocks listed in Indian bourses. The FIIs portfolio investment cap is set in respect of each individual company, which is the guideline for what is the maximum that FIIs can invest in that company. This figure is different for different companies, depending on the sectoral cap for the sector to which the company belongs, if the company has decided to stay with the generic cap of 24 per cent, if the company has raised the generic cap to the sectoral cap or any other intermittent cap. Hence, if one were to address the question, what would be the effect of increasing the FIIs investment cap, naturally one has to analyse the current FIIs investment levels in the company vis-à-vis the investment that is allowed so that the gap between these two can be assessed, if any. If the gap, as of now, is fairly minimum then one can conclude that further investments require further increases in the cap or otherwise.

## The Study

The study has undertaken an analysis of the FII investment gap in the companies included in the S & P CNX 500 index of National Stock Exchange. The reason for choosing the companies included in this index is because it is a broad-based index. It represents about 94 per cent of total market capitalization and about 98 per cent of the total turnover on the NSE. The S &P CNX 500 companies are disaggregated into 73 industry indexes namely S&P CNX industry indexes. Industry weightages in the index reflect the industry weightages in the market. Hence, it is felt that the findings of the study on these companies can be generalized.

The study compares the FIIs investment in each of these companies as of September 30, 2004 with the FII investment cap. The FII investment gap is defined as the difference between the investment allowed under the FII investment cap provision for the company and the actual investment. This gap estimate is made both in terms of number of shares and in terms of the market value prevailing as on the estimate date of September 30, 2004. Information on the shareholding pattern of these companies as of September 30, 2004, the closing market price of these shares is downloaded from the NSE site, www.nseindia.com. The information on the FII investment cap for each of these companies is assessed from the Reserve Bank of India site, www.rbi.org.in

Since information is not available for 31 companies they are excluded from the study. In all the findings of this study relates to 469 companies included in the S & P CNX 500 index of National Stock Exchange as of September 30, 2004.

## Sample Profile

The FIIs hold 8.12 per cent of the total outstanding shares of the 469 companies studied as of September 2004, emerging as the biggest institutional investor, ahead of the mutual funds, domestic financial institutions and the private corporate bodies. In an overall ranking they occupy the third position after the promoters and the Indian public, who hold higher levels of investment than FIIs. The share of FIIs has also registered an increase over their holding in September 2003, from 5.85 per cent to 8.12 per cent.

**Table 2**
**Shareholding Pattern**

| Category | Total shares outstanding – September 2004 (in mn.) | Percentage of shares held – September 2004 | Total shares outstanding – September 2003 (in mn.) | Percentage of shares held – September 2003 |
|---|---|---|---|---|
| Promoters | 33,975 | 58.23 | 31,368 | 58.98 |
| Mutual Funds | 1,650 | 2.83 | 1,705 | 3.21 |
| Domestic Financial Institutions | 4,090 | 7.01 | 4,013 | 7.55 |
| FIIs | 4,735 | 8.12 | 3,109 | 5.85 |
| Private Corporate Bodies | 2,240 | 3.84 | 2,021 | 3.8 |
| Indian Public | 8,960 | 15.36 | 8,002 | 15.05 |
| NRIs/OCBs | 795 | 1.36 | 928 | 1.75 |
| Others | 1,900 | 3.26 | 2,028 | 3.81 |
| Total | 58,345 | 100 | 53,182 | 100 |

However, within the sample, the FIIs investment is not uniform. In fact, their share holding shows a wide disparity among the companies. The investment held by FIIs is less than 1 per cent in as many as 234 companies of the total 469 companies studied. It is about less than 5 per cent in 308 companies. Only as few as 4 companies enjoy an investment of more than 40 per cent.

**Table 3**
**FIIs shareholding as of September 30, 2004**

| FIIs shareholding as a per cent of total outstanding shares | Number of companies |
|---|---|
| 0-1 | 234 |
| 1-5 | 74 |
| 5-10 | 51 |
| 10-15 | 46 |
| 15-20 | 32 |
| 20-25 | 20 |
| 25-30 | 6 |
| 30-35 | 0 |
| 35-40 | 2 |
| 40-45 | 1 |
| 45-50 | 1 |
| 50-55 | 1 |
| 55-60 | 0 |
| 60-65 | 1 |

The companies studied also includes the companies included in the S&P CNX Nifty, which is a well diversified 50 stock index accounting for 24 sectors of the economy. It is used as a benchmark for index based derivatives among other things. The average total traded value for the last six months of all Nifty stocks is approximately 77 per cent of the traded value of all stocks on the NSE. Nifty stocks represent about 61 per cent of the total market capitalization as on August 31, 2004. In order to carry out the study in more detail the companies are grouped into those included in the S&P CNX Nifty ( referred to as Nifty companies from now onwards) and those not included (referred to as non-nifty companies from now on) to analyse if there is any significant difference in FIIs investment in these two groups of companies. For this purpose an independent samples t test is carried out.

**Table 4**
**t test results**

| | N | Mean | Standard deviation | t value |
|---|---|---|---|---|
| Nifty Companies | 50 | 16.9278 | 12.8318 | 6.934# |
| Non-Nifty Companies | 419 | 4.1476 | 6.6009 | |

# p < 0.05

The t test results show that the FIIs investment in Nifty companies is significantly different from non-Nifty companies. Hence, the following table.

**Table 5**
**Shareholding Pattern in Nifty Companies as of September 2004**

| Companies | FIIs Shareholding (in mn.) | Total outstanding shares (in mn.) | FIIs Shareholding as a % of total outstanding shares |
|---|---|---|---|
| NIFTY | 3,227 | 23,285 | 13.85 |
| Non-NIFTY | 1,508 | 35,060 | 4.30 |
| Total | 4,735 | 58,345 | 8.12 |

The table above shows that the FIIs investment is certainly more concentrated in the Nifty companies than in Non-Nifty companies. The FIIs shareholding is around 13.85 per cent in Nifty companies as against 4.30 per cent in the Non-Nifty companies. But, this analysis is not complete, though the shareholding of the FIIs as a per cent of the total outstanding shares of the company makes it comparable with similar figures for other companies, it does not indicate the amount of FIIs investment in each of these companies in relation to others. This is because a mere comparison of the number of shares held by FIIs is meaningless as the market price per share varies across companies and it takes different quantum of money to acquire the same number of shares in different companies. Hence, this analysis is further extended to include the monetary value of the FIIs investment as of September 30, 2004. Since the cost of FIIs investment in each of these companies is not readily available, the market value of FIIs investment in each of these companies is arrived at by multiplying the number of shares held by the FIIs by the closing market price per share as of the same day. This will give an understanding of the value of the FIIs investment at market value as of September 30, 2004.

**Table 6**
**Value of FIIs Investment**

| Category | FIIs Shareholding (Rs. mn.) | FIIs Shareholding as a percentage of the total value |
|---|---|---|
| Nifty | 1,328,556 | 85.16 |
| Non-Nifty | 231,520 | 14.84 |
| Total | 1,560,076 | 100 |

Table 6 clearly brings out that, when the shareholding of FIIs is analysed in terms of the market value of their investment as of September 30, 2004, about 85 per cent of the total value of their investment is held in Nifty companies and only about 15 per cent is in Non-Nifty companies. This shows, once again as mentioned above, that there is a clear concentration of FIIs investments in Nifty companies. Within the Nifty and Non-Nifty classification also there is a concentration of FIIs investment in a few number of companies. A separate analysis of the Nifty and Non-Nifty companies bears evidence to this fact. About 25 per cent of the total market value of the FIIs investments is in just two companies namely Infosys and Reliance Industries where the investment is about 14 and 12 per cent respectively. 50 per cent of the total market value of the FIIs investment is only in 6 companies namely Infosys Technologies (13.87%), Reliance Industries (12.44%), ICICI Bank (7.51), HDFC (7.05), ONGC (5.25%) and Satyam (4.88). The total value of the FIIs investment in these companies is around Rs.677,516 million. When the companies are arranged in a decending order of their FIIs investment, it is found that 20 of the companies account for around 81.67 per cent and the balance 30 companies share only 18.83 per cent of the total market value of the FIIs investments, each one accounting for less than 1.5 per cent. In the bottom 13 companies, the FIIs investment is less than 0.5 per cent. Dabur India, Tata Chemicals, VSNL, Colgate-Palmolive and Britannia enjoy less than 0.1 per cent of the FIIs investments in value terms. In the Non-

Nifty category the top five companies which are the most favored destinations for FIIs investments are Container Corporation, Bank of Baroda, Canara Bank, I-Flex and Asian Paints. As many as 71 companies of the 416 companies in this category have absolutely no FIIs investment in them.

## The Analysis

The objective of the study is to bring to light the investment gap in the FIIs investments by comparing the current investment levels of FIIs in the chosen sample companies against the cap allowed.

**Table 7**
**Cap and Gap Analysis of FIIs Investment**

(No. of shares in mn.)

| Category | Total outstanding shares | Permissible Investment for FIIs (Cap) | FIIs shareholding | Gap Available for Investment |
|---|---|---|---|---|
| All Companies | 58,345 | 17,123 | 4,734 | 12,389 |
| Nifty | 23,285 | 7.937 | 3,227 | 4,711 |
| Non-Nifty | 35,060 | 9,186 | 1,508 | 7,678 |

It may be noticed from the above table that the percentage of the investment gap in case of Nifty companies is around 59 and it is 84 for the Non-Nifty companies. The total gap in respect of all the companies works out to 72 per cent. This is in line with the findings presented in Tables 5 and 6, where it is brought out that the FIIs investments in Nifty companies is higher than in Non-Nifty companies, both in terms of number of shares held by them and the market value of these shares. However, it should not be forgotten here that the FIIs investment cap is not uniformly the same figure for all the companies studied. It depends on if the company has passed a resolution in the Board and General Body to increase the generic cap of 24 per cent either to the sectoral or any other intermediate level.

**Table 8**
**Gap Analysis of FIIs Investment at Market Value**

| Category | Gap Available for Investment (in mn.number of shares) | Gap in Market Value# (Rs. in mn.) |
|---|---|---|
| All Companies | 12,389 | 2,711,522 |
| Nifty | 4,711 | 1,338,886 |
| Non-Nifty | 7,678 | 1,372,637 |

# Gap shares * Market price per share as of September 30,2004

This finding presented above is not surprising. Though the number of shares available for further investment by FIIs is less in Nifty companies than Non-Nifty companies, in terms of value the difference is not very wide as the average market price per share of the Nifty category, in general, is very much higher than that of the Non-Nifty category.

The top 5 companies where the gap is at the maximum in Nifty category of companies are Bharti Televentures, Reliance Industries, ONGC, Hindustan Lever and Wipro. In the Non-Nifty companies the top 5 companies are Mphais BFL, Neyveli Lignite, LIC Housing Finance, Tata Teleservices(Maharastra) and Himachal Futuristic.

This analysis automatically brings up an issue of how FIIs choose to invest in a company. What are the various parameters that are considered? This is because of the findings that the FIIs investment is highly concentrated in few companies and it is very negligible in a large number of companies. The issue that needs to be addressed now is if the FIIs investment has to be increased, then what should be done in terms of making the companies attractive for them. This automatically brings out the issue of what are the parameters that FIIs look for in choosing a particular stock for their investment.

When there are lot of research studies on what are the macro economic determinants of FIIs investment flows the research studies on how do they choose a particular stock for investment are very negligible. So this study goes on further to address this issue as well.

**Impact cost**

The FIIs investment is portfolio investment in nature. It means it gets churned frequently to take advantage of the changes in the market opportunities. An analysis of the ratio of gross sales to gross purchases of the FIIs over the 9-month period of this calendar year from January 2004 to September 2004 bears evidence to this fact. This ratio is found to be at its maximum of 121% in the month of May 2004 and at its least at 61% in April 2004. Since this figure is generally high, it could be concluded that FIIs keep churning their portfolio to a great extent.

**Table 9**
**Trading Strategy of FIIs**

| Period | Gross Purchases (Rs. Crores) | Gross Sales (Rs. Crores) | Ratio of Gross Sales/Gross Purchases(per cent) |
|---|---|---|---|
| January 2004 | 16830.20 | 13653.50 | 81 |
| February 2004 | 14952.10 | 12555.00 | 84 |
| March 2004 | 17238.20 | 11633.90 | 67 |
| April 2004 | 19691.50 | 12053.30 | 61 |
| May 2004 | 15531.60 | 18778.10 | 121 |
| June 2004 | 10633.50 | 10116.80 | 95 |
| July 2004 | 11096.20 | 10182.80 | 92 |
| August 2004 | 12594.80 | 9702.30 | 77 |
| September 2004 | 12385.10 | 9999.80 | 81 |

One of the pre-requisites for an investor to be able to comfortably trade frequently in the market (to reconstitute the investment portfolio) is the ability to do so comfortably in a market without having to suffer a great transaction cost. In other words, it requires the market to be liquid. Financial –foreign shareholders have financial focus and lay emphasis on liquidity, argue Coffee (1991) and Aguilera and Jackson (2003). Liquidity, in this context, means the ability of the market to absorb large quantities of trade without a heavy transaction cost. The transaction cost, here, would mean not the fixed costs like brokerage, depository chares etc. but the cost that is attributable to lack of market liquidity. Since these costs are different in different countries and also vary across the stocks listed in the same country's bourses, it could be one of the important considerations for the Foreign Portfolio Investors.

**Table 10**
**Market Impact Cost Comparison for Equity Trades**

| Country | Market Impact (basis points) |
|---|---|
| Australia | 6.7 |
| Brazil | 28.66 |
| Canada | 17.79 |
| Germany | 4.32 |
| India | 32.18 |
| Korea | 18.66 |
| Luxembourg | 74.20 |
| Malaysia | 18.32 |
| United States - NYSE | 10.51 |

Source: Elkins/McSherry (2000)

'Obtaining a deep and liquid market has been a central goal of reforms of the 1990s. the impact cost of Nifty of transactions of Rs.5 million which is the best measure of market liquidity was as high as 0.15 per cent in early 2002. Over the entire period of 2002-2003 and 2003-04, the market has been much more liquid, with an impact cost of 0.1 per cent'. (Economic Survey 2003-2004, pp. 66) The market impact of a trade is measured by the impact cost. Impact cost is the cost of executing a transaction in a given stock for a specific predefined order size at any given point of time. Impact cost, as it is reported by the NSE for the Nifty companies is used in this study. Impact cost is calculated for an order size of Rs.5 million for each stock on a monthly basis. The average of the monthly impact cost of the Nifty stock is taken for the months June-August 2004. The reason for using the average of these three months is to smooth out the impact of a particular month on the cost.

**Market Return**

The basic rationale for the international capital flows is the rate of return which is higher in a foreign market compared to the domestic market. Capital flows across the geographical boundaries of the countries is mainly to enhance the productivity and efficiency of capital at the global level. Hence the rate of return should certainly explain the choice of a particular stock for investment by the FIIs. Mohanty (1998) has found that the institutional investors as a group have invested in companies with good financial performance. Clark and Berko (1996) show a positive contemporaneous relation between equity flows and stock returns using monthly data for Mexico. The study has used the market return of the Nifty companies' stock as the average of the market return for the 3 months June-August 2004, as it is reported by NSE.

**Non-Promoter Shareholding**

The shares that are available for trading in the normal course are those that are with the investors other than the promoters and other interested and special categories of investors. This is an important variable to be considered in investing in a stock because the available free-float in most American companies is above 90 per cent whereas in India promoters have more than 50 per cent stakes in majority of large companies.(Biswal, 2003) The ratio of shares held by Non-promoter category to Promoters category as of September 2004 is used in the model. This is a measure of liquidity of a stock in the bourses. This is the quantum of shares that an investor can actually buy and sell.

The FIIs investment cap has not been included as one of the explanatory variables because only 17 out of the 50 Nifty companies studied have FIIs investment cap different from the generic cap. The balance 33 companies have stayed with the generic cap only. Hence, FIIs investment cap is not considered for the model.

**The Model**

FII INVT = a + b IMPCOST + c MKTRETN + d NONPROM + e
where
FII INVT = FIIs Investment as a per cent of total outstanding shares

IMPCOST = Average of the impact cost for the period June-August 2004 (in per cent)

MKTRETN = Average of the market return for the period June-August 2004 (in per cent)

NONPROM = Ratio of Non-promoters shareholding to total outstanding shares (in per cent)

**Table 10**
**Regression Results**

| Independent Variable | Coefficient | t-Value | Significance Level |
|---|---|---|---|
| Constant | 9.609 | 1.425 | Not significant |
| IMPCOST | -102.944 | -2.120 | 95% |
| MKTRETN | -4.068 | -0.124 | Not significant |
| NONPROM | 0.327 | 5.402 | 99% |

No. of observations = 50 $R^2$ = .705 Adjusted $R^2$=.497 Dependent variable = FII INVT
F statistic = 15.178*
*significant at 99%

FIIINVT = 9.609 -102.944 IMPCOST – 4.068 MKTRETN + 0.327 NONPROM

It can be observed from table 10 where the regression results are reported that impact cost and non-promoters share holding are found to be significant variables and the market return and volatility are not found to be significant. It could be concluded that the liquidity and the cost of trading are the two important variables that FIIs consider for choosing a particular stock for investment. Kang and Stulz (1997) have found that foreign institutional investors (FIIs) tend to select investments in companies which are actively traded. Douma, George and Kabir (2003) argue on the basis of their findings of their study on FIIs that they invest in large liquid companies which enable them to exit their positions quickly at relatively lower costs. The impact cost has a negative sign as expected meaning the higher the impact cost the lower the FIIs investment in the company and vice versa. A one per cent change in impact cost would cause a 102 per cent change in FIIs investment. The non-promoters shareholding as a percentage of total outstanding shares is also found to be significant and has a positive sign. The higher the quantum of shares with non-promoters category, the higher the FIIs investment and vice versa. A one per cent change in the shareholding of non-promoters category of shareholders would cause a 0.327 per cent change in FIIs investment.

The reason for the non-significance for the variable, market return may be that the market returns that are considered by an FII are the market return available for equity returns of this country vis-à-vis their home equity returns. Once the average return in the foreign market is higher than the average return on home market investment, may be the differences in the return on the specific stocks in a market may not be as important as its liquidity. Bartram and Dufey (2001) argue the emerging market securities represent an interesting component because of their comparative low correlation with the developed markets. As a result, these securities have considerable power of diversification in spite of their high absolute volatility. 'India's deepening globalization is leading to higher correlations between Indian equity indexes and world markets. However, these correlation coefficients are as yet small, and there are considerable gains from diversification for global portfolios that harness Indian equity indexes.' (Economic Survey 2003-2004, pp.68)

**Summary of Findings**

1. The FIIs investments are highly concentrated in terms of their market value in a very small number of companies.

2. There seems to be a clear distinction in the FIIs shareholding in NIFTY and Non-NIFTY companies.

3. There is a wide gap between the actual investments by FIIs and the investments allowed as per the cap.

4. The gap in their investments exist both in NIFTY and Non-NIFTY companies.

5. The investments that may further be made in these 469 companies analysed is as high as Rs.2711 billion (works out to around US $ 60,244 million at an assumed rate of Rs.45/US$) which, when compared to the current figure of net equity investment of FIIs in all the companies through portfolio investment scheme as of September 2004 is Rs. 1115 billion, is very high..

6. When a model, with the FIIs investment as dependent variable and impact cost, market return, and the shareholding of non-promoters category of shareholders to total outstanding shares was tested with empirical data, it was found that impact cost and the quantum of shares available for trading in the market seem to be two important considerations for FIIs for their investment purposes. But of the two significant

variables, impact cost has emerged as the most important variable explaining FIIs investment in a company.

**Discussion on findings**

The FIIs investments, though shown an increasing trend over time, are still far below the permissible limits. This means, the convergence of the sectoral cap for FIIs and FDI investments alone may not really help bring in more funds unless some specific measures are taken up. One such measure in this line could be the newly announced INDONEXT, the platform for trading the small and mid-cap companies which might bring some focus on these companies and hopefully add some liquidity and volume to their trading, which may attract some further investments in them by FIIs

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