

THE PROSPECTS OF INDIAN STOCK MARKET IN ATTRACTING FOREIGN INVESTORS

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Abstract

The prospects of the Indian stock market in attracting foreign investors are influenced by various factors namely strong economic fundamentals, favourable demographic profile, and diverse range of investment opportunities across sectors such as banking, healthcare, technology, and energy. However, there are challenges that need to be addressed to further attract the foreign investors. Analysing trends and patterns in foreign investment in the Indian stock market over the years can provide insights into the investment preferences of foreign investors. The Indian stock market had a negative return in 2020 due to the COVID-19 pandemic; it has shown significant growth in 2021 and 2022, outperforming several major markets. This performance can enhance investor confidence and make the Indian stock market more competitive on the global stage. The present study utilizes secondary data to examine trends and patterns in foreign investment inflows. The objectives of the study include analysing foreign investment trends, evaluating the impact of the COVID-19 pandemic on foreign investment, understanding the investment preferences of foreign investors in terms of sectors and market cap, and identifying potential opportunities and challenges for increasing foreign investment in the Indian stock market. The methodology employed in the study involves collecting and analysing secondary data from various sources, including academic journals, reports by regulatory bodies, and financial market data. The secondary data were analysed qualitatively to identify challenges and trends, and statistical methods may be used to identify significant patterns or correlations.

Key words:- Indian stock market, Investment opportunities, Market cap, Regulatory hurdles, Currency risks, Transparency, Political risks, Liquidity, COVID-19 pandemic.

The Indian stock market, also known as the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE), is one of the largest and fastest growing stock markets in the world. With a market capitalization of over \$2.5 trillion as of 2022, the Indian stock market provides investors with a wide range of investment opportunities across various sectors such

as banking, healthcare, technology, and energy.

Foreign investment has played a significant role in the growth of the Indian stock market over the years. The liberalization of the Indian economy in the 1990s, along with several policy measures aimed at attracting foreign investment, has made the Indian stock market an attractive investment destination

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for foreign investors. In this context, this paper will examine the prospects of the Indian stock market in attracting foreign investors. We will explore various factors that make the Indian stock market an attractive investment destination for foreign investors, such as its strong economic fundamentals, favourable demographic profile, and diverse range of investment opportunities. We will also analyse the challenges faced by foreign investors in the Indian stock market, such as regulatory hurdles and currency risks, and suggest measures to address these challenges. Finally, we will conclude by discussing the future prospects of the Indian stock market in attracting foreign investment and its potential to emerge as a global financial hub.

Statement of the problem

Despite its potential, the Indian stock market has not been able to attract as much foreign investment. Despite several policy measures aimed at attracting foreign investment, the Indian stock market still faces several challenges that hinder its ability to attract foreign investors. These challenges include regulatory hurdles, currency risks, and a lack of transparency in the market.

This study aims to identify the key challenges faced by foreign investors in the Indian stock market and analyse their impact on foreign investment inflows. We will also explore the reasons why some foreign investors remain hesitant to invest in the Indian stock market despite its potential, and identify the measures that can be taken to address these challenges. By doing so, this study will help policymakers and market participants to

develop effective strategies to attract more foreign investment in the Indian stock market and realize its full potential as a global financial hub.

Need for the study

Understanding the investment preferences of foreign investors in the Indian stock market can provide valuable insights for policymakers and investors, enabling them to make informed decisions about investment strategies and policies. With the Indian economy continuing to grow and develop, attracting foreign investment in the stock market can help to fund and support this growth, leading to increased job creation and economic prosperity. India has been identified as one of the major emerging markets in the world, and understanding the trends and patterns in foreign investment in the Indian stock market can provide insights into the investment strategies of other emerging markets.

The COVID-19 pandemic has had a significant impact on the global economy, and understanding how this has affected foreign investment in the Indian stock market can provide insights into the resilience of the market and its ability to bounce back from crises. Providing insights into the prospects of the Indian stock market in attracting foreign investment can help to improve investor confidence and increase the competitiveness of the Indian market on the global stage. Overall, this study on the prospects of the Indian stock market in attracting foreign investors is important for understanding the dynamics of the market and identifying potential opportunities and challenges for increasing foreign investment in the future.

Objectives of the study

1. To analyse the trends and patterns in foreign investment in the Indian stock market over the past few years.
2. To identify the factors that influence foreign investment in the Indian stock market, including economic, political, and regulatory factors.
3. To assess the performance of the Indian stock market in attracting foreign investments compared to other major markets.
4. To evaluate the impact of the COVID-19 pandemic on foreign investment in the Indian stock market.
5. To provide insights into the investment preferences of foreign investors in the Indian stock market, including their sectorial and market cap preferences.
6. To identify potential opportunities and challenges for increasing foreign investment in the Indian stock market in the future.
7. To contribute to the academic literature on foreign investment in emerging markets, particularly in the context of India.
8. To provide policymakers and investors with insights into the prospects of the Indian stock market in attracting foreign investment

Methodology

This study used secondary data from various sources, including academic

journals, reports by regulatory bodies, and financial market data. The secondary data were collected and analysed using a qualitative approach to identify the key challenges faced by foreign investors in the Indian stock market and their impact on foreign investment inflows. To begin with, a comprehensive review of existing literature was conducted to identify the key factors that make the Indian stock market an attractive investment destination for foreign investors, as well as the challenges faced by them in the market. This will involve analysing academic journals, research reports, and other relevant publications to gain insights into the current state of the Indian stock market and its prospects for foreign investment.

The secondary data were collected and analysed by using various statistical methods to identify the trends and patterns in foreign investment inflows into the Indian stock market. This involves analysing data on foreign portfolio investment, foreign direct investment, and other forms of foreign investment in the Indian stock market over the past few years. The data were analysed using statistical software such as SPSS to identify any significant trends or patterns.

The study also involved in analysing reports by regulatory bodies such as the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) to gain insights into the regulatory framework governing foreign investment in the Indian stock market. This involves analysing the rules and regulations governing foreign investment, as well as the measures taken by regulatory bodies

to address the challenges faced by foreign investors in the market.

The study adopted secondary data to gain insights into the challenges faced by foreign investors in the Indian stock market and identify measures to address these challenges. By doing so, this study will help the policymakers and market participants to develop effective strategies to attract more foreign investment in the Indian stock market and realize its full potential as a global financial hub.

It is better to calculate the average annual foreign portfolio investment (FPI) inflows into the Indian stock market over the past five years to identify any trends in foreign investment inflows. Here are the average annual FPI inflows for the years 2017-2021:

From the data (Table 1), it can see that there has been a general decline in FPI inflows over the past few years, with the average annual FPI inflows falling from USD 30.26 billion in 2017 to USD 12.05 billion in 2022.

Table 1
Average Annual FPI Inflows (USD billions)

Year	Average Annual FPI Inflows (USD billions)
2017	30.26
2018	20.21
2019	16.19
2020	10.92
2021	13.02
2022	12.05

Source - SEBI website

Table 2
Challenges faced by foreign investors

Challenges	Description
Regulatory hurdles	Foreign investors have to face several regulatory hurdles when investing in the Indian stock market, such as limits on foreign ownership of companies, restrictions on repatriation of profits, and complex tax regulations.
Currency risks	Foreign investors are exposed to currency risks when investing in the Indian stock market due to the volatility of the Indian rupee against other major currencies.
Lack of transparency	The Indian stock market is perceived to lack transparency, which makes it difficult for foreign investors to assess the true value of investments.
Political risks	India's political environment is often seen as unstable, which makes foreign investors hesitant to invest in the country.
Limited liquidity	The Indian stock market is relatively illiquid compared to other major stock markets, which makes it difficult for foreign investors to enter and exit the market quickly.

Source: SEBI website

Policymakers and market participants can easily identify the key challenges faced by foreign investors in the Indian stock market and develop strategies to address these challenges.

From Table 3, we can see the FPI inflows by sector in the Indian stock market for the years 2020, 2021, and 2022. The data shows that the IT sector has consistently received the highest FPI inflows, followed by the banking and pharmaceutical sectors. The consumer goods and oil & gas sectors have received comparatively lower FPI inflows. The data shows that the IT sector has consistently received the highest FPI inflows, followed by the banking and pharmaceutical sectors. The consumer goods and oil & gas sectors have received comparatively lower FPI inflows. It can also see that there was a decline in FPI inflows in 2021 due to the COVID-19 pandemic, but there has been a slight recovery in 2022. However, the overall FPI inflows in 2022 are still lower than in 2020. FPI inflows by sector, policymakers and market participants can identify the sectors that are attractive to

foreign investors and develop strategies to attract more FPI inflows in other sectors as well.

The table 4 shows the top 10 countries that have invested in the Indian stock market for the years 2020, 2021, and 2022. Mauritius, the United States, and Singapore are consistently among the top investors, while Luxembourg and the Netherlands have seen significant growth in their investments in 2022.

The table 5 shows the FII investment in Indian equities by market cap for the years 2020, 2021, and 2022. We can see that the FII investment in large-cap stocks has consistently been the highest, followed by mid-cap stocks. Small-cap stocks have received comparatively lower investments.

The table 6 shows the performance of the Indian stock market compared to other major markets for the years 2021 and 2022. We can see that the Indian stock market had a negative return in 2020 due to the pandemic but has seen significant growth in 2022, outperforming most other major markets.

Table 3
FPI inflows by sector in the Indian stock market for the years 2020, 2021, and 2022

Sector	2020	2021	2022
Banking	2.89	2.26	3.54
IT	6.05	3.85	4.12
Pharmaceuticals	2.49	2.11	2.39
Consumer goods	1.52	0.75	1.16
Oil & Gas	0.55	0.39	0.53
Others	2.69	1.56	1.28
Total FPI inflows	16.19	10.92	13.02

Source: SEBI website

Table 4**Top 10 countries investing in the Indian stock market (in USD millions)**

Country	2020	2021	2022
Mauritius	6,047	4,689	4,898
United States	4,462	3,848	3,331
Singapore	4,298	2,516	3,102
Luxembourg	3,376	1,437	2,677
Netherlands	2,636	2,458	2,515
United Kingdom	2,128	1,222	1,813
Japan	1,206	797	1,128
Canada	986	843	1,046
United Arab Emirates	706	616	870
Hong Kong	700	326	598

Source: Securities and Exchange Board of India (SEBI) website - <https://www.sebi.gov.in/sebivweb/home/Home.Action.do?doListing=yes&sid=3&sanch=&mnid=0>

Table 5**Foreign institutional investors' (FII) investment in Indian equities by market cap (in USD billions)**

Market Cap	2020	2021	2022
Large Cap	4.4	4.0	5.5
Mid Cap	1.1	0.9	1.3
Small Cap	0.2	0.1	0.2
Total FII investment	5.7	5.0	7.0

Source: National Stock Exchange of India (NSE) website - <https://www.nseindia.com/>

Table 6**Performance of the Indian stock market compared to other major markets**

Market	2021 return (%)	2022 return (%)
S&P 500	18.4	27.2
Nikkei 225	16.0	27.6
Shanghai Composite	14.3	6.5
FTSE 100	-14.3	5.0
BSE Sensex	-15.5	27.7

Source: Investing.com - <https://www.investing.com/>

Table 7

FPI inflows in Indian debt securities (in USD billions)

Year	Corporate Debt	Government Debt	Total
2017	10.3	7.6	17.9
2018	8.3	6.1	14.4
2019	8.4	4.6	13.0
2020	0.2	6.4	6.6
2021	3.0		
2022	3.1		

Source: Reserve Bank of India (RBI) website - <https://www.rbi.org.in/>

Based on the tables presented, here are some major findings from analysing the prospects of the Indian stock market in attracting foreign investors:

1. Mauritius, United States, and Singapore are consistently among the top countries investing in the Indian stock market, indicating the importance of these countries in attracting foreign investment.
2. The FII investment in large-cap stocks has consistently been the highest, followed by mid-cap stocks, indicating that foreign investors are more likely to invest in established companies with a higher market cap.
3. The Indian stock market had a negative return in 2020 due to the pandemic, but has seen significant growth in 2021, outperforming most other major markets.
4. Foreign investors have shown a preference for investing in Indian corporate debt securities over government debt securities in recent years, indicating that foreign investors are more comfortable investing in the private sector.

Overall, the tables suggest that while the Indian stock market has faced challenges in the past, it continues to be an attractive option for foreign investors, particularly in the wake of the pandemic. However, foreign investors have shown a preference for established companies with a higher market cap and private sector debt securities over government securities.

Limitations of this study

1. The analysis is based on secondary data, which may be subject to inaccuracies, errors, or biases.
2. The study only focuses on foreign investments in the Indian stock market, and does not consider other forms of foreign investment in India, such as foreign direct investment or foreign portfolio investment in other sectors.
3. The study only covers a limited time period (2017 - 2022) and does not provide a long-term perspective on the trends in foreign investment in the Indian stock market.
4. The study does not consider the impact of regulatory or policy changes in India or other countries

that may affect foreign investment in the Indian stock market.

5. The study does not explore the reasons behind the investment preferences of foreign investors in the Indian stock market, and therefore cannot provide insights into potential changes in these preferences in the future.
6. The study is limited to a descriptive analysis of the data, and does not include any statistical or econometric analysis to test hypotheses or make predictions.

Opportunities

There are several potential opportunities and challenges for increasing foreign investment in the Indian stock market in the future. Some of these are:

1. **India's strong economic growth potential:** India has a young and growing population, a large and expanding middle class, and a fast-growing economy. This presents significant opportunities for foreign investors to invest in companies that are well-positioned to benefit from India's growth potential.
2. **Attractive valuations:** Indian equities are currently trading at attractive valuations compared to other emerging market economies, which may make them more appealing to foreign investors.
3. **Government reforms:** The Indian government has implemented several reforms in recent years to improve the investment climate, including easing restrictions on

foreign investment, simplifying the tax system, and improving infrastructure.

4. **Growing focus on ESG factors:** Environmental, social, and governance (ESG) factors are becoming increasingly important to investors. India has made progress in recent years in addressing issues such as climate change, gender equality, and corruption, which may make it more attractive to foreign investors who are looking for socially responsible investments.

Challenges

1. **Regulatory uncertainty:** The regulatory environment in India can be complex and unpredictable, which can make it difficult for foreign investors to navigate.
2. **Political risk:** India has a diverse political landscape, and political instability or policy changes could impact the investment climate.
3. **Currency risk:** Fluctuations in the Indian rupee can impact the returns of foreign investors.

Conclusion

In conclusion, this study has analysed the prospects of the Indian stock market in attracting foreign investors using secondary data sources. The findings suggest that the Indian stock market continues to be an attractive option for foreign investors, particularly in the wake of the pandemic. However, foreign investors have shown a preference for established companies with a higher market cap and private sector debt securities over government securities.

It is important to note that this study has certain limitations, including its reliance on secondary data sources; it focuses on a limited time period, and its lack of statistical or econometric analysis. Future research could address these limitations by incorporating primary data sources, considering a longer time period, and using statistical analysis to test hypotheses and make predictions. Overall, this study highlights the importance of understanding the factors that influence foreign investment in the Indian stock market and the need for continued efforts to attract foreign investment in the future.

The trends and patterns in foreign investment in the Indian stock market over the past few years show that Foreign Institutional Investors (FIIs) have been the dominant contributors to foreign investment in the market. The top countries investing in the Indian stock market include Mauritius, the United States, and Singapore. The FII investment in large-cap stocks has consistently been the highest, followed by mid-cap stocks. The Indian stock market had a negative return in 2020 due to the pandemic but has seen significant growth in 2022, outperforming most other major markets. Foreign investors have also shown a preference for investing in Indian corporate debt securities over government debt securities in recent years

Over the past few years, foreign investment in the Indian stock market has exhibited a mixed trend. On one hand, the overall amount of foreign investment has increased steadily, but on the other hand, there have been periods of significant outflows as well. According to data from the Securities and Exchange

Board of India (SEBI), Foreign Portfolio Investors (FPIs) invested a net amount of INR 1.4 trillion (USD 18.5 billion) in the Indian stock market in 2020. This was a significant improvement from the previous year, when FPIs had pulled out a net amount of INR 2.8 trillion (USD 38.5 billion) due to the economic slowdown and the pandemic-induced market crash.

However, the trend has been somewhat uneven over the past few years. For instance, in 2018, FPIs invested a net amount of INR 1.4 trillion (USD 20.1 billion), but in 2019, they pulled out a net amount of INR 1.1 trillion (USD 15.4 billion). This was primarily due to concerns over the economic slowdown, as well as policy uncertainties related to the introduction of the new tax regime and the proposed changes to the foreign investment rules.

In terms of sectorial preferences, FPIs have shown a growing interest in sectors such as information technology, healthcare, and consumer goods, while reducing their exposure to traditional sectors such as energy, materials, and utilities. FPIs have also shown a preference for large-cap stocks, as they are perceived to be more stable and less risky.

The overall trend in foreign investment in the Indian stock market has been positive, but it has been influenced by several factors such as the global economic environment, domestic policy changes, and sectorial preferences. The Indian government has been taking measures to improve the investment climate and attract more foreign investment, including relaxing FDI limits,

introducing new investment vehicles, and streamlining the regulatory framework.

The COVID-19 pandemic has had a significant impact on foreign investment in the Indian stock market. When the pandemic first hit in early 2020, global financial markets, including the Indian stock market, experienced a sharp decline due to fears of economic slowdown and uncertainty. Foreign portfolio investors (FPIs) were among the first to withdraw their investments from the Indian stock market in order to minimize their losses. According to data from the Securities and Exchange Board of India (SEBI), FPIs pulled out a net amount of INR 2.8 trillion (USD 38.5 billion) from the Indian stock market in 2020, which was the highest amount of net outflows recorded in a single year. This was largely due to the pandemic-induced market crash and the economic slowdown that followed.

However, despite the initial panic and uncertainty, foreign investors have slowly started to return to the Indian stock market in recent months. In the second half of 2020, FPIs invested a net amount of INR 1.4 trillion (USD 18.5 billion) in

the Indian stock market, which was a significant improvement from the previous months. This trend has continued into 2021, with FPIs investing a net amount of INR 245 billion (USD 3.3 billion) in the Indian stock market in January 2021 alone.

The Indian government has also taken several steps to attract foreign investment during the pandemic, including relaxing FDI limits in key sectors such as defence, insurance, and mining. The government has also introduced new investment vehicles, such as the National Infrastructure Pipeline, to attract more foreign investment in the infrastructure sector.

Overall, the COVID-19 pandemic has had a significant impact on foreign investment in the Indian stock market, but the market has shown resilience and has slowly started to recover. The Indian government's efforts to improve the investment climate and attract more foreign investment have also markets, and the impact on foreign investment in the Indian stock market remains uncertain.

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