(1) **Reduces Cost of Equity Capital**

When FIIs invest in Indian capital markets it increases the availability of funds. It encourages Indian companies to invest, expand and make profits. This in turn promotes economic growth. FPI helps to achieve a higher degree of liquidity in the stock markets, increase price-earning (PE) ratios and therefore reduces cost of capital for investment.

(2) **Improves market efficiency**

SEBI and other regulatory bodies have to improve trading efficiency in the capital market inorder to attract more FII in the country.

FIIs are professional bodies of asset managers and financial analyst. They invest on the basis of well-researched strategies and a realistic stock valuation. They increase competition and efficiency of financial markets. They encourage companies to give information about their business.

(3) **Improves Corporate Governance**

FIIs are professional bodies of asset managers and financial analyst. They do not tolerate malpractices by managers in shareholders. FPI leads to more corporate governance, as more transparency and disclosure will be required from companies by foreign investors.

(4) **Non-debt Capital**

FPI is welcomed by developing countries as they are non-debt capital flows. They encourage flow of savings from developed to developing countries. They help to meet the deficit in current account of BOPs.

Negative Impact of FPI on Capital Market

01. **Sudden Outflow of Capital**

FIIs invest in other countries for short term to earn high returns – Hot money. If suddenly FIIs start selling shares etc. at short notice, banks may experience shortage of funds.

02. **Leads to Inflation**

When FPI flows in India, demand for rupee rises. RBI sells rupee in the market. This leads to excess liquidity i.e. too much money and less amount of goods. This in turn creates the problem of inflation.

03. **Problem to Small Investors**

Foreign Portfolio Investors earn profit by investing in stock markets of emerging / developing countries. If FPIs are allowed to invest more in the stock market it influences working of stock market. When FIIs buy stocks, their prices will increase i.e stock market will rise. But when FIIs sell shares, stock market crashes. In the process, sometimes small investors may suffer losses.

04. **Adversely affects Exports**

FPI flows lead to currency appreciation and exports become costly. Therefore export of goods and services may be less.