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FII and DII on Indian capital market: Performance and impact of trump's reciprocal tariffs

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Abstract
Institutional investment is the term used to describe the financial or real assets of a nation that are invested in by institutions or organisations, such as banks, insurance firms, mutual fund houses, etc. In short, local institutional investors trade in their nation's securities and assets using pooled funds. Political and economic developments in domestic countries have an impact on these investing choices. The net investment flows into the economy are also influenced by domestic institutional investors in addition to foreign ones. With an emphasis on the behavioural characteristics of FIIs and DIIs, this study aims to determine whether there is a behavioural dependency between FIIs and DIIs in the stock market and whether FII behaviour influences DII behaviour. Furthermore, the study will analyze the potential impact of this behavioural dependency on stock market trends and overall market stability.

Keywords: FII, capital, investors, DII, foreign portfolio investors

Introduction
A country's economic development is mainly dependent on its industrial and commercial activity. Many studies (Masoud, 2013; Srinivasan, 2012) [8, 16] frequently contend that a country's economic growth is directly related to stock market movements. The stock market is crucial in an economy because it facilitates trading between surplus fund units (investors) and deficit fund units (stock issuers) (Fauzi & Wahyudi, 2016). In today's economy, stock markets are an essential source of cash for carrying out industrial and commercial activity. It provides company finance by raising capital through shares from domestic and international individuals and institutions. Funds flow from households to the various sectors of the economy. It also provides a platform for foreign institutional investors and mutual fund managers for investment.

Any investor or investment fund based in or registered in a nation other than the one in which it is currently investing is considered an institutional investor. Mutual funds, insurance firms, hedge funds, and pension funds are examples of institutional investors. The growing Indian market had attracted the foreign investors, which are called Foreign Institutional Investors (FII) to Indian equity market. Role of FII has increased and changed the face of Indian Stock Market. It has brought both qualitative and quantitative change. It had also increased the breadth and depth of market.

Concept of FII
Foreign institutional investors are referred to as FIIs. Any company or organisation that makes investments in financial assets, including stocks, bonds, and other securities, outside of its home nation is known as a financial investment institution (FII). In India, FIIs are allowed to engage in Indian financial markets if they comply with specific rules and regulations and are registered with the Securities and Exchange Board of India (SEBI). Pension funds, mutual funds, hedge funds, insurance companies, and other sizable financial institutions may be among these investors. Because they may assist spur economic growth and bring in large quantities of capital, FIIs are a vital source of investment for developing nations like India. Yet, the financial markets and the domestic economy may also be impacted by their investing activity.

FII refers to the investment made by resident of one country in the financial capital and asset

of another country it facilitates and persuades large productivity and help in shaping up balance of payments. It means an institution established or incorporated outside India which intends to make investment in securities in India. They are registered as FIIs in accordance with Section 2 (f) of the SEBI (FII) Regulations 1995. In India FIIs investment started in September 1992. FII flows in India have continuously grown in importance. FII investments were recorded Rs. 2595.10 Cr in 1993 increasing to Rs. 135459.08 Cr. The period from 2008 to 2013 has been very critical for the world economy and for the Indian economy. The global financial crisis first struck in 2008, and the Eurozone crisis followed in 2011. During the Global Financial Crisis, the world economy entered a recession, while the United States, the world's largest country, experienced a slowdown. FIIs account for over 13% of the total market capitalisation on the Indian National Stock Exchange. In terms of FII investment, it has increased steadily over the years, with the exception of 1998-1999 and 2008-2009, when FIIs sold more Indian stock market shares than they bought.

Concept of DII

Domestic Institutional Investor is referred to as DII. A DII is an institutional investor that conducts business in the nation in which it has its headquarters and makes domestic market investments in financial assets including stocks, bonds, and other securities. Mutual funds, insurance providers, pension funds, banks, and other financial institutions are all considered DIIs in India. In the Indian financial market, DIIs are a major source of investment and contribute significantly to market stability and liquidity. The financial markets' performance can be greatly impacted by the investing activities of DIIs, who generally make investments in a range of financial assets, including debt, stock, and money market instruments. A brief overview of the Nifty100 Overall, DIIs and their investment activities are a significant part of the Indian financial market and are essential to its growth and stability.

Literature Review

FIIs play an essential role in the global financial system, and their investments can have a substantial impact on the performance of financial markets in various nations. They can also raise market volatility and create arbitrage opportunities. However, according to a study by V. Ravi Anshuman (2008), foreign institutional investors (FIIs) have a negative impact on stock market volatility in India. While the combined trading activity of domestic investors increases market volatility, the combined trading activity of FIIs reduces it. This asymmetry is more pronounced for aggregate domestic trades, where positive shocks have a bigger effect than negative shocks in overall trading activity. Stock volatility is not increased by FIIs, but it is when FIIs sell to domestic clients or when domestic clients trade with one another. The Indian stock market's FII and DII preferences were examined by Ajay Shah (2008). Both FII and DII do not pursue returns and favour larger, broadly distributed firms. Nonetheless, the author discovered proof of a significant behavioural difference between FII and DII. Both country-specific and multi-country studies are adding to the body of empirical research on this subject, which is still developing. By analysing data from FII and DII shareholding patterns in a developing market economy like as India, this research adds to the body of literature. According to the data, DII usually consider the long term when making investment decisions, but FII tend to be short-term investors.

Using data from January 1999 to February 2009, Md. Aamir Khan *et al*. (2010) described the causal relationship between the net investment of FIIs and the Nifty. The author has also emphasised the one-way relationship between the Nifty and FIIs at every stage of the long-term cycle. The unit root, ADF, and PP tests were used to examine the data in the paper. Based on their data, they concluded that there is more correlation between time series during a bear market than during a bull market because during the latter, other market players become more involved, which lessens the influence of FIIs.

Rajnarayan Gupta (2010) has investigated the elements that influence the Sensex's movement. The unit root test and an empirical estimation model were used by the researcher to evaluate the data. According to the author's study of the data, the country's economy also influences the stock market's performance, and foreign capital only plays a part in its movement. Using a time series of daily data for the period from January 1999 to May 2002, Paramita and Suchismita Bose (2002) investigated the link between foreign institutional investment (FII) flows to the Indian equities market and its potential variables.

To compare the results of various developed and emerging Asian markets, Raju M.T. and Ghosh Anirban (2004) investigated how stock market volatility affected stock pricing. According to the author's analysis, there is less skewness and kurtosis in the Indian market. Compared to many developed markets, Indian marketplaces have begun to become more informationally efficient.

Gordon and Gupta (2003) discovered a causal relationship between FII inflows and BSE returns. They noted that by investing at low prices and selling at high ones, FIIs operate as market makers and book gains. As a result, different studies have produced conflicting results about the causal relationship between FII net inflows, stock market capitalisation, and BSE/NSE returns. Thus, it is necessary to investigate whether FIIs are the reason behind or a result of changes in the Indian stock market.

Jatinder Loomba (2012) [7] the purpose of this research is to get insight into the dynamics of FII trading activity and its impact on the Indian equities market. Using data on BSE Sensex and FII activities, the analysis was carried out over a ten-year period, from January 1, 2001, to December 31, 2011. The data indicates a noteworthy positive association between the impact of FII activities on the Indian capital market. According to the data, the FII net inflows provide a reasonable explanation for the changes in the Indian capital market.

According to Suchismita Bose's (2012) analysis, the impact of FII investments on mutual fund flows may outweigh the impact of stock market gains. Although the analysis does not establish a causal relationship between the net investments of domestic mutual funds and the returns of domestic stocks, it does find evidence that the net investments made by FIIs have a causal influence on stock market returns.

Puja Padhi and Pramod Kumar Naik (2014) Using a three-factor vector auto regression (VAR) methodology, this study investigates the dynamic relationship between institutional investment (FII and mutual funds) and stock

market returns for India. They discover that the Indian stock market is greatly influenced by the movements of mutual funds as well as FII funds.

Using a variety of statistical techniques, Srinivas (2016) [15] sought to determine the effect of FII on the Indian stock market between 2008 and 2013, with a primary focus on the Global Financial Crisis of 2008 and the Euro Zone Crisis of 2011. The findings corroborated the body of research showing the FII's substantial relationship and influence on the Indian market.

Objectives of the study

- To assess the performance of the Indian stock market
- To analyse the impact of Trump's reciprocal tariffs on Indian Stocks and comprehensive analysis of the potential implications for investors.

The performance of the Indian stock market

The performance of the Indian stock markets is greatly influenced by the investing activities of FIIs and DIIs, who have grown in importance. Prices, liquidity, and volatility are just a few of the ways that FII and DII operations can impact the stock market. Therefore, it is essential for investors, legislators, and other stakeholders to comprehend how FII and DII operations affect the stock market. Due to the recent volatility of the markets caused by FII and DII activities, even retail investors are being impacted. This greatly impacted the retail fund flow in the markets and hence, in totality heavy inflow or outflow of funds are being seen in the markets which moves as per the net buying or selling of these institutional investors

In the most recent fiscal year, FII's net investments in Indian debt and stocks reached all-time highs, supported by rising interest rates, increasing earnings prospects, and anticipation of an economic rebound. FIIs' net investments in Indian debt and stocks were $7.46 billion between 2016 and 2017. Gross purchases in the equities section totalled Rs 18530.06 crore, while gross sales came to Rs 12324.56 crore. Consequently, FIIs were net purchasers of Rs 6205.50 crore worth of stocks. The debt segment's gross sales were Rs 2026.23 crore, while the gross purchase was Rs 3357.32 crore. Accordingly, FIIs were net purchasers of debt of Rs 1331.09 crore as of March 25, 2025.

FII assets in India cross a trillion dollars and equity ownership at six months high

With a 26.7% rise since the start of the year 2025, the total assets held by FIIs in debt, equities, AIF, mutual funds, and hybrid funds exceeded $1 trillion for the first time. At 16.43%, FII ownership of Indian stocks reached its highest level since March 2024. FII investments in Indian stocks increased significantly from $873 million in August to above $7 billion in September 2024.

The overall amount of FII assets under custody increased by 25.5% in 2023, from $633.56 billion in 2022 to $795.20 billion. Remarkably, only in 2022 and 2018 did FIIs' total assets under custody decrease. The percentage of Indian stocks owned by FIIs increased to 16.43%, the highest level since March 2024. The greatest monthly buying since December 2023, when FPIs net bought shares worth $7.9 billion, occurred in September, when FIIs invested about $7 billion in Indian stocks, a significant increase from August's $873 million. The increase in ownership is encouraging for the stability of the Indian market and economy.

Foreign institutional investors: Hot Money

Foreign institutional investors (FIIs) have become significant players in the Indian capital market, despite being blamed for the massive and coordinated capital flight from the nation during the recent financial crisis. Their investments are frequently referred to as "hot money" because they can be withdrawn at any time. But as the so-called "hot money" of 2016 appears headed for a nearly USD 2-billion pullout, Indian capital markets appear to be losing their reputation as a "safe haven" for foreign portfolio investors. This is the worst period in the last eight years for foreign investments, and any reprieve from such a sell-off is thought to be unlikely until the second half of 2017.

In terms of foreign investment, the aggregate net outflow has made 2016 the worst year for Indian capital markets since 2008, when FPIs withdrew a staggering Rs 41,215 crore in the wake of the global financial crisis. With the election of Donald Trump and the announcement of demonetisation by the Indian government, there has been a significant withdrawal of foreign portfolio investment (FPI), with debt outflows of Rs 15,194 cr, foreign portfolio investors had already taken out Rs 28,919 crore from India. However, it should be remembered that there was a significant influx of funds from DII sources during this time (or rather, at all periods) when FPI was withdrawing funds from India.

From October to December 2016, it invested a total of Rs. 27,426.12 crore in India. FPIs withdrew a staggering Rs 78,027 crore in January and Rs 34,574 crore in February of 2025, indicating ongoing volatility in foreign investment trends.

Impact of Trump's Reciprocal Tariffs on Indian Stocks: A Comprehensive Analysis of the Potential Implications for Investors

US President Donald Trump's latest pronouncement (February 2025) regarding the application of retaliatory tariffs has sent shockwaves through global markets, with Indian equities taking a large burden. This research combines insights to identify the industries and equities that are most vulnerable to these tariffs, examining both direct and indirect effects on India's economy and capital markets. India is not the only country impacted. The United States has also slapped duties on China (54%), Vietnam (46%), Bangladesh (37%), and Thailand (36%). According to industry participants and experts, India's situation is substantially better than that of its competitors, even though duties may cause challenges for Indian goods.

However, the implementation of these tariffs might have a considerable impact on Indian exporters, particularly in critical industries such as steel, textiles, and automotive manufacture, raising concerns about the potential consequences for India's economy and trading relationship with the United States.

The latest tariffs are part of the ongoing US-India trade relationship, and they will damage shipments from India to the US. The US contributes for 18% of India's total exports and 10.73% of bilateral commerce, thus the impact might be severe. As of 2024, India's main exports to the United States included drug formulations and biologicals ($8.1 billion), telecom instruments ($6.5 billion), precious and semi-precious stones ($5.3 billion), petroleum products ($4.1 billion), gold and other precious metal jewellery ($3.2 billion), ready-made cotton garments, including accessories

($2.8 billion), and products of iron and steel ($2.7 billion).

Why is US slapping tariffs?

The United States levied tariffs for a variety of reasons. First, the United States intends to defend its home manufacturing sector by making local industries more competitive in the global market. By implementing tariffs, the Trump 2.0 administration intends to encourage people to purchase American-made goods, thereby increasing local production. Second, the duties are part of an effort to minimise the trade deficit with India, which was $35.31 billion in fiscal year 2023-24. The US aims to "balance this gap and promote fairer trade practices." Finally, the United States has expressed concerns about global trade practices, claiming that certain nations, particularly India, receive unfair trade advantages that undermine competition.

US tariff impact on India

Following US tariffs on most countries, including India, foreign portfolio investors (FPIs) withdrew Rs 10,355 crore from Indian equities markets during the first four trading sessions of April 2025 (April 1-4). In the upcoming weeks, there will probably be further volatility in the Indian stock markets

India is expected to be significantly impacted by the recent changes in trade tariffs. The increased expenses of exporting goods to the US are one urgent issue that Indian companies will have to deal with. There is a chance that American consumers and businesses would become less interested in Indian items when their prices rise because of higher tariffs. Industries that are already struggling with a 25% tariff, including steel and automobiles, may be especially affected. An increase in tariffs might make matters worse, causing sales to drop even more and impacting these industries' total profitability. Tariffs may be lowered in the future because of the ongoing bilateral trade agreement talks between the US and India, which might eventually help exporters. Furthermore, India stands to benefit from the realignment of global supply chains if it can improve logistics, make doing business easier, and maintain policy stability. These enhancements can make India a desirable location for companies wishing to diversify their supply networks.

High Market Exposure in the Pharmaceutical Sector in the US

The Indian pharmaceutical sector is the most direct victim of Trump's tariff threats because it depends heavily on US exports for its earnings. On February 14, 2025, the Nifty Pharma Index fell 2.87%, with companies including Dr. Reddy's Laboratories (46% of FY24 sales from the US), Lupin (37%), and Sun Pharma (32%), seeing steep drops. Indian generics make up almost 40% of the US generic medication industry, and the planned tariffs could make them less cost-competitive. The announcement caused shares of companies like Laurus Labs and Natco Pharma to drop 9.29% and 9.65%, respectively, suggesting that higher tariffs could squeeze profitability. Potential supply chain interruptions and decreased profitability for API (active pharmaceutical ingredient) producers, who depend on economies of scale to preserve pricing advantages, are examples of indirect effects. A lengthy tariff imposition could encourage US-based firms to reshore production, further destabilising Indian exporters, given that India exported $7.6 billion worth of pharmaceuticals to the US in 2023.

Automobile and Related Sectors

Bilateral Trade Vulnerability Because of its dependence on US demand, the automobile industry-and car component manufacturers in particular-faces significant dangers. The worst-hit equities are Sona BLW Precision Forgings (40 percent exposure to North America) and Bharat Forge (25 percent US revenue), as reciprocal tariffs may increase prices for American consumers. With $6.79 billion in auto parts exports to the US in FY24, India is a good target for retaliatory actions. Manufacturers of luxury cars are likewise vulnerable. Trump's reciprocal approach might reverse India's recent reduction in high-end motorcycle tariffs from 50% to 30%, which would affect luxury automakers and businesses like Harley-Davidson India. The larger auto ancillary market, which includes Ramkrishna Forgings (58%) and Samvardhana Motherson (18% US exposure), is likely to face margin pressures due to higher input costs and reduced export competitiveness.

Textiles and Apparel: Competitive Edge Under Threat

The textile sector in India, which accounts for 12% of all exports, is another important industry that is vulnerable to tariff increases. Of India's $7.4 billion in textile exports in FY24, 27% go to the US. Reduced orders for companies like Arvind Limited and Welspun India may result from US importers switching to suppliers in Bangladesh or Vietnam, where tariff differences may favour less expensive options. Reciprocal tariffs may counteract the current budget's reduction in textile import levies from 13% to 11%, especially for synthetic fibres and completed clothing. Given that the US has 3% weighted average taxes on imports while India has 8.5%, Indian exporters are fighting for market share.

Chemicals and Specialty Materials: Cascading Effects on Industrial Demand

The chemicals sector, encompassing agrochemicals, dyes, and industrial intermediates, is bracing for turbulence. UPL Ltd., PI Industries, and Jubilant Ingrevia-key exporters of herbicides like Glyphosate and Glufosinate-saw stock declines of 3-5% following Trump’s announcement. These companies rely on the US for over 30% of their revenue, and higher tariffs could disrupt pricing strategies calibrated to undercut American competitors. Speciality chemicals used in pharmaceuticals and electronics face similar risks. For instance, Aarti Industries, which supplies critical intermediates to US pharma giants, may encounter reduced off-take agreements if tariffs inflate procurement costs for US clients.

Renewable Energy: Green Ambitions Meet Protectionist Policies

India's renewable energy industry is at a turning point, especially for producers of solar modules. With Trump hinting at tariffs on imported solar panels, shares of Waaree Energies, which gets half of its revenue from the US, fell 2%. If US tariffs eliminate cost benefits, the PLI solar manufacturing initiative, which distributed ₹8,700 crore to increase domestic production, may be jeopardised. Suzlon Energy and other wind turbine makers are equally at risk. A hostile atmosphere for Indian clean tech exporters is suggested by Trump's past support for fossil fuels and

mistrust of renewable subsidies, which could jeopardise India's goal of 500 GW of renewable energy by 2030.

Iron, Steel, and Industrial Machinery: Revisiting the Smoot Hawley Era

There are additional constraints on the metals industry, which is still recuperating from Trump's tariffs from 2018. If reciprocal tariffs replicate India's 30% charge on motorcycle imports, Tata Steel and JSW Steel, which export 15-20% of their production to the US, may experience a decline in their profit margins. The indirect effects are seen by producers of industrial machinery such as Larsen & Toubro, whose exports of turbines and construction equipment to the US may decrease in the face of trade uncertainty. The dangers of increasing protectionism are highlighted by historical analogies to the Smoot-Hawley Tariff Act of 1930, which cut international trade by 60%. India's export revenues might be reduced by $2-3 billion if US tariffs were raised by 4-6 percentage points. This would have a ripple impact on employment and related businesses.

Mid- and Small-Cap Stocks: Bearish Sentiment Amplifies Volatility

Aside from sector-specific risks, FII outflows have disproportionately affected mid- and small-cap equities, as evidenced by the 12% decline in the Nifty Midcap 100 Index in 2025. As international investors return capital to the United States due to rising bond yields and the strength of the dollar, the valuations of companies in industries such as textiles (Trident Ltd.), chemicals (Galaxy Surfactants), and auto components (Endurance Technologies) have fallen. Sell-offs in high-beta mid-caps have been made worse by the "quit India" movement among FIIs, which is motivated by Trump's "America First" policy. For example, in spite of strong domestic demand, Granules India and Mankind Pharma had declines of 5.31% and 4.99%, respectively. Investors are advised to choose stocks from the bottom up by analysts, who warn that until trade tensions ease, mid-caps may perform worse than large-caps.

Strategic Responses and Investor Considerations

To reduce risks, Indian authorities are discussing tariff reductions on 30 products, such as chemicals and medical devices, while increasing US imports for energy and defence. These steps might not stop FII withdrawals, though, as they are a component of a larger flight from emerging markets. Investors are encouraged to: 1. Diversify their portfolios by including less exposed US industries such as utilities and FMCG. 2. Given the superior robustness of large-cap stocks (the Nifty trades at 20x ahead PE, a 7% discount to its 5-year average), give them priority over mid-cap stocks. 3. Use gold exchange-traded funds (ETFs) to hedge currency risks. In February 2025, when the rupee fell to ₹83.5/USD, there was a 9% gain.

Conclusion: Navigating a Protectionist Storm

Due to Trump's reciprocal tariffs, Indian exporters are now in a vulnerable situation, with existential risks to the auto, textile, pharmaceutical, and renewable energy industries. Although trade talks and selective tariff reductions may provide temporary respite, structural weaknesses in industries that rely on exports call for long-term re-evaluation. Investors need to strike a mix between prudence and opportunism, taking advantage of India's strong domestic consumption narrative and protecting themselves from worldwide trade turbulence. With a trade war reminiscent of the 1930s looming big over the world's fifth-largest economy, the road ahead requires agility.

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