

REVISITING THE ROLE OF DOMESTIC INSTITUTIONAL INVESTORS IN THE INDIAN BANKING SECTOR: GROWTH CATALYSTS AND STRATEGIC OUTLOOK

¹P. Swapna, ²Dr. T.Lokeswara Rao, ³Dr. M. Kameswara Rao,

¹Research Scholar, School of Management Studies, Gandhi Institute of Engineering and Technology
University, Gunupur, Odisha, India

²Associate Professor & Research Supervisor, SMS, GIET University, Gunupur, Odisha, India

³Research Co-Supervisor and Project Manager, Birlasoft Ltd., Bengaluru, India

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Abstract

Domestic Institutional Investors (DIIs) have progressively gained prominence in the Indian financial ecosystem, particularly within the banking sector. Their investments, marked by a long-term focus and strategic orientation, have significantly influenced the sector's capital stability, market behavior, and governance models. This study investigates the evolving role of DIIs in shaping the Indian banking sector's growth, resilience, and future trajectory. Drawing upon both primary and secondary data, this paper evaluates DII investment trends from 2018 to 2024, examines retail investor sentiment, and explores regulatory mechanisms that guide DII engagement. The results indicate a growing alignment between DII strategies and banking sector modernization, particularly in areas such as digital banking and capital adequacy. Additionally, the findings highlight the interdependent dynamics between institutional flows and retail confidence. The study provides actionable insights for investors, policymakers, and banking strategists.

Keywords: Domestic Institutional Investors (DIIs), Indian Banking Sector, Financial Stability, Investment Trends, Market Capitalization, Policy Impact

1. INTRODUCTION

The Indian banking sector forms the backbone of the country's financial system, facilitating capital formation, credit delivery, and overall economic development. Over the past decade, this sector has undergone a transformative journey fueled by digitization, regulatory reforms, and shifts in investment behavior. A key pillar supporting this evolution is the growing role of **Domestic Institutional Investors (DIIs)**—which include mutual funds, insurance companies, pension funds, and development financial institutions.

DIIs have emerged as **critical stabilizers** in the Indian capital markets, especially during periods of foreign capital withdrawal. Their investments are marked by consistency, sectoral preference, and a long-term horizon, which differentiate them from the more volatile Foreign Institutional Investors (FIIs). In the Indian banking sector, DIIs are not only injecting capital but also influencing governance, transparency, and corporate responsibility.

According to SEBI data, the total assets under management (AUM) by DIIs in India increased from ₹23.4 trillion in FY2018 to ₹47.3 trillion in FY2024, registering a **Compound Annual Growth Rate (CAGR) of 12.8%**. Much of this growth is directed toward the **financial services sector**, with banks being the primary beneficiaries.

Table 1: Growth in Assets Managed by DIIs (FY2018–FY2024)

| Year | Total AUM by DIIs (₹ Trillion) | YoY Growth (%) |
|--------|--------------------------------|----------------|
| FY2019 | 26.1 | 11.5% |
| FY2020 | 28.8 | 10.3% |
| FY2021 | 33.5 | 16.3% |
| FY2022 | 38.7 | 15.5% |
| FY2023 | 43.1 | 11.4% |
| FY2024 | 47.3 | 9.7% |

Source: SEBI Mutual Fund Data, IRDA Reports

The **banking sector**, as a recipient of these investments, has shown corresponding growth in market capitalization. Data from the **NSE and BSE** indicate that **Bank Nifty**, the index tracking the top 12 Indian banks, grew from **24,600 points in January 2018 to 47,500 points by December 2024**, recording nearly **93% growth** in six years.

Table 2: Bank Nifty Index Performance vs DII Net Inflows in Banking Sector

| Year | Bank Nifty (Avg) | DII Net Inflow in Banks (₹ Cr) | Annual Return (%) |
|------|------------------|--------------------------------|-------------------|
| 2018 | 24,600 | 26,782 | 8.3% |
| 2019 | 27,950 | 32,104 | 13.6% |
| 2020 | 22,350 | 38,211 | -20.0% (COVID) |
| 2021 | 33,800 | 40,975 | 51.2% |
| 2022 | 38,100 | 44,980 | 12.7% |
| 2023 | 42,000 | 49,122 | 10.2% |
| 2024 | 47,500 | 52,305 | 13.1% |

Source: NSE India, SEBI Investor Bulletins (2024)

This impressive performance, partially attributed to consistent DII inflows, also reflects DIIs' strategic confidence in the **sound fundamentals of Indian banks**—especially those in the private sector with higher return on assets (ROA), better cost-to-income ratios, and stronger non-performing asset (NPA) recovery processes.

2. LITERATURE REVIEW

The growing influence of **Domestic Institutional Investors (DIIs)** in India's capital markets has been the subject of extensive scholarly attention over the past decade. As long-term investors with a vested interest in the domestic economy, DIIs have been increasingly recognized for their ability to **stabilize market volatility, enhance capital efficiency, and strengthen the structural integrity** of key sectors such as banking and finance.

2.1 Role of DIIs in Market Stabilization

Kumar (2018) argued that DIIs have matured into foundational pillars of India's equity markets, significantly contributing to market depth, liquidity, and institutional credibility. Their systematic investment patterns reduce reliance on foreign flows and help mitigate sharp volatility during external shocks. Bansal and Pasricha (2020) further substantiated this by highlighting the **counter-cyclical behavior of DIIs**—notably their sustained inflows during episodes of FII sell-offs, such as the 2008 global financial crisis and the COVID-19 market crash of 2020.

“DIIs act as shock absorbers during global downturns, providing capital continuity when foreign investors exit,” (Bansal & Pasricha, 2020, p. 117).

2.2 DIIs and Indian Banking Sector Growth

The Indian banking sector has particularly benefited from DII participation. Sharma and Gupta (2019) emphasized that DIIs played a central role in **recapitalizing public sector banks** post-NPA crisis, contributing significantly to Tier-I capital buffers through equity infusions. Their investments were often linked to banks exhibiting higher compliance with Basel III norms, operational efficiency, and governance standards. In a more recent study, Sinha (2021) examined the role of DIIs in funding the **digital transformation** of Indian banks. The research identified a trend wherein DIIs strategically increased stakes in banks demonstrating agility in adopting fintech solutions, mobile banking infrastructure, and data-driven credit models.

“DIIs prefer banks that align with emerging technologies, indicating a preference for strategic innovation and long-term financial resilience,” (Sinha, 2021, p. 73).

2.3 Regulatory Framework and Investment Climate

Joshi (2020) analyzed the **impact of regulatory reforms**—notably SEBI's rationalization of investment limits and RBI's push for financial inclusion—on DII behavior. These policy shifts increased domestic investor confidence, promoting greater allocation to banking stocks. Das and Mukherjee (2022) emphasized that such reforms have enhanced **governance disclosures**, enabling DIIs to demand higher accountability from bank boards and executive leadership. However, Das and Mukherjee also warned that **regulatory uncertainties**, such as abrupt changes in NPA provisioning norms or capital adequacy guidelines, can disrupt DII investment consistency, particularly in public sector banks.

2.4 Gaps in Literature

While much of the existing literature emphasizes DIIs' macro-level stabilizing influence and capital deployment strategies, **limited research addresses how DII behavior affects retail investor confidence**, particularly in the banking sector. Furthermore, the interaction between **macroeconomic indicators (e.g., inflation, repo rates, GDP growth)** and DII decision-making remains underexplored. Likewise, studies have yet to rigorously assess the **sectoral rotation patterns** of DIIs—whether they cyclically favor private banks over PSBs during periods of regulatory reform or digital innovation.

"Understanding the dual impact of institutional behavior and retail sentiment is crucial in a country like India, where retail investors are gaining prominence post-COVID." (Mehta & Verma, 2023)

3. Research Objectives

1. To analyze the volume and pattern of DII investments in Indian banks between 2018 and 2024.
2. To examine the relationship between DII inflows and the performance of banking sector indices.
3. To assess the impact of DII activity on retail investor confidence and investment decisions.
4. To explore future implications of DII participation in light of technological and regulatory changes.

4. RESEARCH METHODOLOGY

4.1 Research Design: This study employs a **mixed-method** design—using both quantitative (secondary financial data) and qualitative (retail investor surveys) approaches.

4.2 Data Collection

- **Primary Data:** Survey conducted among 85 retail investors using structured questionnaires distributed online.
- **Secondary Data:** Monthly fund flows of DIIs and index values from NSE and SEBI covering January 2018 to December 2024.

4.3 Tools for Analysis

- **Statistical Methods:** Descriptive statistics, multiple regression, Pearson’s correlation, and t-tests.
- **Software:** MS Excel and SPSS.

4.4 Conceptual Framework

| Variables | Classification |
|---|----------------------|
| DII Fund Flow | Independent Variable |
| Banking Sector Index (e.g., Bank Nifty) | Dependent Variable |
| Market Volatility, Inflation, Repo Rate | Moderating Variables |

5. ANALYSIS AND RESULTS

This chapter presents the empirical findings derived from secondary market data (2018–2024) and primary survey responses. The objective is to evaluate the relationship between **Domestic Institutional Investor (DII) activity** and the **performance of the Indian banking sector**, alongside its influence on **retail investor sentiment**.

5.1 DII Fund Flow Trends (2018–2024)

An examination of DII net investments from FY2018 to FY2024 reveals a **notable upward trend**, particularly **post-2020**. The investment volume peaked in **FY2022–23**, coinciding with sharp sell-offs by Foreign Institutional Investors (FIIs). This pattern indicates **DII's growing confidence** in the long-term fundamentals of the Indian economy, especially in the **banking sector**.

Table 5.1: DII Net Investments in Indian Markets (₹ Crores)

| Financial Year | DII Net Investment | Major Market Events |
|----------------|--------------------|-------------------------------------|
| 2018–19 | ₹ 66,305 Cr | Normal market cycle |
| 2019–20 | ₹ 74,972 Cr | Pre-COVID market corrections |
| 2020–21 | ₹ 98,978 Cr | COVID recovery phase |
| 2021–22 | ₹ 103,326 Cr | FII withdrawal begins |
| 2022–23 | ₹ 119,542 Cr | Peak DII investment during FII exit |
| 2023–24 | ₹ 105,214 Cr | Sustained inflows, focus on banking |

Source: SEBI, NSDL Data Compilation

This trend supports the hypothesis that **DII's act as counter-cyclical stabilizers**, especially during periods of external volatility.

5.2 Correlation and Regression Analysis

A **Pearson correlation analysis** was conducted to evaluate the relationship between DII inflows and the **Bank Nifty index**, a key benchmark for the Indian banking sector.

Pearson's Correlation Coefficient (r): 0.431 → Indicates a **moderate positive correlation** between DII inflows and Bank Nifty index movements.

Regression Equation:

$$\text{Bank Index} = 10453 + 0.183(\text{DII Investment}) + \{\text{Bank Index}\} = 10453 + 0.183(\{\text{DII Investment}\}) +$$

$$\text{Bank Index} = 10453 + 0.183(\text{DII Investment}) + \epsilon$$

Where:

- **Bank Index** represents the monthly average closing value of the Bank Nifty.
- **DII Investment** is measured in ₹ crores (monthly net inflows).
- ϵ is the error term.
- **R² = 0.19** → This implies that **19% of the variation in the Bank Nifty** can be explained by DII investment activity.

Table 5.2: Regression Summary Output

| Parameter | Coefficient | t-Statistic | p-Value | Interpretation |
|------------------------------|-------------|-------------|---------|----------------------------------|
| Intercept (β_0) | 10453 | 4.72 | <0.01 | Significant base index level |
| DII Investment (β_1) | 0.183 | 3.41 | <0.05 | Statistically significant impact |

| | | | | |
|----------------|------|---|---|----------------------------|
| R ² | 0.19 | — | — | Moderate explanatory power |
|----------------|------|---|---|----------------------------|

These results support a **positive linear relationship**, albeit with other macroeconomic factors influencing the remaining 81% of index variability.

5.3 Retail Investor Sentiment Analysis

Based on a structured survey of 150 retail investors across urban financial centers (e.g., Hyderabad, Visakhapatnam, Bhubaneswar), the following insights were gathered:

Table 5.3: Retail Investor Perception of DII Activity

| Observation | % Respondents |
|--|---------------|
| DII activity considered a reliable signal | 62% |
| Increased equity exposure post-DII buying | 47% |
| Neutral or unaware of DII flows | 18% |
| Follow both DII and FII signals simultaneously | 23% |

These findings reflect the **rising financial literacy among retail investors** and a growing reliance on **institutional behavior as a market indicator**.

“Retail investors increasingly mirror DII sentiment, leading to a potential multiplier effect in capital allocation,” (Survey Field Notes, 2024).

6. FINDINGS

Based on the data analysis and interpretation, the key findings are:

- Positive Correlation:** There is a moderate positive correlation ($r = 0.431$) between DII fund inflows and Bank Nifty performance, suggesting that DII activity influences banking sector growth.
- Retail Investor Sentiment:**
 - 62% of surveyed retail investors perceive DII inflows as a positive market signal.
 - 47% increased their equity holdings following DII buying periods.
 - A minority (18%) showed no impact, mostly due to limited awareness.
- Stabilizing Role:** DIIs often counterbalance FII outflows, especially during volatile periods, helping stabilize banking stocks.
- Investment Patterns:** DIIs show a strong preference for large-cap, fundamentally sound banks—particularly private sector banks—indicating a risk-averse, long-term strategy.
- DII Influence Growing:** Post-2020, DII participation increased markedly, reflecting enhanced domestic confidence and supportive policy frameworks.

7. CONCLUSION

Domestic Institutional Investors (DIIs) have become integral to the Indian banking sector’s evolution, contributing not just capital but also institutional stability and governance credibility. This study reveals that DII inflows have a moderate yet consistent impact on the performance of

banking stocks, especially those of large-cap banks, as evidenced by the positive correlation with the Bank Nifty index.

Their counter-cyclical role, particularly during periods of foreign capital outflows or economic uncertainty, has helped buffer market volatility. DIIs, with their long-term investment horizon and strategic focus, bring more sustainable capital than speculative flows, thereby supporting steady financial development.

Moreover, their increasing involvement in funding digital initiatives, ESG-aligned projects, and fintech collaborations reflects a shift from traditional investment behavior toward transformational engagement. This indicates a maturation of domestic capital markets and institutional investor capabilities.

The study also highlighted retail investor behavior, showing that DII activity influences market sentiment and retail participation. A majority of individual investors view DII inflows as a confidence-building signal, prompting higher equity engagement.

Looking ahead, as India's regulatory framework continues to evolve and promote institutional investment, DIIs are likely to play an even more prominent role in guiding sectoral reforms, enabling digital transitions, and improving capital adequacy. Their actions will be critical in navigating economic headwinds, driving inclusive banking growth, and achieving long-term financial resilience.

In summary, DIIs are no longer passive investors—they are active catalysts of structural change in the Indian banking ecosystem. For policymakers, market participants, and stakeholders, close monitoring of DII strategies and flows is essential for forecasting market behavior and shaping effective investment and policy decisions.

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