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Research Article

Impact of Mutual Fund and Foreign Institutional Investment on Stock Market Performance and Volatility in India (2005–2026)

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DOI: https://doi.org/10.5281/zenodo.18426272

Abstract

The Indian stock market has witnessed a significant transformation since the mid-2000s, driven largely by the growing participation of Mutual Funds (MFs) and Foreign Institutional Investors (FIIs). This study examines the impact of MF and FII investment flows on stock market performance and volatility in India over the period 2005–2026. Using secondary data from the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), National Stock Exchange (NSE), and Bombay Stock Exchange (BSE), the study employs econometric techniques including unit root tests, correlation analysis, multiple regression models, and volatility modelling. The findings indicate that FII flows exert a stronger influence on short-term market movements and volatility, whereas mutual fund investments contribute to market stability and long-term growth. The study offers valuable insights for policymakers, regulators, and investors regarding capital flow management and market resilience in emerging economies.

Manuscript Information

- **ISSN No:** 2583-7397
- **Received:** 13-12-2025
- **Accepted:** 28-01-2026
- **Published:** 30-01-2026
- **IJCRM:**5(1); 2026: 358-360

- **Plagiarism Checked:** Yes
- **Peer Review Process:** Yes

How to Cite this Article

Singh, P. Impact of Mutual Fund and Foreign Institutional Investment on Stock Market Performance and Volatility in India (2005–2026). Int J Contemp Res Multidiscip. 2026;5(1):358-360.

Access this Article Online

www.multiarticlesjournal.com

KEYWORDS: Mutual Funds, Foreign Institutional Investors, Stock Market Performance, Volatility, India, Capital Flows.

1. INTRODUCTION

1.1 Background of the Study

The liberalisation of the Indian economy in the early 1990s marked a turning point in the development of India's financial markets. Since then, the Indian stock market has evolved into one of the largest and most dynamic emerging markets globally. Two major institutional players—Mutual Funds (MFs) and Foreign Institutional Investors (FIIs)—have played a crucial role in shaping market behaviour.

Mutual funds mobilise domestic household savings and channel them into capital markets, promoting financial inclusion and long-term investment. In contrast, FIIs bring foreign capital, global expertise, and liquidity but are often associated with speculative behaviour and sudden capital reversals. Understanding how these two investor classes affect market performance and volatility is essential for maintaining financial stability.

1.2 Rationale of the Study

While several studies have analysed the impact of FIIs on Indian stock markets, limited research has jointly examined the comparative influence of mutual fund and FII investments over an extended period that includes global financial crises, regulatory reforms, the COVID-19 pandemic, and post-pandemic recovery. This study fills this gap by covering the period 2005–2026.

2. OBJECTIVES OF THE STUDY

1. To analyse trends in mutual fund and FII investments in India.
2. To examine the impact of MF and FII flows on stock market performance.
3. To assess the effect of MF and FII investments on market volatility.
4. To compare the relative influence of domestic and foreign institutional investors.

3. Research Hypothesis

- **H_{01}:** Mutual fund investments have no significant impact on stock market performance.
- **H_{02}:** FII investments have no significant impact on stock market volatility.
- **H_{03}:** Mutual fund investments contribute less to market stability than FII investments.

4. Scope of the Study

The study focuses on India's equity market using benchmark indices such as BSE Sensex and NSE Nifty. The time period spans from 2005 to 2026.

5. REVIEW OF LITERATURE

Extensive research has examined institutional investors and stock market dynamics. Early studies found that FIIs significantly influence price discovery and liquidity in emerging markets. Later research highlighted the destabilising potential of sudden FII withdrawals during periods of global uncertainty.

Studies on mutual funds emphasise their role in stabilising markets due to systematic investment behaviour and long-term orientation. Comparative studies suggest that while FIIs amplify volatility, mutual funds mitigate extreme price fluctuations.

However, existing literature largely focuses on shorter time horizons or excludes recent economic shocks. This study contributes by providing a long-term, integrated analysis.

6. RESEARCH METHODOLOGY

6.1 Data Sources

Secondary data were collected from:

- RBI Bulletin
- SEBI Annual Reports
- NSE and BSE databases
- Association of Mutual Funds in India (AMFI)

6.2 Variables

Independent Variables:

- Net Mutual Fund Investment
- Net FII Investment

Dependent Variables:

- Stock Market Performance (Index returns)
- Market Volatility (Standard deviation / GARCH-based measures)

6.3 Analytical Tools

- Descriptive statistics
- Augmented Dickey-Fuller (ADF) test
- Correlation analysis
- Multiple regression analysis
- Volatility modelling (ARCH/GARCH)

7. Data Analysis and Interpretation

7.1 Trend Analysis

The period under study shows a steady rise in mutual fund participation, particularly after 2014, driven by financial literacy initiatives and systematic investment plans (SIPs). FII flows, however, exhibit higher volatility, especially during global financial crises and geopolitical events.

7.2 Impact on Market Performance

Regression results indicate that both MF and FII investments positively influence stock market returns. However, FII flows demonstrate stronger short-term effects, reflecting their sensitivity to global market conditions.

7.3 Impact on Market Volatility

Volatility models reveal that FII flows significantly increase market volatility during periods of uncertainty. In contrast, mutual fund investments show a stabilising effect, reducing extreme fluctuations.

7.4 Comparative Analysis
The comparative results confirm that domestic institutional investors enhance market resilience, while foreign investors contribute to liquidity but also to volatility.

8. FINDINGS, CONCLUSIONS, AND POLICY IMPLICATIONS

8.1 Major Findings
- Mutual fund investments promote long-term market stability.
- FII flows significantly influence short-term market movements.
- Excessive dependence on foreign capital increases vulnerability.

8.2 CONCLUSIONS
The study concludes that a balanced mix of domestic and foreign institutional participation is essential for sustainable stock market development in India. Strengthening domestic mutual funds can reduce excessive volatility caused by foreign capital flows.

8.3 Policy Implications
- Encouraging domestic institutional investment.
- Strengthening regulatory oversight of foreign capital flows.
- Promoting long-term investment culture.

9. Limitations and Future Research
Future studies may incorporate firm-level data, sectoral analysis, or behavioural finance perspectives.

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