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K S Chalapati Rao
M R Murthy
K V K Ranganathan

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Institute for Studies in Industrial Development
Narendra Niketan, I P Estate, New Delhi - 110 002, India

FOREIGN INSTITUTIONAL INVESTMENTS AND THE INDIAN STOCK MARKET

K.S. Chalapati Rao, K.V.K. Ranganathan and M.R. Murthy*

To facilitate foreign private capital flows in the form of portfolio investments, developing countries have been advised to develop their stock markets. It was suggested that these investments would help the stock markets directly through widening investor base and indirectly by compelling local authorities to improve the trading systems. While the volatility associated with portfolio capital flows is well known, there is also a concern that foreign institutional investors might introduce distortions in the host country markets due to the pressure on them to secure capital gains. In this context, this paper seeks to assess the importance of foreign portfolio investments in India relative to other major forms and to study the relationship between foreign portfolio investments and trends in the Indian stock market during the past four years.

Introduction

The character of global capital flows to developing countries underwent significant changes on many counts during the 'nineties. By the time the East Asian financial crisis surfaced, the overall size of the flows more than tripled. It stood at US$ 100.8 bn. in 1990 and rose to US$ 308.1 bn. by 1996. The increase was entirely due to the sharp rise in the flows under private account that rose from US$ 43.9 bn. to 275.9 billion during the same period. In relative terms the percentage of private account capital flows increased from 43.55 to 89.55 per cent (Table 1). Simultaneously, the Official Development Assistance (ODA), declined both in relative and absolute terms. All the main components of the private account capital transfers, namely, (a) commercial loans, (b) foreign direct investments (FDI), and (c) foreign portfolio investments (equity and bonds) (FPI) recorded significant increases. Portfolio flows increased at a faster rate than direct investments on private account. As a result, starting with a low level of 11.16 per cent, the share of capital flows in the form of portfolio investments quadrupled to reach 37.22 per cent in 1996 reflecting the enhanced emphasis on private capital flows with portfolio investments forming the second important constituent of the flows during the 'nineties. In this process multilateral bodies led by the International Finance Corporation (IFC) played a major role.[1]

Following the East Asian financial crisis, initially there was a slow down followed, by a decline in private capital flows. While bonds and portfolio equity flows reacted quickly and declined in 1997 itself, loans from commercial banks dropped a year later in 1998. Decline in FDI was also delayed. But the fall in FDI was quite small compared to the other three major forms of private capital flows. While flows on official account increased, following the crisis, they continue to constitute only a small portion of the total flows. Thus, starting with the resolve by the developed countries to provide one per cent of their GNP as developmental aid, the industrialised world preferred to encourage private capital transfers through direct investments instead of official assistance [Goyal, 1980, Pp. 843-50; Goyal, 1982].[2] The declining importance of official development finance is attributed to budgetary constraints in donor countries and the optimism of private investors in the viability of the developing countries [World Bank, 1998, p. 5].

K.S. Chalapati Rao, M.R. Murthy and K.V.K. Ranganathan are Principal Researchers in Institute for Studies in Industrial Development, Narendra Niketan, Indraprastha Estate, New Delhi - 110 002.

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Table 1. Aggregate Net Long-term Resource Flows to Developing Countries

(US$ bn.)

Type of flow	1990	1991	1992	1993	1994	1995	1996	1997	1998
A. Official Flows	56.9	62.6	54.0	53.3	45.5	53.4	32.2	39.1	47.9
B. Total Private Flows	43.9	60.5	98.3	167.0	178.1	201.5	275.9	299.0	227.1
of which.									
International Capital Markets	19.4	26.2	52.2	100.0	89.6	96.1	149.5	135.5	72.1
- Private Debt Flows	15.7	18.6	38.1	49.0	54.4	60.0	100.3	105 3	58.0
- Commercial Banks	3.2	4.8	16.3	3.3	13.9	32.4	43.7	60 1	25.1
- Bonds	1.2	10.8	11.1	37.0	36.7	26.6	53.5	42.6	30.2
-Others	11.4	3.0	10.7	8.6	3.7	1.0	3.0	2.6	2.7
- Portfolio Equity Flows	3.7	7.6	14.1	51.0	35.2	36.1	49.2	30.2	14.1
Foreign Direct Investment	24.5	34.4	46.1	67.0	88.5	105.4	126.4	163.4	155.0
C. Aggregate Net Resource Flows (A+B)	100.8	123.1	152.3	220.2	223.6	254.9	30K. 1	338.1	275.0
Share of' Private flows in Total Flows (C)	43.55	49.15	64.54	75.84	79.65	79.05	89.55	88.44	82.58
Share of Portfolio Capital Flows (equity+bonds) in Private Flows (B)	11.16	30.41	25.64	52.69	40.37	31.12	17.22	24.35	19.51

Source: Based on World Bank, *Global Development Finance*, 1999, Table 2.1.

Portfolio investments spread risk for foreign investors, and provide an opportunity to share the fruits of growth of developing countries which are expected to grow faster. Investing in emerging markets is expected to provide a better return on investments for pension funds and private investors of the developed countries. For developing countries, foreign portfolio equity investment has different characteristics and implications compared to FDI. Besides supplementing domestic savings, FDI is expected to facilitate transfer of technology, introduce new management and marketing skills, and helps expand host country markets and foreign trade [World Bank, 1997, p. 31]. Portfolio investments supplement foreign exchange availability and domestic savings but are most often not project specific. FPI, are welcomed by developing countries since these are non-debt creating. FPI, if involved in primary issues, provides critical risk capital for new projects. Since FPI takes the form of investment in the secondary stock market, it does not directly contribute to creation of new production capabilities. To enable FPI flows which prefer easy liquidity, multilateral bodies, led by the International Finance Corporation (IFC), have been encouraging establishment and strengthening of stock markets in developing countries as a medium that will enable flow of savings from developed countries to developing countries.

FPI, it is expected, could help achieve a higher degree of liquidity at stock markets, increase price-earning (PE) ratios and consequently reduce cost of capital for investment. FPI is also expected to lead to improvement in the functioning of the stock market as foreign portfolio investors are believed to invest on the basis of well-researched strategies and a realistic stock valuation. The portfolio investors are known to have highly competent analysts and access to a host of information, data and experience of operating in widely differing economic and political environments. Host countries seeking foreign portfolio investments are obliged to improve their trading and delivery systems which would also benefit the local investors. To retain confidence of portfolio investors host countries are expected to follow consistent and business-friendly liberal policies. Having access to large funds, foreign portfolio investors can influence developing country capital markets in a significant manner especially in the absence of large domestic investors.

Portfolio investments have some macro-economic implications. While contributing to build-up of foreign exchange reserves, portfolio investments would influence the exchange rate and could lead to artificial appreciation of local currency. This could hurt competitiveness. Portfolio investments are amenable to sudden withdrawals and therefore these have the potential for destabilising an economy. The volatility of FPI is considerably influenced by global opportunities and flows from one country to another. Though it is sometime argued that FDI and FPI are both equally volatile [Claessens et al, 1993], the Mexican and East Asian crises brought into focus the higher risk involved in portfolio investments.

The present paper has two objectives. One, to assess the importance of different types of foreign portfolio investments in capital flows to India. And two, to understand the investment behaviour of foreign portfolio investors through an analysis of the portfolios of five US-based India specific funds. Such an exercise, it is hoped, would explain the relationship between foreign institutional investments and trading pattern in the Indian stock market better than aggregate level analysis.

FPI and India

While foreign portfolio investments are not new to the Indian corporate sector, the importance of portfolio investments received special impetus towards the end of 1992 when the Foreign Institutional Investors (FIIs) such as Pension Funds, Mutual Funds, Investment Trusts, Asset Management Companies, Nominee Companies and incorporated/institutional Portfolio Managers were permitted to invest directly in the Indian stock markets. The entry of FIIs seems to be a follow up of the recommendation of the Narasimham Committee Report on Financial System. While recommending their entry, the Committee, however, did not elaborate on the objectives of the suggested policy. The Committee only stated:

> The Committee would also suggest that the capital market should be gradually opened up to foreign portfolio investments and simultaneously efforts should be initiated to improve the depth of the market by facilitating issue of new types of equities and innovative debt instruments [*Narasimham Committee Report*, p. 121].

Press reports of early 1993 indicate that the Asian Department Bank (ADB) influenced the Committee's recommendations [Patriot, 1993; Hindustan Times, 1993; Dataline Business, 1993]. The then ADB President's *Report on India's Request for a Financial Sector Program Loan*, mentioned that:

> The Bank (ADB) had also called for capital market reforms including allowing private mutual funds to operate, *allowing investment in Indian firms by foreign investors* and allowing increased access to world capital markets for Indians (emphasis added).[3]

Attracting foreign capital appears to be the main reason for opening up of the stock markets for FIIs [Lalitha, 1992]. The Government of India issued the relevant Guidelines for FII investment on September 14, 1992. Only a few days prior to this, a statement attributed to IFC suggested that India would have to wait for some years before the expected large foreign investment materialises [Financial Express, 1992]. Regarding the entry of FIIs the then Finance Minister said at a meeting organised by the Royal Institute of International Affairs (London) that the decision to open up the stock market to investments by foreign companies would be good for the country as India needed international capital. He further said that a non-debt creating instrument such as this was superior to raising loans of the classical type so that an unsustainable debt burden was not piled up. The Finance Minister also said that the liberalisation of the economy would bring in international capital of about $10 bn a year rising to $12-13 bn. over the following 2-3 years [*Economic Times*, 1992]. It may also not be a mere coincidence that India decided to open its stock markets to FII investments in the aftermath of the stock scam. The Sensex, BSE Sensitive Index, fell to 2,529 on August 6, 1992 from the unprecedented high level of 4,467 reached on April 22, 1992. As an incentive, FIIs were allowed lower rates for capital gains tax. This was justified on the basis that `(T)his will guard against volatility in fund flows' [*Economic Survey*, 1993-94, p. 54].[4] Indian industry did protest against this and called for a level playing field [Pai Panandiker].

During the period 1992-93 to 1998-99 out of the total capital inflow to India of about US$ 28.6 billion, a little more than US$ 15 billion or nearly 54 per cent of the total, was on account of foreign portfolio investments. These aggregate capital flows were a little less than the foreign currency assets at the end of 1998-99. During the period, external debt did increased from US$ 85 bn. to 98 bn. [*Economic Survey*, 1999-2000]. Much of the increase, however, took place by 1995. Thus, the strategy of relying on non-debt creating instruments seems to have yielded results. The flows, however, did not match the initial expectation that capital flows will aggregate US$ 12-13 bn. a year, i.e., nearly US$ 50-60 bn. for the five year period 1993 to 1997. Within portfolio investments, FIIs had a share of nearly 50 per cent and GDRs 44 per cent (Table 2). From the point of capital flows and managing balance of payments, it does appear that an active pursuance of GDRs could be a viable alternative to FII investments. Unlike portfolio investments, GDRs are generally project specific and hence the benefits from such issues are more tangible.

Table 2. Inflow of Foreign Investments in the Post-liberalisation Period

(Amount in US$ mn.)

Year	Total Inflows (Direct+ Portfolio)	Of which, Portfolio Investments		
		Total	Of which FIIs#	GDRs@
(1)	(2)	(3)	(4)	(5)
1992-93	559	244	1	240
1993-94	4,153	3,567	1,665	1,520
1994-95	5,138	3,824	1,503	2,082
1995-96	4,892	2,748	2,009	683
1996-97	6,133	3,312	1,926	1,366
1997-98	5,385	1,828	979	645
1998-99	2,401	-61	-390	270
Total	28,661	15,462	7,693	6,806

\# Represent fresh inflow/outflow of funds by FIIs.
@ Figures represent GDR amounts raised abroad by the Indian companies.
Source: India, Ministry of *Finance, Economic Survey: 1999-2000*.

FII Investments on the Indian Stock Exchanges

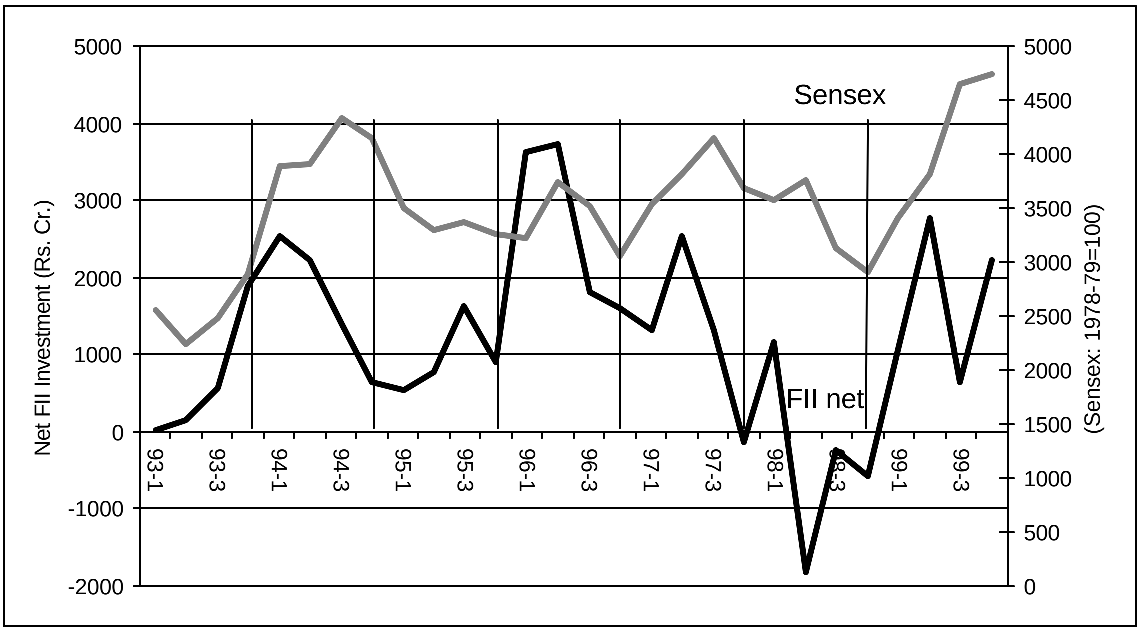
In November 1995, SEBI notified the Foreign Institutional Investors Regulations which were largely based on the earlier guidelines issued in 1992. The regulations require FIIs to register with SEBI and to obtain approval from the Reserve Bank of India under the *Foreign Exchange Regulation Act, 1973* to enable them buy and sell securities, open foreign currency and rupee bank accounts and remit and repatriate funds. For all practical purposes, full convertibility of rupee is applicable to FII investments. Gradually, the scope of FII operations has been expanded by permitting (a) additional categories of investors, (b) recognising other instruments in which they can invest, and (c) altering the individual and aggregate FII shares in any one Indian company. The latest position is that an FII (investing on its own behalf) or a sub-account can hold up to 10 per cent of paid-up equity capital (PUC) of a company. The total investment by all FIIs and sub-accounts in any one company cannot exceed 24 per cent of the total PUC. In companies which pass a special resolution in this regard, the total FII investment can reach up to 30 per cent of the PUC. Imposition of investment ceilings, one expects, was aimed at: *one*, preventing cornering of shares that could result in take-over operations;[5] and *two*, to keep price fluctuations under limits. The 24 per cent limit does not include investments made by the foreign portfolio investors outside the portfolio investment route, *i.e.*, through the direct investment approval process. Investments made through purchases of GDRs and convertibles are also excluded. For calculating the FII investment limits, investments by NRIs and Overseas Corporate Bodies predominantly controlled by them, which were included earlier, are no longer included for purposes of monitoring the FII investment ceilings.[6] In the Budget Speech 2000-2001 it was proposed to raise the upper limit to 40 per cent.

In spite of the fact that FPI has been given an important place in India's financial sector under the liberalisation package, very few studies of the FII operations in India exist. One reason for this has been the paucity of data. Empirical studies have remained confined to aggregate level studies [Joshi, 1995; Pal, 1998, Pp. 589-98; Samal, 1997, Pp. 2,729-32]. The studies generally point to the positive relationship between FII investments and movement of the Bombay Stock Exchange share price index. We looked at the relationship in a somewhat different way. It has been noticed that net FII investments were lower in the fourth quarter in all the years except 1993, their first year of operations, and 1999. The average of BSE Sensex also fell in the last quarter except in 1993 and 1999. Contrary to the expectations FII investments picked up during the last quarter itself after a dip in the third quarter of 1999. Average level of Sensex also did not decline during the last quarter. It does, however, appear that FIIs buy in the first and second quarters following the depression created by their low activity or relative selling pressure in the last quarter. The decline, which starts in the third quarter, reaches the maximum in the last quarter[7] (Graph). One of the possible explanations for the BSE Sensex also declining during the last quarter could be that the local market players look towards FIIs for leads. In such a situation, even with relatively small turnovers, FIIs can swing the market by their actions. The extent of FII influence on market players can probably be gauged from the fact that SEBI asked the stock exchanges not to release FII trading details [*Hindu Business Line*, 1999][8] as SEBI decided to release the data with a one day lag and after due confirmation with the FIIs' custodians.

To give better empirical content to the general understanding that FIIs influence the Indian equity markets we tried to get detailed data on FII transactions. Our efforts at getting FII-wise information from the RBI and SEBI, however, did not meet with any success.[9] In view of this, we had to rely on other sources. At the beginning of March 2000, the number of FIIs registered with SEBI stood at 502. The sheer number of FIIs does not give a full picture of the FII operations in India since each of the FIIs can represent unlimited number of sub-accounts. On the number of sub-accounts, however, no information is available. With the importance attached to sub-account-wise investment limits one would have expected SEBI to provide information on these. Also, a good number of FIIs are under common control (as indicated by their names, addresses and telephone numbers) and render individual FII limits less relevant.

Graph

Quarterly Movements in Net FII Investments and Average Sensex Levels: 1993:1999



Note: Quarterly averages of Sensex closing values.
Source: Net FII investments are taken from CMIE, *Capital Markets*, October 1998 and SEBI.

After 1993-94, SEBI stopped giving a category-wise break up of the registered FIIs in India. From an examination of the registration numbers, available from the SEBI web site, it appears that most FIIs fall under two categories: `FA' and `FD' (Table 3). FA appears to stand for fund advisers and asset management companies implying that most FIIs (56.57 per cent) work as representatives of others. From a similar deduction it appears that FD stands for investment funds.[10] These two categories account for 93 per cent of the FIIs. There are 9 FIIs under the category `FC' which are most likely pension funds. The other important category is `FE' which includes an assortment of insurance companies, investment trusts and government bodies.

Out of the 502 FIIs, as many as 200 were from USA and another 121 have UK addresses. A few FIIs are reported to be from Hong Kong, Singapore, Luxembourg, etc., but some of them, it is our assessment, had their origin in USA and UK. For instance, those registered from Singapore include: Citicorp Investment Bank (Singapore) Ltd., Templeton Asset Management Ltd., and J.P. Morgan Securities Asia Pvt. Ltd. The registrants from Hong Kong include Jardine Fleming Intl. Mgt. Inc., Merril Lynch Far East Ltd., and ABN Amro Asia Ltd. One of the registrants from Bahrain is Citicorp Banking Corp. Very few FIIs had their addresses in tax havens like Bahamas and Cayman Islands. Only one FII has given a Mauritius address. It thus appears that the phenomenon of FIIs is essentially a domain of funds from USA and UK.

The larger FIIs have multiple associates in India including locally incorporated companies which operate either as brokers, managers or mutual fund operators.[11] Some of the FIIs floated joint ventures with Indian companies: either belonging to the broking community or India's business groups. Coupled with the fact that the FIIs can invest through the GDR route, it appears that the operations of FIIs cannot be understood if investments by FIIs registered with SEBI are examined in isolation. The network of entities belonging to the Jardine Fleming Group may provide a concrete example in this regard (Box 1). We shall discuss the involvement of FIIs in the Indian mutual funds industry a little latter to further provide evidence in this regard.

Table 3. Country-wise Distribution of FIIs Registered with SEBI

Country	Asset Management Cos./Fund Advisers$ [FA]	Investment Funds/ Trustees on Behalf of Such Funds [FD]	Insurance Cos. Investment Trusts, Government Bodies, etc. [FE]	Pension Funds [FC]	Others	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)
USA	102	86	5	7	-	200
UK	68	42	10	1	-	121
Hong Kong	31	2	1	-	-	34
Singapore	19	1	2	-	1	23
Luxembourg	8	22	-	-	-	30
Australia	5	10	1	-	-	16
Switzerland	12	2	1	-	-	15
Canada	8	4	-	1	-	13
Netherlands#	7	6	-	-	-	13
Italy	6	1	-	-	-	7
Japan	4	1	-	-	-	5
Others (Incl. unclassified)	14	6	5	-	-	25
Total	284	183	25	9	1	502

$ This classification is based on relating registration numbers with the names of FIIs.
# Including one from Netherlands Antilles.
Source: Based on the registration details given at SEBI's website.

From the available information it appears that FIIs do not play a major role in the primary market. According to SEBI, in 1995-96, out of the 1,426 public issues involving an issue amount of Rs 14,240 crore, in 79 issues Rs 212 crore were reserved for FIIs. In the following year Rs 549 crore were reserved in 23 issues out of a total amount of Rs 11,557 crore issued by 751 companies. In 1997-98 the amount reserved was Rs 12 crore in 3 issues [SEBI, 1996-97 and 1997-98; 1998-99, Pp. 50-51].[12] The following exercise will, therefore, be concentrating on the FII operations in the secondary market. In the secondary market also, going by the values, FIIs are more active on the equity market than in the debt segment [BSE, 2000, Pp. 13-18].[13] At the Bombay Stock Exchange, which accounts for about half of the FII sales and purchases, against the total market turnover of Rs 5,27,960 crore in 1999, FII purchases were Rs 17,165 crore and sales, Rs 13,174 crore.[14] The total turnover for 1998 stood at Rs 2,65,995 crore; FII purchases at Rs 6,684 crore and their sales, Rs 6,940 crore. Thus, in comparison to total trading values on the BSE, FII sales and purchases appear to be quite small.

For understanding the investment pattern of FIIs we tried to examine the N-30D filings of investment funds with the US capital market regulatory body, namely, the Securities and Exchange Commission (SEC). Form N-30D is required to be filed by registered investment companies and contains semi-annual and annual reports mailed to the shareholders.[15] The SEC data are available for different years. One can, therefore, make useful comparisons over a period. The filings also offer details on the investment strategies of FIIs. A study of American funds could be quite representative of the FIIs investment behaviour in India because most FIIs registered in India are from the USA.

BOX - 1
JARDINE FLEMING# & INDIA

Jardine Fleming India Fund Inc.,	Maryland, USA
Investment Adviser:	Jardine Fleming International Management Inc. (JFIM), British Virginia Islands. Regd. with SEBI as an FII from HK.
Broker:	Jardine Fleming India Broking Pvt. Ltd., India (*Affiliate of JFIM)*
Revolving Credit Agreement WITH:	Jardine Fleming Bank Ltd. (*Affiliate of JFIM*)
Administrator:	Mitchell Hutchins Asset Management Inc. Wholly-owned subsidiary of Paine Webber
Mauritius Administrator:	Multiconsult Ltd., Mauritius
Custodian:	Citibank, US & India
JF India Trust Trustee & Registrar:	HSBC Trustee (Mauritius) Ltd., Mauritius
Investment Manager:	JF Unit Trust Management Ltd., British Virgin Islands
Manager:	JF India Fund Management Ltd., British Virgin Islands
Investment Adviser:	Jardine Fleming Investment Management Ltd.
Registrar's Agent: & HK Representative:	Jardine Fleming Unit Trusts Ltd.
Jardine Fleming India Asset Management Pvt. Ltd., India	Asset Management Co. of Jardine Fleming Mutual Fund.
Fledgeling Nominees Intl. Ltd., Cayman Islands.	Regd. as FII with SEBI. C/o Jardine Fleming India Securities Pvt. Ltd., India, Mumbai.
Robert Fleming Nominees Ltd., London	Regd. as FII with SEBI. C/o Jardine Fleming India Securities Pvt. Ltd., India, Mumbai.
Jardine Fleming India Securities Pvt. Ltd.	Approved by the FIPB in June 1994 for undertaking merchant banking, corporate finance, stock broking and asset management. The approval was for Jardine Fleming, Mauritius.
Jardine Matheson's Joint Venture with Tata Industries with Bermuda as the home country	Approved by FIPB in April 1996 for undertaking retailing, distribution financial services, property, hotels, engineering and construction.
Fleming Fund Management (Luxembourg) S.A., Luxembourg	Regd. as FII with SEBI

\# Jardine Fleming was established in 1970 in Hong Kong and is jointly owned by Jardine Matheson Holdings Limited and Robert Fleming Holdings Limited. Early last year Flemings fully acquired Jardine Fleming.

Note: Prepared in early 1999 by way of illustration and is by no means exhaustive.

By a process of string search in the text, we could identify 53 funds which invested in India in 1998.[16] Only five of them were specific to India.[17] The others invested in GDRs of Indian companies, India specific funds of USA or UK or directly in a few Indian companies. Apart from the five India specific funds, only six other funds invested in more than ten Indian companies in 1998. This may indicate that the focus of FIIs on India is quite narrow.

Investment Pattern of Five India Specific Funds

The five India specific funds whose investment details for 1996 and 1998 we will be presenting in the following are: (i) India Growth Fund Inc.; (ii) India Fund Inc.; (iii) Jardine Fleming India Fund Inc.; (iv) Morgan Stanley India Investment Fund Inc.; and (v) Pioneer India Fund.[18] All the five have different investment advisers and the total value of investment in 535 Indian companies in mid-1996 was US$ 915 mn.[19] The number of companies compares well with the official estimates for 1996-97 that FIIs have been active in over 600 scrips out of more than 6,000 listed ones. It has also been indicated that out of the 427 registered at that time, on an average 130 were active in any given month and about two-thirds of the purchases and sales were accounted for by only 25 FIIs [*Economic Survey*, 1996-97, p. 61]. But by 1998, presumably as a fall out of the East Asian crisis, the sanctions following India exploding nuclear devices in May 1998 and the general slow down of the Indian economy, the number of companies in which the funds invested declined and stood at 375 (Table 4).[20] The market value of the assets held by the funds declined to US$ 762 mn. Decline in the number of companies is common to four of the five funds.

The accompanying study of trading at BSE[21] showed that out of the nearly 6,000 companies listed at the exchange, the largest 500 companies in terms of market turnover account for over 99 per cent of the turnover. FII investments have generally confined to this set of high turnover companies as the share of such companies in the market value of investments increased from 86 to 98 per cent between 1996 and 1998 (Table 5). This suggests that FII operations are progressively confining to liquid shares.[22] By 1998, it is also observed that A Group (Specified) companies, in which carry forward deals are permitted,

Table 4. Basic Details of Five India Specific Funds

Name of the Fund (1)	Investment Adviser (2)	No. of Companies Invested in: 1996 (3)	1998 (4)	Value of Investment (Mn. US$): 1996 (5)	1998 (6)
1. Morgan Stanley India Investment Fund Inc.#	Morgan Stanley Asset Management Inc.	255	165	387.59	291.34
2. India Growth Fund Inc.	UTI Investment Advisory Services Ltd., India	224	174	134.31	276.02
3. India Fund Inc.#	(i) Advantage Advisers, a subsidiary of CIBC Oppenheimer Corp. (ii) Infrastructure & Financial Services Ltd., India	188	27	282.08	95.21
4. Jardine Fleming India Fund Inc.#	Jardine Fleming Intel. Management Inc., British Virginia Island	77	77	79.97	84.24
5. Pioneer India Fund	(i) Pioneer Management Corp. (ii) Kothari Pioneer AMC Ltd., India	93	52	31.02	14.78
All the Five Funds		535	375	914.97	761.59

\# Claimed tax residency status in Mauritius.
Note: The number of companies do not add up to the total as more than one fund invested in some of the companies.
Source: Based on the Funds' N30-D filings with the U.S. Securities and Exchange Commission (SEC). For the first three funds the data refers to June-end of the respective years. For Jardine Fleming it is May-end and for Pioneer it is April-end.

Table 5. Shares of Different Categories of Companies in the Market Value of Investments

Company Category	Market Value (US$ mn.)		Percentage in Total	
	1996	1998	1996	1998
(1)	(2)	(3)	(4)	(5)
Top Market Turnover Companies$	791.64	746.84	86.52	98.06
A Group#	623.70 (521.76)	619.58	68.17 (57.03)	81.35
Sensex Companies	326.27	256.33	35.66	33.66
Foreign -Controlled Cos. (FCCs)	190.29	214.04	20.80	28.10
Public Sector Companies	151.98	157.29	16.61	20.65
Large Indian Houses	339.85	108.63	37.14	14.28
All Companies	914.97	761.59	100.00	100.00

Percentages do not add up to 100 because of over-lapping of the groups.

$ Ranked according to the total market turnover at BSE in the corresponding year.

The A-group was expanded in February 1998 to include 50 companies. Figures in brackets indicate the aggregate and percentage with regard to the composition of the Group prior to its expansion.

increased their share from 68 per cent to 81 per cent.[23] The share of Sensex (pre-November 1998) companies remained at about one-third of the total value. However, it is significant that the five funds invested in practically all the Sensex companies, implying that their operations could potentially influence the index. Names and other particulars of the top 25 companies in terms of value for each of the five funds are given in the Annexure. While the share of foreign-controlled companies (FCCs) in the value of investment increased from about 21 to 28 per cent. The share of public sector companies increased from about 17 to 21 per cent. Along with the decline in the number of companies in which the funds invested, the share of top companies in terms of market value of investment increased substantially. The share of top ten companies increased from about 26 per cent to 45 and that of top 100 from 77 per cent to 94 per cent. In all, the value of the investment of the five funds is concentrated in about 150 companies (Table 6).

Table 6. Share of Top Companies in the Market Value of Investments by Five India Specific Funds

Top Companies#	Percentage in Total Value of Investment	
	1996	1998
(1)	(2)	(3)
10	25.90	44.77
50	61.01	82.82
100	77.33	93.87
150	86.54	98.06
All Companies	100.00 (535)	100.00 (375)
Total Amount (Mn. US$)	914.97	761.59

Based on value of investment and includes investment in GDRs.
Figures in brackets are the number of companies invested in the respective years.

A sector-wise classification of the companies, in which the funds have invested shows that there was a major shift in the investment exposure within two years.[24] Computer software (development and training) group of companies which was not among the top 10 in 1996, reached the top-most position in 1998. Pharmaceuticals sector improved its position from the fifth to the third position. Food & Beverages and Personal Care products made their entry into the top 10. Major industries that moved down below the 10th position were: metals and metal products, textiles, cement and electrical machinery (Table 7).

It may be noted that at the Bombay Stock Exchange also computer software, food and beverages, pharmaceuticals and personal care products improved their position in 1998 compared to 1996. Similarly, trading values showed increased concentration and the number of companies traded declined during the same period. While share of FCCs in the turnover increased, that of Indian large companies declined. The resemblance between the distribution of trading values at BSE and exposure of FII investments seem to suggest a strong positive relationship between the two and possible influence of FII investment pattern on trading at BSE. This goes to strengthen the general conclusion drawn on the basis of comparison of quarterly net FII investments and movement of the Bombay Stock Exchange Sensitive.

Table 7. Investment Exposure of Five India Specific US Funds: Changing Sectoral Importance between 1996 and 1998

Ranking		Industry	Market Value of Investments (US$ mn.)		Percentage to Total	
1996	1998		1996	1998	1996	1998
		(1)	(2)	(3)	(4)	(5)
1	2	Automobiles	93.77	85.21	10.25	11.19
2	14	Metals and Metal Products	65.72	19.54	7.18	2.57
3	4	Non-Electrical Machinery	60.85	55.85	6.65	7.33
4	6	Diversified	59.43	44.28	6.50	5.81
5	3	Pharmaceuticals	53.07	67.16	5.80	8.82
6	13	Auto-Ancillaries	50.84	20.82	5.56	2.73
7	19	Textiles	42.38	6.03	4.63	0.79
8	17	Electrical Machinery	41.56	11.73	4.54	1.54
9	18	Cement	39.02	10.99	4.26	1.44
10	16	Entertainment/Multimedia	33.33	16.22	3.64	2.13
14	1	Computer Software (Devt&Trg)	25.68	133.94	2.81	17.59
19	5	Food, Beverages & Tobacco Pr.	19.06	47.14	2.08	6.19
16	7	Personal Care Products	20.61	44.02	2.25	5.78
11	8	Telecommunications	37.92	27.94	4.14	3.67
15	9	Refineries	22.83	25.53	2.50	3.35
12	10	Public Sector Banks	30.64	24.73	3.35	3.25
		Total (including others)	914.96	761.58	100.00	100.00

Source: Complied on the basis of the Funds' N-30D filings with the US SEC.

A factor which emerged from the funds' filings is that three[25] out of the five funds claimed tax residency status in Mauritius with which India has entered into double taxation treaty. That this was a mere strategy of tax planning is evident from the fact that one of the funds (India Fund Inc.) reported that

> (T)he Fund has established a branch in the Republic of Mauritius. ... Multiconsult Ltd. (the `Mauritius Administrator') provides certain administrative services relating to the operation and maintenance of the Fund in Mauritius. The Mauritius Administrator receives a monthly fee of $1,500 and is reimbursed for certain additional expenses.[26]

The other two funds also paid similar amounts to Multiconsult.[27] The Mauritius company should only be lending its address, as, for such small amounts, one cannot think of any other professional service. In this background, from the taxation of profits and capital gains, point of view, the country status described earlier has little relevance.[28] Incidentally, the address of Multiconsult Ltd., is used, apart from India Fund Inc. and Morgan Stanley India Investment Fund Inc., the two other funds claiming Mauritius residency status, also by such other foreign investors that invested in India and as varied as US West Cellular Investment Co., Chatterjee Petrochem (an NRI company which received approval to invest in Haldia Petrochem) and Marconi Telecommunications.

FIIs and Emergence of Computer Software, Consumer Non-Durables and Pharmaceutical Sectors

There appears to be a good deal of co-ordination and similarity in business approach among the five Funds in spite of each having different investment advisers. All of them started looking at the computer software, pharmaceutical as also fast moving consumer goods sectors while reducing their exposure to commodities and chemicals (Box 2).

The FII preferred sectors seem to have caught the attention of others too. The emergence of software, pharmaceuticals and personal care products in BSE market turnover could be a reaction of the local investors, especially the mutual funds promoted in association with FIIs, to the FIIs' investment strategy. For instance, Prudential ICICI Growth Plan managed by Prudential-ICICI Asset Management Co. (AMC), a joint venture of Prudential Corp. Plc., of UK and ICICI, by the end of 1998, had a quarter of its net asset value (excluding cash) in consumer goods companies, 17.01 per cent in pharmaceutical companies and 15.91 per cent in software companies. The combined share of the three sectors worked out to as high as 58.56 per cent. The electronic newsletter of the company dated March 17, 1999 informed that the share in the three sectors increased further to 72 per cent. Similarly, in the case of Birla Advantage Fund, managed by Birla Capital International Ltd.,[29] as on November 30, 1998, the share of the three sectors stood at nearly half of the overall value of investments.[30] It may be noted that after the mid-November revision, the three sectors have an overall weightage of 43.52 in the Sensex. Taking advantage of the popularity of software scrips, a few companies are reported to have even changed their names indicating their involvement in information technology, probably, to mislead the investors [*Hindu Business Line*, 1999; SEBI, 1999].[31]

BOX - 2

Investment Choices of US -Based India Specific Funds

India Growth Fund Inc: June 30, 1998

In January 1997, it was decided to decrease the Fund's investment exposure in industries such as *cement, iron and steel, commercial vehicles, chemicals, and heavy engineering*. ... exposure was *increased in information technology, pharmaceuticals/ healthcare and food and agro products*. ... The decision to restructure the portfolio *by reducing exposure to a small number of companies* and reducing exposure in declining and cyclical sectors has started to show results. The decision to *divest of stocks in small and madcap companies*, eliminate smaller holding where potential for appreciation was limited, ... has helped ... (emphasis added)

Pioneer India Fund: April 30, 1998

We *added pharmaceutical stocks*, with the belief that these companies should be able to advance regardless of the region's economic condition. ... In our strongest move of the period, we *significantly increased investments in the Indian software and computer industry.* (emphasis added).

India Fund Inc: June 30, 1998

The Fund continued its strategy *of overweighting the software sector* which is considered to be a longterm secular growth industry for India. This sector remains an inherent hedge in the case of a weakening currency due to high export earnings ... the Fund *steadily increased its exposure to ... consumer companies in areas of healthcare, food, detergents and other household goods* as people shift to using high quality branded products. The Fund *increased its holdings of both Hindustan Lever and ITC ...* The Fund *further reduced its holdings in commodities such as petrochemicals and textiles w*here growth prospects continued to deteriorate due to delayed economic recovery in India ... (emphasis added).

Morgan Stanley India Investment Fund Inc: June 30, 1998

Given the political outlook and the poor visibility on the economy we remain defensive on the market and our Fund is being structured on these lines. We *remain positive on software, media, pharmaceuticals and the FMCG sectors* and we are *holding on to our large weightings in these sectors*. (emphasis added).

Jardine Fleming India Fund Inc: May 31, 1998

The Fund's portfolio is comprised of high quality counters with the manager's investment focus both on return equities and on those sectors where India has proven skills. Consequently, *the consumer, technology and pharmaceutical sectors are noticeably featured* together with utility stocks in an environment of some caution. (emphasis added).

Prudential-ICICI introduced a new fund specialising in what are now being popularly referred to as FMCG (fast moving consumer goods) scrips [*Hindu Business Line*, 1999].[32] According to Prudential-ICICI, FMCGs include:

> ... tea, coffee, bread, butter, cheese, biscuits, soaps, detergents and various other products that you use every day.

Regarding the favoured companies the AMC stated that:

> ... (T)he list speaks for itself: Hindustan Lever, Cadbury, Britannia, Procter & Gamble, Nestle, Reckitt & Colman, Henkel Spic, Indian Shaving Products, Marico & Smith Kline Beecham.
>
> ... All these are companies which feature great brands, a strong distribution network across the country, professional management and financial soundness, apart from consistent performance year after years. As a testimony to this fact, the stocks of these companies have performed better than the market in the last three years, giving an annualised return of 34.3 per cent as compared to an annualised return of only 4 per cent in the BSE 200 and the Sensex.[33]

The emphasis on FMCG thus actually implied emphasis on transnational corporations (TNCs) because of their well-known brand names, large advertisement expenditures and distribution networks. The importance of TNCs in market turnover of BSE may be a reflection of this phenomenon. This, seen in the context of new FCCs avoiding the stock market may mean that the existing listed ones will continue to be the favourites of investors as they have limited options. Paradoxically, these are the companies that may not need to raise resources from the Indian investors.

FIIs and the Indian Mutual Funds Industry

It was seen in the above that two of the FII associated local mutual funds also followed the pattern set by FIIs. In this context, it may be useful to examine the relative importance of FII affiliates in the Indian Mutual Funds industry. Following SEBI guidelines of 1993, which defined the structure of mutual funds (MFs) and asset management companies, mutual funds were launched in the private sector for the first time. A few years earlier in 1987, public banks and insurance companies, were allowed to enter the mutual funds sector which was till then the preserve of Unit Trust of India. While initially they raised considerable amounts, the mobilisation suffered with the general industry performance. Of late, private sector mutual funds have started becoming important once again [RBI, 1999]. An important contributory factor is the tax break allowed in the Budget 1999-2000 when the income distributed under the US-64 and other open-ended equity-oriented schemes of UTI and other Mutual Funds was exempted from dividend tax and income received by individuals from MFs was fully exempted from income tax. As a result, during April-December 1999, MFs raised Rs 35,915 crores in gross terms compared to Rs 16,288 crore in the corresponding period of 1998. The performance in net terms is more impressive: Rs 12,194 crore against a net outflow of Rs 950 crore in the previous period. During April-December 1999, share of private sector was 68.4 per cent in gross mobilisations and 74.33 per cent in net terms [*Economic Survey*, 1999-2000, p. 67]. Private sector MFs accounted for nearly ten per cent of the net assets of all mutual funds at the end of March 1999 [SEBI, 1998-99, p. 68]. By the end of the year the share doubled to nearly 21 per cent [SEBI, 1999, p. 26]. From independent compilations on mutual funds, it does appear that within the private sector MFs, funds with foreign associates have come to occupy an important position (Table 8).[34]

While it can be expected that foreign affiliated mutual funds would follow the investment pattern of FIIs, it is important to note that many domestic ones also followed FIIs. The sectors favoured by FIIs account for a substantial portion of the net assets under control of many MFs. Even the UTI started focussing on certain of these sectors. UTI Chairman is reported to have said in February 2000 that US-64's (flag ship fund of UTI) exposure to the information technology sector rose to 19.13 per cent at the end of December 1999 from 5.68 per cent a year earlier.[35] UTI's involvement with IT and pharmaceutical sectors is further revealed in its floatation of sector specific funds. UTI has floated five funds called UTI Growth Sector Funds. These are: Brand Value fund (FMCG), Pharma and Healthcare fund, Software Fund, Petro Fund, and Services Sector Fund. While understandably the Software fund is exclusively for computer software companies, the Services Sector Fund also concentrates on computer related companies [*Economic Times*, 1999].[36] Among the others who promoted sector specific funds are: Birla Mutual, IL & FS, Kothari Pioneer, Prudential ICICI, SBI Mutual and Tata Mutual. Interestingly, it is reported that though it is not a sector specific fund, JM Equity Fund's reliance on the software sector increased from 34 per cent in September 1999 per cent at the end of December 1999 [Gulati, 2000].[37]

Table 8. Assets Under the Management of Different Categories of Mutual funds

(Rs Crore)

Category		At the end of		Increase	
		1998	1999	amount	Per cent
(1)		(2)	(3)	(4)	(5)
A.	Unit Trust of India	54,339	67,207	12,868	23.68
B.	Bank Sponsored MFs (6)	4,504	7,290	2,786	61.86
C.	Institutions (4)	1,993	2,999	1,006	50.48
D.	Private Sector incl. (22)	4,924	19,532	14,608	296.67
	- Indian Companies (6)	776	2,225	1,449	186.73
	- JVs: Predominantly Indian (7)	2,163	7,977	5,814	268.79
	- JVs: Predominantly Foreign (9)	1,985	9,330	7,345	370.03
Total (A+B+C+D)		65,760	97,028	31,268	47.55

Source: Based on the data provided by the Association of Mutual Funds in India (AMFI) at it website www.amfiindia.com. Figures in brackets indicate the number of funds.
Assets under the management of UTI are at book value.
JVs: Joint Ventures.

From the above it emerges that mutual funds are gaining prominence in the Indian Stock market and that (i) the share of foreign affiliated MFs is growing, (ii) a number of Indian funds are following the investment strategies of the foreign ones, (iii) there are sector specific funds for IT, Pharmaceuticals and FMCG, (iv) schemes of many funds focus on these sectors without actually claiming themselves to be one such. This provides further explanation to the sectoral developments in the Indian stock market during 1999. Such concerted effort may have further underplayed the importance of the other sectors and widened the differences in P/E ratios between the so-called new economy sectors and the others.[38] The latest change in Sensex announced by BSE further acknowledges the increasing importance of IT, media and pharmaceutical companies. From April 10, 2000 Satyam Computer Services, Zee Telefilms, Reddy Labs and Reliance Petroleum would replace Tata Chemicals, Tata Power, IDBI and Indian Hotels Co. in the Sensex [*Economic Times*, 2000].[39]

It may be noted further that while there was net outflow on account of foreign portfolio investors during 1998-99, private sector mutual funds in India mobilised Rs 1,453 crore on net terms. During the first nine months of 1999-2000 the net collections were Rs 9,064 crores which compare well with net inflows of foreign portfolio capital of Rs 6,766 and Rs 11,735 crore during 1997-98 and 1996-97, respectively [Economic Survey, 2000, p. S-77]. It can thus be expected that progressively stock prices would be affected not only by net FII investments but also the size of funds under control of their local counterparts. While FIIs can remit capital and profits back to their home countries, the local affiliates will have to invest in the domestic market only [SEBI, 1999].[40] Yet another development during 1999 which affected share price movement in India is the listing of Infosys Technologies and Satyam Infoway, a subsidiary of Satyam Computers, on Nasdaq of USA. It is now believed in stock market circles that prices of information technology companies in India are influenced by the Nasdaq

[*Economic Times*, 2000].[41] This phenomenon is going to be increasingly prominent as more and more Indian companies get traded abroad.

Summing Up

There has been a significant shift in the character of global capital flows to the developing countries in recent years in that the predominance of private account capital transfer and especially portfolio investments (FPI) increased considerably. In order to attract portfolio investments which prefer liquidity, it has been advocated to develop stock markets. The general perception about the foreign portfolio investments is that, not only do they expand the demand base of the stock market, but they can also stabilise the market through investor diversification [UN, 1996, p. 151]. Towards the end of 1992, the Government of India allowed FIIs to buy and sell securities directly on the country's stock markets, primarily to attract foreign capital. Concessional rates of tax on capital gains and to some extent the limits on the extent of foreign equity were expected to reduce the volatility and possibly to protect managements from hostile take-overs.

From the point of attracting foreign capital, the initial expectations have not been realised. Investment by FIIs directly in the Indian stock market did not bring significantly large amount compared to the GDR issues. GDR issues, unlike FII investments, have the additional advantage of being project specific and thus can contribute directly to productive investments. FII investments, seem to have influenced the Indian stock market to a considerable extent.

Though 502 FIIs are reported to be registered with SEBI at the beginning of March, 2000, due to inter-linkages among many FIIs, the effective number of entities would be much smaller. These factors render the limits on shareholding in a company by a particular FII serve only a limited purpose. While the country-wise distribution of FIIs suggests the predominant place of USA and UK in FII registrations in India, these inter-linkages make the two countries' dominance more prominent. It has also been noticed that only a few FIIs are active on the Indian stock market. While portfolio investments are known to be volatile, the fact that only a few FIIs and that too mainly from two countries namely USA and UK are interested in the Indian stock market increases its vulnerability to fluctuations.

Analysis of the investment exposure of five US-based India specific funds suggested a close resemblance between FII investment profile and trading pattern at the BSE. This finding takes quite further the general understanding that net FII investments influences stock prices in India as it traces the relationship to the sectoral level. The heavy emphasis on computer software, consumer goods in the Indian stock markets seems to have much to do with the process initiated by the FIIs after 1996 as a defensive mechanism.[42] Compared to 1996, in 1998, they reduced their exposure in terms of the number of companies and the amount involved. One implication that can be drawn from the similarity between FII investments and trading on the Indian stock market is that the Indian Investors, since they perceive FIIs to trade on the basis of well-researched strategies, may have followed the FIIs like a `herd' and in the process accentuated the selective process introduced by the FIIs. FIIs having a strong presence in the Indian Mutual Funds segment meant that the funds have also started following a similar investment pattern. Many Mutual Funds floated specific funds for the sectors favoured by the FIIs. As a result, the differences have got so accentuated that food and beverages and computer software reached the top in 1998 and accounted for nearly two-fifths of the turnover at BSE during the same year. In line with the changing emphasis of FIIs, by 1999 consumer non-durables receded and computer software took the lead.

An implication of MFs gaining strength in the Indian stock market could be that unlike individual investors, whose monies they manage, MFs can create market trends whereas the small individual investors can only follow the trends. The situation becomes quite difficult if the funds gain a vested interest in certain sectors by floating sector specific funds. One can even venture to say that the behaviour of MFs in India has turned the very logic that mutual funds invest wisely on the basis of well-researched strategies and individual investors do not have the time and resources to study and monitor corporate performance, upside down. Thus, the entry of FIIs has not resulted in greater depth in Indian stock market; instead it led to focussing on only a few sectors.

Growing concentration of trading in a few sectors could reduce the stability base of the stock markets. The expectation that by adding liquidity to local markets, foreign investments would reduce the volatility which results from the thinness of the markets in developing economies may thus prove unfounded. So far as the incentive of lower tax is concerned, FIIs have apparently tried to circumvent even the low taxes by using Mauritius as a shelter. Ultimately to provide a level playing field, even the domestic investors had to be offered lower rates of capital gains tax.

From the point of monitoring company managements, it can be argued that the FIIs and large domestic financial institutions together can play a useful role to force company managements improve their performance and refrain from indulging in mal-practices and investor-unfriendly decisions as together they hold substantial shares in many large Indian companies. This argument has the inherent weakness that the FIIs cannot remain attached to a single company. They are expected to exert pressure on managements by their selling or buying activity. On the other hand, government through holdings controlled by it, in the long term interest of Indian industry can, if there is political will, take a firm stand. There are also other problems with utilising foreign portfolio equity for monitoring domestic companies. One is not sure how much of the such equity is in fact return of the flight capital. In such a case, the so-called FII investment will only support the existing managements. Even if it is accepted that FII investment could be helpful in monitoring, due to their propensity to invest in a few liquid shares, the problem of monitoring a large number of companies still remains.

The need for a proper regulatory system is reflected from the fact that due to severe regulatory failure even the presence of FIIs did not help the revival of India's primary market for a long time. A strong domestic base is a prerequisite for providing depth and spread to the stock market and to enable it to counter any precipitative action by the FIIs not based on fundamentals. The only safeguard can be Indian financial institutions (FIs) holding large shares and in their capacity for direct intervention. The size of the holdings and internal resources with Indian FIs will be an important factor in containing the volatility induced by FIIs. Attracting FIIs cannot be a substitute for domestic policy formulation and institutional development.

While it is said that to attract portfolio investments and retain their confidence, the host countries have to follow stable macro-economic policies, the fact is that developing countries have their own compulsions arising out of the very state of their social, political and economic development. How FIIs view the domestic situation can be seen from the following extract from a semi-annual report of Jardine Fleming India Fund Inc.

> *Politics, as usual, remains the joker for investors* in the Indian market. The decision of Kesri, President of the Congress Party, to withdraw his Party's support from the United Front Government, came as a complete surprise to almost all and caused the market to fall approximately 10 per cent in a short period. This simultaneously jeopardised not only the passage of the Budget *but also Chidambaram's tenure at the Finance Ministry. Kesri's actions are regrettable since they destroy shareholder value*, tarnish India's global reputation, and exacerbate the hardship of the 350 million Indians who continue to live in poverty [Jardine Fleming India Fund Inc., 1997, p. 4] (emphasis added).

Obviously, political personalities or fundamentalist and extremist organisations would have a logic of their own in whatever they do. Fall-out of their actions on foreign investment and Indian stock markets will be the last thing on their minds when they act. This is the reality of developing countries. Whether or not they indulge in local politics, they seem to impress upon (even pressurise) the host governments to follow liberal policies in order to attract large inflows.[43]

To trends suggest that the Indian stock market may weaken its relationship with the rest of the economy. As it focuses excessively on certain sectors [Economic Times, 2000].[44] Can the developing countries rely on the wisdom of the stock market, particularly if it reacts to external factors, for industrialising their economies is a question that needs to be examined in greater detail. To the extent that this phenomenon has been introduced and accentuated by FII operations gives rise to a doubt whether foreign portfolio investments would serve the objective of local stock market development or the tangible benefit from them would only confine to getting the balance of payment support along with its attendant risks.

Annexure Fund-wise List of Top 25 Companies in terms of Value of Investment

S.No.	Company	Industry/Activity	FCC	Sensex	GDR Issue	Top Turnover Company$	A Group	Percentage Share in Total Value#
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
INDIA FUND INC								
1	NIIT Ltd	Computer Software		Y		Y	A1	12.52
2	Infosys Technologies Ltd	Computer Software		Y		Y	A1	7.38
3	Punjab Tractors Ltd	Automobile				Y	A1	6.89
4	Hindustan Lever Ltd	Personal Care	Y	Y		Y	A	6.64
5	Reliance Industries Ltd	Diversified		Y	Y	Y	A	5.43
6	ITC Ltd	Food & Beverages	Y	Y	Y	Y	A	4.43
7	Hindustan Petroleum Corp Ltd	Refineries		Y		Y	A	4.01
8	Dr Reddy's Laboratories Ltd	Pharmaceuticals			Y	Y	A	3.90
9	Satyam Computer Ltd	Computer Software				Y	A1	3.70
10	Ranbaxy Laboratories Ltd	Pharmaceuticals		Y	Y	Y	A	3.45
11	Mahanagar Telephone Nigam	Telecommunications		Y	Y	Y	A	3.32
12	Larsen & Toubro Ltd	Diversified		Y	Y	Y	A	2.97
13	Hindalco Industries Ltd	Metals		Y	Y	Y	A	2.29
14	Videsh Sanchar Nigam Ltd	Telecommunications			Y	Y		1.74
15	ABB Ltd	Machinery - Elect.	Y			Y	A	1.59
16	DSQ Software Ltd	Computer Software				Y		1.44
17	Tata Iron & Steel Co Ltd	Metals		Y		Y	A	1.37
18	Oriental Bank Of Commerce	Banks – Public Sector				Y	A	1.34
19	TVS Suzuki Ltd	Automobile	Y			Y	A1	1.33
20	Bank Of Baroda	Banks Public Sector				Y	A1	1.27
21	Associated Cement Companies	Cement		Y		Y	A	1.06
22	E Merck Ltd	Pharmaceuticals	Y			Y	A1	1.04
23	Bharat Heavy Electricals Ltd	Machinery - Non.Elect		Y		Y	A	0.99
24	Madras Refineries Ltd	Refineries				Y	A1	0.98
25	Indian Rayon & Industries Ltd	Diversified			Y	Y	A	0.96
	Total							**82.04**

(Contd…)

Annexure (Contd.)

S. No.	Company	Industry/Activity	FCC	Sensex	GDR Issue	Top Turnover Company$	A Group	Percentage Share in Total Value#
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
INDIA GROWTH FUND INC								
1	ITC Ltd	Food & Beverages	Y	Y	Y	Y	A	9.75
2	Hindustan Lever Ltd	Personal Care	Y	Y		Y	A	7.36
3	NIIT Ltd	Computer Software		Y		Y	A1	5.71
4	TVS Suzuki Ltd	Automobile	Y			Y	A1	5.52
5	Bajaj Auto Ltd	Automobile		Y	Y	Y	A	4.65
6	Smithkline Beecham ConsHealth	Food & Beverages	Y			Y	A	4.46
7	Punjab Tractors Ltd	Automobile				Y	A1	3.86
8	Reliance Industries Ltd	Diversified		Y	Y	Y	A	3.66
9	Hindustan Petroleum Corp Ltd	Refineries		Y		Y	A	3.39
10	Hero Honda Motors Ltd	Automobile	Y			Y	A	3.28
11	Mahindra & Mahindra Ltd	Automobile		Y	Y	Y	A	2.78
12	Mahanagar Telephone Nigam	Telecommunications		Y	Y	Y	A	2.30
13	Satyam Computer Ltd	Computer Software				Y	A1	2.26
14	Nestle India Ltd	Food & Beverages	Y	Y		Y	A	2.11
15	EIH Ltd	Hotels & Resorts			Y	Y	A	2.00
16	DSQ Software Ltd	Computer Software				Y		1.95
17	Colgate Palmolive (India) Ltd	Personal Care	Y	Y		Y	A	1.88
18	Hindalco Industries Ltd	Metals		Y	Y	Y	A	1.55
19	Credit Rating Information Serv	Finance - General				Y		1.55
20	Vashishti Detergents Ltd	Cons. Non-Durable	Y			Y		1.48
21	National Aluminium Co Ltd	Metals				Y		1.43
22	Housing Development Fin Corp	Finance - Housing				Y	A	1.22
23	Castrol India Ltd	Auto-Ancillaries	Y	Y		Y	A	1.17
24	Carrier Aircon Ltd	Consumer - Durable	Y			Y	A1	1.07
25	Tata Tea Ltd	Food & Beverages				Y	A	1.00
	Total							**77.39**

(Contd…)

Annexure (Contd.)

S. No.	Company	Industry/Activity	FCC	Sensex	GDR Issue	Top Turnover Company$	A Group	Percentage Share in Total Value#
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
JARDINE FLEMING INDIA FUND								
1	Hindustan Lever Ltd	Personal Care	Y	Y		Y	A	12.14
2	ITC Ltd	Food & Beverages	Y	Y	Y	Y	A	8.04
3	Bajaj Auto Ltd	Automobile		Y	Y	Y	A	4.41
4	Hindustan Petroleum Corp Ltd	Refineries		Y		Y	A	4.27
5	Videsh Sanchar Nigam Ltd	Telecommunications			Y	Y		4.23
6	Satyam Computer Services Ltd	Computer Software				Y	A1	4.21
7	State Bank Of India	Banks – Public Sector		Y	Y	Y	A	3.53
8	Mahanagar Telephone Nigam	Telecommunications		Y	Y	Y	A	3.26
9	Bank Of Baroda	Banks – Public Sector				Y	A1	3.19
10	TVS Suzuki Ltd	Automobile	Y			Y	A1	3.00
11	Punjab Tractors Ltd	Automobile				Y	A1	2.92
12	BSES Ltd	Power Gen./ Distn.		Y	Y	Y	A	2.67
13	Housing Development Fin Corp	Finance – Housing				Y	A	2.51
14	Reliance Industries Ltd	Diversified		Y	Y	Y	A	2.26
15	Reliance Industries Ltd	Diversified		Y	Y	Y	A	2.25
16	ICICI Banking Corporation Ltd	Banks Public Sector				Y	A1	2.12
17	Mahanagar Telephone Nigam	Telecommunications		Y	Y	Y	A	2.03
18	Videsh Sanchar Nigam Ltd	Telecommunications			Y	Y		1.97
19	NIIT Ltd	Computer Software		Y		Y	A1	1.77
20	Reliance Petroleum Ltd	Refineries				Y		1.52
21	Indian Hotels Co Ltd	Hotels & Resorts		Y	Y	Y	A	1.42
22	Aptech Ltd	Computer Software				Y		1.39
23	Infosys Technologies Ltd	Computer Software		Y		Y	A1	1.39
24	Carrier Aircon Ltd	Consumer - Durable	Y			Y	A1	1.29
25	ICI (India) Ltd	Diversified	Y			Y	A1	1.29
	Total							**79.08**

(Contd…)

Annexure (Contd.)

S. No.	Company	Industry/Activity	FCC	Sensex	GDR Issue	Top Turnover Company$	A Group	Percentage Share in Total Value#
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
MORGAN STANLEY INDIA INVESTMENT FUND								
1	Bharat Heavy Electricals Ltd	Machinery - Non.Elect		Y		Y	A	13.87
2	Infosys Technologies Ltd	Computer Software		Y		Y	A1	11.69
3	Container Corp Of India Ltd	Service - Transport				Y		8.12
4	Housing Development Fin. Corp	Finance - Housing				Y	A	7.01
5	Zee Telefilms Ltd	Entertainment				Y	A1	5.25
6	Punjab Tractors Ltd	Automobile				Y	A1	3.66
7	Smithkline Beecham Pharm.	Pharmaceuticals	Y			Y	A	3.28
8	Hero Honda Motors Ltd	Automobile	Y			Y	A	3.20
9	State Bank Of India	Banks – Public Sector		Y	Y	Y	A	2.65
10	Hoechst Schering Agrevo	Pesticides/Agro Chem	Y			Y		2.25
11	Novartis India Ltd	Pesticides/Agro Chem	Y	Y		Y	A1	2.22
12	TVS Suzuki Ltd	Automobile	Y			Y	A1	2.21
13	ITC Ltd	Food & Beverages	Y	Y	Y	Y	A	2.09
14	Hoechst Marion Roussel Ltd	Pharmaceuticals	Y			Y		1.88
15	Cipla Ltd	Pharmaceuticals				Y		1.78
16	MRF Ltd	Auto-Ancillaries				Y	A	1.71
17	Supreme Industries Ltd	Plastic Products				Y	A	1.51
18	NIIT Ltd	Computer Software		Y		Y	A1	1.47
19	Sandarac Fasteners Ltd	Auto-Ancillaries				Y		1.30
20	Sun Pharmaceutical Industries	Pharmaceuticals				Y	A1	1.23
21	Cummins India Ltd	Machinery – Non.Elect	Y			Y	A1	1.14
22	Colour-Chem Ltd	Chemicals – Dyes	Y					1.07
23	ICI (India) Ltd	Diversified	Y			Y	A1	1.00
24	Motor Industries Co Ltd	Auto-Ancillaries	Y			Y		0.98
25	Revathi-CP Equipment Ltd	Machinery – Non.Elect	Y			Y		0.88
	Total							**83.45**

(Contd…)

Annexure (Contd.)

S. No.	Company	Industry/Activity	FCC	Sensex	GDR Issue	Top Turnover Company$	A Group	Percentage Share in Total Value#
(1)		(2)	(3)	(4)	(5)	(6)	(7)	(8)
PIONEER INDIA FUND								
1	Bharat Petroleum Corp Ltd	Refineries				Y	A	5.32
2	Satyam Computer Services Ltd	Computer Software				Y	A1	4.73
3	Hindustan Petroleum Corp Ltd	Refineries		Y		Y	A	4.54
4	Larsen & Toubro Ltd	Diversified		Y	Y	Y	A	4.22
5	Tata Infotech Ltd	Computer Hardware				Y		3.87
6	Videsh Sanchar Nigam Ltd	Telecommunications			Y	Y		3.76
7	Pentafour Software & Exports	Computer Software				Y	A1	3.30
8	Mahanagar Telephone Nigam	Telecommunications		Y	Y	Y	A	3.24
9	Ranbaxy Laboratories Ltd	Pharmaceuticals		Y	Y	Y	A	3.21
10	Oil & Natural Gas Commission	Petrochemicals				Y		3.10
11	Bajaj Auto Ltd	Automobile		Y	Y	Y	A	3.00
12	NIIT Ltd	Computer Software		Y		Y	A1	3.00
13	Infosys Technologies Ltd	Computer Software		Y		Y	A1	2.94
14	Industrial Credit & Invt Corp (I)	Term Lending Inst.		Y	Y	Y	A	2.88
15	Pentafour Software & Exports	Computer Software				Y	A1	2.77
16	TVS Suzuki Ltd	Automobile	Y			Y	A1	2.45
17	State Bank Of India	Banks – Public Sector		Y	Y	Y	A	2.28
18	Housing Development Fin. Corp	Finance – Housing				Y	A	2.20
19	ABB Ltd	Machinery – Elect.	Y			Y	A	2.19
20	National Aluminium Co Ltd	Metals				Y		1.84
21	Reliance Industries Ltd	Diversified		Y	Y	Y	A	1.83
22	Novartis India Ltd	Pesticides/Agro Chem	Y	Y		Y	A1	1.72
23	Pfizer Ltd	Pharmaceuticals	Y			Y	A	1.69
24	Bank Of India	Banks – Public Sector				Y	A1	1.66
25	Cochin Refineries Ltd	Refineries				Y	A1	1.58
	Total							**73.32**

A1: Companies which were included in the A-Group in February 1998.
With respect to total value of investments of the fund.
$ Among the top 500 companies in terms of market turnover in 1998.

NOTES

1 IFC promoted foreign portfolio investment in developing countries by helping to establish `country funds', venture capital funds and debt funds that invest in emerging market securities issues. IFC also claims that by pioneering and actively promoting such funds for developing countries, IFC introduced many international portfolio investors to emerging markets. See: http://www.ifc.org/depts/html/ capmkts.htm.

2 Brandt Commission Report: *North-South - A Programme for Survival,* Pan Books, 1980.

3 From the letter written in April 1993 by Shri Chandra Shekhar, former Prime Minister, to the then Finance Minister.

4 The then Finance Minister said: `Under the scheme of permitting Foreign Institutional Investors (FIIs) in our capital market, we had indicated that such investors would be liable to tax at 20 per cent on investment income and 10 per cent on long term capital gains. I also propose to extend a concessional rate of tax of 30 per cent in respect of short term capital gains for such investments'. Budget Speech 1993-94, para 63. The Union Budget 1999-2000 removed this discrimination and the Indian investors are also eligible for the lower long term capital gains tax of 10 per cent.

5 This may be in response to the earlier experience when in the early 'eighties an NRI tried to take over two major companies of that time, namely, Escorts & DCM.

6 Experience shows that ceilings are generally reached in case of smaller companies only.

7 The general decline in the fourth quarter is attributed to book closure during November by most American fund managing houses. It is stated that there `will be lack of trading activity in November and a `buyers' strike till at least 15 November, with FIIs not being involved in any markets at all'. See: Ridham Desai, `FII selling is not India-specific', http://www.capitalmarket.com/capitalmarket/mag/cm1418/face.htm.

8 It was reported that some brokers were giving inflated figures of purchases or sales of FIIs to give a false impression of FII activity in the market.

9 It was emphasised that not only the detailed trading information, but also total trade/investment by individual FIIs and the names of the companies along with the extent of FII investment is price sensitive and thus cannot be disclosed. One got a feeling that one should not be too much concerned with FII investments as the money as well as the risk was after all of FIIs.

10 This deduction is based on the names of the FIIs and was ascertained from SEBI sources. We have been informed that at present only two categories namely, FA & FD are being followed.

11 Morgan Stanley was among the earliest to tap the local market with its mutual fund in 1993-94 after the sector was thrown open to private sector.

12 Though SEBI does not report the corresponding figures for 1998-99, the fact that FIIs would not have contributed in any significant manner is evident from the fact that out of the total capital raised during the year, the amount reserved for banks and financial institutions was only Rs 33.83 crore.

13 Out of the net investment of Rs 6,697 crore at the all-India level during 1999, Debt accounted for only Rs. 119 crore.

14 Total reported FII purchases at the all-India level in 1999 were reported to be Rs 36,394 crore and sales Rs 29,816 crore. (See: Bombay Stock Exchange, *Stock Exchange Review*, January 2000). BSE turnover measures one-sided transactions, *i.e.*, sales or purchases. In case of FIIs, they can either sell or purchase from others or from other FIIs. The transactions of FIIs cannot, therefore, be strictly compared with the total net turnover of the Exchange. If one averages sales and purchases, the share of FIIs in 1998 works out to about 2.5 per cent of total net turnover of BSE. The corresponding share in 1999 was 2.9 per cent.

15 Companies that have fewer than 500 investors and less than $10 million in net assets are not required to file annual and quarterly reports with the SEC.

16 Out of the total list of N-30D filings during 1996 and 1998, we searched for the words, India, International, Global, Asia, Emerging, etc., in the funds' names. The filings of the funds thus identified were downloaded. Out of these, those having `India' within the body of the file were further identified.

17 The funds' investments in the neighbouring countries are negligible both in terms of numbers and value.

18 The 1998 data generally refers to the post-sanctions period. The exercise was not extended to 1999 because Pioneer India fund ceased to be India specific and renamed itself as Pioneer Indo-Asia Fund, the N-30D filing of Jardine Fleming was available only for March 1999 and India Fund Inc. is no longer traceable at the SEC website. In any case, the years chosen cover an important period during which the substantial shifts occurred in the industry-wise trading pattern.

19 Excluding small investments in Pakistan.

20 For instance, India Fund Inc. stated: Several events during the first six months influenced the market. The Asian economic crisis continued to negatively impact the markets. The elections in India resulted in yet another coalition government, continuing the political instability in the country. Most significant, however, was the testing of nuclear weapons by the BJP government, which triggered economic sanctions by the U.S. and other countries. And, Pioneer India Fund informed: As the rest of the world looked for a competitive advantage so too did India. Economic reform continued, even in the face of political change. Unfortunately, as this report goes to press, India also initiated a series of nuclear tests that put the world and the region on edge.

21 Some Aspects of the Indian Stock Market in the Post-Liberalisation period'.

22 For instance, explaining their investment strategy, Sun F&C Mutual Fund said, `Contrary to belief, some smaller companies do offer tremendous value opportunities. However, they often bring with them lack of liquidity. Companies with reasonable levels of liquidity, on the other hand, allow us the freedom of buying and selling the value shares as and when we want. *Investment in small companies is, therefore, restricted to a small percentage of the fund'* (emphasis added). The fund is managed by Sun F&C Asset Management (India) Pvt. Ltd., a joint venture of Foreign and Colonial Emerging Markets Ltd., UK with Sun Securities (India) Pvt. Ltd. See: www.sunfc.com/invest/factsheet.html. On its part ING Savings Trust said `(T)he portfolio is designed to have concentrated holding within reasonable risk limits, rather than an unproductive and excessive diversification'. See: the Monthly

Update for December 1999 at: www.ingsavingstrust.com/technical fin/sub/mark2.html.

23 For the classification of companies and description of the Specified Group, see the accompanying paper: `Indian Stock Market in the Post-Liberalisation Period: Some Insights' in this issue of this Journal.

24 Since value of investment varies with share prices, interpretation in terms of exposure may be more appropriate rather than treating the amounts as investment.

25 These are India Fund Inc.; Jardine Fleming India Fund Inc.; and Morgan Stanley India Investment Fund Inc.

26 The relevant file at SEC is : 0000891554-98-00105.txt.

27 In the case of Jardine Fleming India Fund Inc. it was $1,500 a month and for Morgan Stanley it was $22,000 a year, or $1,833 per month.

28 This is in sharp contrast to the country-wise distribution presented earlier, and which indicated that only one out of the 472 FIIs furnished a Mauritius address. Indeed, we came across other funds which were using the Mauritius route. For instance, Fleming India Fund of Luxembourg operates through a wholly-owned Mauritius subsidiary.

29 Joint venture of Aditya Birla Group and Capital Group of Companies Inc. USA.

30 Based on the information downloaded from the respective fund managers' web sites. Further evidence to this phenomenon can be seen from the sectoral composition of investments by FFF-Fleming India Fund at the end of February 1999. IT accounted for 27.7 per cent of the investments followed by Consumer Non-durables with 19.6 per cent and Pharmaceuticals with 12.1 per cent. Similarly, the top five holdings of JF India Trust as on February 26, 1999 were Hindustan Lever (9.8 per cent), Satyam Computer Services (8.6 per cent), ITC Ltd. (6.6 per cent), Infosys Tech. (5.8 per cent) and VSNL (4.9 per cent).

31 SEBI is reported to be concerned that shares of some of the companies which changed their names showed high volatility and had advised the stock exchanges to examine the matter. SEBI tightened the issue norms for companies in the IT sector later in October 1999. In case the company going for an initial public offer does not have distributable profits in three out of five preceding years from out of IT activities. In case the company fails to fulfil this criterion, it can access the market if the issue is appraised and financed by a bank or financial institution. The same conditions apply to a listed company which changed its name to reflect activities in the IT sector.

32 The idea seems to be catching on fast. Kothari Pioneer was reported to have planned two funds *Kothari Pioneer FMCG Fund and Kothari Pioneer Pharma Fund*.

33 Extracted from the description of the Prudential ICICI FMCG Fund downloaded from web site of the Prudential ICICI Asset Management.

34 Some of the foreign affiliated MFs are: Alliance Mutual (Alliance Capital Asset Management, USA); Birla Mutual Fund (Sun Life Assurance Co., Canada); Cholamandalam Cazenove (Cazenove Fund Management, UK); Credit (Lazard Group, UK and Edinburg Fund Management); DSP Merrill Lynch (Merril Lynch, USA); Dundee MF (Dundee group, Canada); Kothari Pioneer (Pioneer Group Inc., USA); Morgan Stanley MF (Morgan Stanley, US); Prudential ICICI (Prudential Corp, UK); Sun F&C (Foreign & Colonial Foreign & colonial, UK); Sundaram MF (Newton Investment Management, UK); Tata MF (Dresdner RCM Global Investor Holdings, UK); and Zurich India MF (Zurich Financial Services, Switzerland).

35 See: www.indiainfoline.com/mufu/news/29html.

36 For details see: UTI's website www.unittrusrtofindia.com. It was estimated IT, Pharmaceuticals and FMCG accounted for close to 30 per cent of US-64 exposure to equity in December 1999. Exposure of other schemes of UTI to information technology is also quite high at 12 per cent (in December 1999). It is relevant to note in this respect the statement of UTI Chairman that `(W)e might have entered a bit late, but we have entered big'.

37 Some other funds with 40 per cent or more of their net assets in computer software and hardware companies during Dec/Nov 99-Feb. 2000 are Tata Tax Saving Fund; ING Growth Portfolio; Alliance 95; IL&FS Growth & Value; Kotak Mahindra-K30; and SBI Magnum Tax Gain '93.

38 See the accompanying paper `Some Aspects of the Indian Stock Market in the Post-Liberalisation Period', foot note 70.

39 It was suggested that just four companies Infosys, NIIT, Satyam computers and Zee Telefilms would claim a fifty per cent weightage in the Sensex.

40 Indian MFs have, however, been allowed in September 1999 to invest in ADR/GDR issues of Indian companies. MFs are permitted to invest in ADRs/GDRs initially within overall limit of US$ 500 mn. An individual MF should not exceed 10 per cent of the net assets managed by them subject to a minimum of US$ 20 mn. and a maximum of US$ 50 mn.

41 Chief Investment Officer of SBI Mutual Fund was reported to have Said: `Running with the Nasdaq is a fact, but I see it as a short-term phenomenon'.

42 For instance, India Fund Inc., in its report for the period ending June 30, 1998 informed that `(T)he Fund's strategy of maintaining positions in defensive sectors of the economy such as consumer non-durables and pharmaceuticals as well as its strong overweighting in the technology sector continued to generate out performance'. See 0000891554-98-001105.txt, the relevant filing with the SEC.

43 President of Morgan Stanley India Investment Fund Inc., said in his letter to the shareholders than the investors base both local and international is looking to this government to kick-start the reform process, which should serve as a pointer to the direction where the policy framework of the government is headed. If the current government can establish its reformist credentials, then the markets will improve quickly. If, for any reason, this government falls short and fails to deliver on the reforms agenda or on issues such as reforms in insurance industry, legislation on patents or accelerating investment in infrastructure, then India as a country runs the risk of having wasted another year. See: The Fund's filing with the SEC, namely, 0001047469-99-008656.txt.

44 It was indeed claimed that the IT sector on whom the Indian stock market is placing heavy emphasis has little to do with the local conditions. The Chief Investment Officer of Jardine Fleming was reported to have said that `(I)t's fairly obvious. IT companies are different: they don't borrow from local banks, their customers are international and their sales

don't at all depend on what happens in India'. Similar was the view attributed to HCL group head. According to him: `(O)ur future has little to do with the Indian market'.

ABBREVIATIONS

ADB	Asian Development Bank
AMC	Asset Management Co.
AMFI	Association of Mutual Funds in India
BJP	Bhartiya Janata Party
BSE	Bombay Stock Exchange
FMCG	Fast Moving Consumer Goods
FIs	Financial Institutions
FCCs	Foreign Controlled Companies
FDI	Foreign Direct Investment
FIIs	Foreign Institutional Investors
FPI	Foreign portfolio investment
GDRs	Global/American Depository Receipts
GNP	Gross National Product
IDPAD	Indo-Duch Programme on Alternatives in Development
IFC	International Finance Corporation
JFIM	Jardine Fleming International Management Inc.
NRIs	Non-resident Indian
ODA	Official Development Assistance
PUC	paid-up capital
FC	pension funds
PE	Price Earning Ratio
RBI	Reserve Bank of India
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
TNCs	Transnational corporations
UTI	Unit Trust of India
VSNL	Videsh Sanchar Nigam Ltd.

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