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The Role of Domestic Institutional Investors (DIIs or Mutual Funds) in Stabilizing Indian Stock Markets against Foreign Institutional Investors (FIIs) Outflows

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Domestic Institutional Investors (DIIs), particularly mutual funds, have emerged as a critical stabilizing force in Indian stock markets, often acting as a counter-cyclical shield against volatile Foreign Institutional Investor (FII) outflows. Driven by high Systematic Investment Plan (SIP) inflows, DIIs provide structural, long-term liquidity, absorbing selling pressure during foreign sell-offs to reduce market volatility.

Keywords: Mutual Funds, Stock Market, Foreign Institutional Investor

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1. Introduction

The Indian stock market has historically been heavily influenced by Foreign Institutional Investor (FII) flows. While FIIs drive high growth and liquidity, their tendency to withdraw capital during global market volatility creates sharp downturns. Recently, the structural growth of Domestic Institutional Investors (DIIs)—including mutual funds, insurance companies, and pension funds—has transformed the landscape. By providing a steady counterforce to foreign capital, DIIs have altered the market dynamics from a "FII-dependent" market to one stabilized by "DII-dominated" domestic savings, offering a significant, recurring demand for equity assets.

Before we delve deep into the subject let us understand some basic term used in the study-

Foreign Institutional Investor (FIIs)

Foreign institutional investors (FIIs) are crucial participants in global markets, investing outside their home countries. They often include pension funds, mutual funds, and hedge funds. This article explores how FIIs contribute to economies, focusing on regulations in countries like India and China, where limits on FIIs seek to balance economic benefits with market stability.[1]

FIIs include hedge funds, insurance companies, pension funds, investment banks, and mutual funds. FIIs can be important sources of capital in developing economies. Many nations, such as India, limit the total value of assets and number of equity shares FIIs can buy, particularly in a single company.[2]

Domestic Institutional Investor (DIIs)

Domestic Institutional Investors are large India-based institutions that invest pooled money intoequity and debt marketson behalf of their clients or policyholders. They are mutual funds, insurance companies, banks, pensionfundsand other domestic financial institutions. Owing to their large capital base, the DIIs can influence the direction and mood in the market through their purchases and sales.

DIIs are significant in keeping the liquidity up and level, particularly in turbulent market periods. DII buying softens the market against sharp corrections when foreign investors pull out capital.

Their investment strategy is usually long-term value, risk management and compliance with regulatory frameworksestablishedby SEBI and other authorities.

All in all, DIIs are useful in enhancing the financial ecosystem of India, as they boost domestic investment, enhance depth in the market, andmaintaina balanced movement of foreign and domestic investment.[3]

Key details about DIIs: It includes the followings-

Core Entities: Indian mutual funds (e.g., SBI Mutual Fund), insurance companies (e.g., LIC of India), pension funds (e.g., EPFO), and domestic financial institutions/banks.

Market Role: DIIs are crucial market stabilizers that often increase buying activity when foreign institutional investors (FIIs) sell, reducing volatility.

Significance: As of early 2026, DII ownership in Indian stocks has grown significantly, often exceeding FII holdings in key indices, indicating strong local confidence.

Driving Factors: Their investment decisions are heavily influenced by domestic economic policy, interest rate shifts, and political stability.

Systematic Investment Plan (SIP): Systematic Investment Plan (SIP), is a smart and steady way to invest money in mutual funds. In this investment approach, investors contribute a fixed amount regularly in an investment vehicle like mutual funds. Instead of investing a large amount as lumpsum, this way of investing makes it easy for investors to grow their wealth in the form of regular investments.

You can start with as little as Rs. 100 per month. It is flexible, so you can choose how much you want to invest regularly, whether it's Rs. 500, Rs. 1000, or more. This method of investing in mutual funds helps you stay disciplined and takes away the stress of timing the market. Over time, this steady form of investment can help you reach your financial goals. It's like setting up a savings plan where your money works harder for you in the long run.[4]

2. Investment by FIIs

Following table provides data of FIIs investment in India for approximate last 15 years.

Table 1: (Investment by FIIs in India)

Financial Year	INR crores				
	Equity	Debt	Debt-VRR	Hybrid	Total
2010-2011	110121.1	36317	0	0	146438
2011-2012	43737.6	49987.9	0	0	93725.5
2012-2013	140032.6	28334.4	0	0	168367
2013-2014	79708.68	-28059.89	0	0	51648.8
2014-2015	111332.59	166127.1	0	0	277460
2015-2016	-14171.57	-4003.76	0	0	-18175
2016-2017	55702.67	-7291.64	0	0	48411
2017-2018	25634.19	119035.7	0	10.29	144680
2018-2019	-87.73	-42355.97	0	3514.24	-38929
2019-2020	6152.26	-48710.23	7331.17	7697.63	-27529
2020-2021	274031.96	-50443.62	33264.6	10247.1	267100
2021-2022	-140009.6	1628.53	12642.8	3498.41	-122240
2022-2023	-37631.57	-8937.74	5814.04	-181.71	-40937
2023-2024	208211.24	121058.8	-2972.4	12766.9	339065
2024-2025	31991.9	53090.09	-497.77	2291.67	86875.9

Source: https://www.cdslindia.com/Publications/FIIFPIInvstmntFinYrData

It is clearly observed from the table that FIIs have withdrawn their investment heavily in previous years.

3. DII Counter-Cyclical Behavior

Stabilizing FII Outflows DIIs frequently demonstrate a counter-cyclical pattern, buying Indian equities when FIIs are net sellers.

- **Absorption of Selling:** During panic selling by FIIs due to global factors (e.g., inflation, US Fed policy), DIIs often absorb the supply of shares, preventing severe price crashes.
- **Evidence of Stabilization:** Research indicates a strong negative correlation between FII and DII flows, with DIIs (particularly mutual funds) acting as catalysts that stabilize the market. For instance, during major market disruptions, DIIs have absorbed over1 trillion in foreign selling.
- **Sectoral Impact:** DIIs tend to show high counter-cyclicality, particularly in Nifty Fin Services and broader-cap indices, hedging against volatility induced by FIIs.

4. The Role of Systematic Investment Plans (SIPs)

The democratization of investment through Mutual Fund SIPs has been a significant structural shift in the Indian market.

- **Recurring Capital:** As of 2024–25, monthly SIP contributions exceeded 25,000 crore, creating a massive, stable pool of domestic liquidity that does not react panic-driven to short-term market volatility, unlike lump-sum foreign investments.[5]
- **Steady Demand:** This consistent inflow provides a solid base that cushions the market from sharp downturns.

5. DIIs vs. FIIs: Different Motivations

The stabilizing role of DIIs is rooted in their investment horizon and objectives:

- **FIIs:** Often driven by global asset allocation, currency fluctuations, and emerging market sentiment.
- **DIIs:** Driven by long-term domestic growth stories, retirement savings, and retail finances.

6. Domestic Strength Offsets Foreign Selling

According toBSEdata, DIIs, which include mutual funds, insurance firms, banks, and pension funds, poured in ₹6 trillion in CY25, surpassing the previous year’s ₹5.26 trillion. This marks the highest-ever annual net investment by domestic institutions since 2007, when such data was first tracked. Robust SIP contributions and growing insurance and pension fund participation have sustained this momentum despite volatile global conditions.

While DIIs supported market stability, FPIs pulled out ₹2.03 trillion from the equity segment during Calendar Year 2025, National Securities Depository Limited(NSDL) data shows. However, FPIs invested $5.7 billion (₹49,590 crore) through the primary market and other routes. The divergence between strong domestic buying and foreign selling highlights India’s growing self-reliance in equity funding.[6]

7. Conclusion

DIIs, led by mutual funds and sustained by consistent SIP flows, have matured into a primary, long-term stability mechanism for the Indian stock market. While FII activity still induces short-term volatility, the robust counterbalance provided by DIIs has significantly cushioned the market against foreign capital reversals, leading to a more resilient, self-sustaining financial ecosystem.

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