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Foreign portfolio investment in India and its consequence on economic portrayers

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Abstract
Foreign Portfolio Investment (FPI) is investment by non-residents in Indian securities including shares, government bonds, corporate bonds, convertible securities, infrastructure securities etc. It is argued that the most important benefits from FPI is that it gives an upward thrust to the domestic stock market prices. FPI along with FDI can contribute to fill the savings investment gap and provide the foreign exchange to support growth and development. India‘s change of policy in relation to FPI, led to large surge of foreign investment in capital market. It revolutionized not only the capital market of the country but also its whole economy. The research paper focuses on the flow of FPI and FDI in India and in particular the impact of FPI on certain economic indicators of India. Regression analysis has been used for capturing the relationship between FPI and selected economic indicators of India.

Keywords: foreign portfolio investment (FPI), foreign direct investment (FDI), gross domestic product (GDP) and economic indicators

Introduction

Foreign Portfolio Investment (FPI) is investment by non-residents in Indian securities including shares, government bonds, corporate bonds, convertible securities, infrastructure securities etc. The class of investors who make investment in these securities are known as Foreign Portfolio Investors. FPI is induced by differences in equity price scenario, bond yield, growth prospects, interest rate, dividends or rate of return on capital in India's financial assets. SEBI has recently stipulated the criteria for Foreign Portfolio Investment. According to this, any equity investment by non-residents which is less than or equal to 10% of capital in a company is portfolio investment. While above this the investment will be counted as Foreign Direct Investment (FDI).Investment by a foreign portfolio investor cannot exceed 10 per cent of the paid up capital of the Indian company. All FPI taken together cannot acquire more than 24 per cent of the paid up capital of an Indian Company. As per SEBI regulations, FPIs are not allowed to invest in unlisted shares and investment in unlisted entities will be treated as FDI. The most important way FPI affects the economy is through its various linkage effects via the domestic capital market.

It is argued that the most important benefits from FPI is that it gives an upward thrust to the domestic stock market prices. FPI along with FDI can contribute to fill the savings investment gap and provide the foreign exchange to support growth and development. The contribution of foreign investment to growth can be direct through the financing of investment, which is invariably a source of growth, or indirect through an increase in consumption or absorption, which in turn will induce an increase in investment. The developmental impact is the greatest in the case of direct financing of investment. FPI can also bring ancillary services in the form of non- financial benefits to the host economy by enhancing the business environment in which firms operate. But the critics of FPI not only refute the above arguments but also argue that FPI will cause more harm than good to the host economies.

Review of Literature

Bekaert and Harvey (2017) studied the impact of financial liberalization on capital flows and the consequent market volatility. From the analysis of data for 16 emerging markets, they found that capital flows increased substantially after liberalization. It was found that, on an average, capital flows increased tenfold in the five years after liberalization compared to the five years preceding liberalization. Of course, the market volatility increased after the capital flows. But, this should be expected in a market economy. The notable favourable consequence of the capital flows was that in all emerging markets, the cost of capital declined after the capital flows. The decline compounded Annual Growth Rate is used for the composition and growth of FPI in India. Cost varied between 5 and 75 basis points. Decline in the cost of capital is investment and growth promoting and therefore eminently desirable for developing countries.

Malayendu Saha (2016) in developing countries, like India, there is a great need or foreign capital, not only to increase productivity of labour but also to build foreign exchange reserves to meet trade deficit. After the opening up of the borders for capital movement, foreign investments in India have grown enormously. Industrial deregulation, a more flexible exchange rate, stronger debt and equity markets, and lower trade barriers have injected buoyancy to the Indian economy and dramatically strengthened her external position.

Miguel and Paul (2015) in their study argued that openness of the system which encourages portfolio flows from economically more-developed countries to less- developed countries. They also argued that portfolio flows positively affects GDP growth of the host economies even if there is

volatility.

Statement of the Problem

India's change of policy in relation to FPI, led to large surge of foreign investment in capital market. It revolutionized not only the capital market of the country but also its whole economy. It modernized India's capital market by increasing stock prices, introducing knowledge flow, market efficiency etc. and saved the Indian economy from the balance of payment crisis, providing non-debt creating capital etc., without any visible dangers to the economy so far.

Therefore, this paper focuses on answering the following research questions:

- Whether portfolio investments have positive impact on related Economic indicators on Indian Economy?
- Whether FPI is more volatile than FDI in India?

Objectives of the Study

- To analyse the flow of FPI and FDI in India.
- To study impact of FPI on selected economic indicators in India.

Hypothesis of the Study

- **H01**: There is no impact of FPI on selected economic indicators in India.

Research Methodology

Sources of Data

Data required for the study is collected from secondary source. The data related to capital flows made by the FPIs is collected from RBI bulletin and Indian securities market review. The Data related to current account deficit and GDP are gathered from the Reserve Bank of India annual report, Handbook of Statistics on the Indian Economy and Report on Currency and Finance.

Period of study

The study period is 10 years from 2007-2008 to 2016-2017.

Tools Used

Techniques such as Range, Standard deviation and Skewness are used for making descriptive analysis of the data and to measure the volatility and other characteristic of the data series that are used in the study. Regression analysis has been used for capturing the relationship between FPI and selected economic indicators of India.

Table 1: Flows of FDI and FPI in India during the Years 2007-08 to 2016-17

US $ Million

YEAR	FDI	FPI	Total
2007-08	34835	27271	62106
2008-09	37838	-13855	23983
2009-10	37763	32376	70139
2010-11	30380	31471	61851
2011-12	34298	17410	51708
2012-13	36046	28647	64693
2013-14	44291	5029	49320
2014-15	55559	40923	96482
2015-16	60220	-3643	56577
2016-17	71532	7766	79298

***Source*:** Compiled from Indian Securities Market: A Review, NSE

The table shows that from the very beginning of the FPI in India, it began to enjoy almost equal position with the FDI. In 2007-08 total FDI in India was 34835 million US dollars and in that year FPI was 27271 million US dollars. The difference between the two was only 7564 million US dollars. By the year 2010-11 FPI achieved dominance over FDI when FPI investment was 31471 million US dollars but FDI was only 30380 million US dollars and the FPI's contribution to the total foreign investment became 50.88 percentages. But the FPI's started to decline showing poor growth and became nil during the year 2015-16 when the growth of FDI's was 60220 million US dollars. During the year 2016-17, the foreign portfolio investments showed a growth of 7766 million US dollars. This analysis of the trend and pattern of FPI revealed many interesting insights. On the whole FPI has shown a positive trend, suggesting the fact that the vast market potential of this country has attracted many foreign investors through the portfolio investments apparently justifying the invitation of FPI in to the Indian economy. The FIIs, ADRs and GDRs have a positive growth rate while the offshore funds has a negative growth rate.

Table 2: Descriptive Analysis for FDI and FPI in India during the Years 2007-08 to 2016-17

	N	Range	Minimum	Maximum	Mean	SD	Skewness
FPI	10	8	1	9	4.60	2.875	.151
FDI	10	41152	30380	71532	44276.20	13572	1.118
Valid N	10	54778	-13855	40923	17339.50	17842	-.503

When analyzing the volatility, it is seen that foreign portfolio investment has maximum volatility, when compared to foreign direct investments which has less volatile. For analyzing the volatility, standard deviation, range, skewness, and coefficient of variation are used. All these four statistic gives consistent result. Standard deviation of FPI value is 13572 million US dollars; compared to other forms of capital flows its value is greater. So FPI has more volatility compared to other forms of capital flows. The skewness, range statistic and coefficient of variation of FPI are greater than other forms of capital flows. So these statistics gives consistent result.

Table 3: FPI and GDP in India during the Years 2007-08 to 2016-17

INR Crores

Year	FPI amount	GDP at factor cost	FPI as a percentage of GDP
2007-08	27271	4581422	2.39
2008-09	-13855	5282086	-
2009-10	32376	6133230	2.50
2010-11	31471	7306990	1.96
2011-12	17410	8536550	0.20
2012-13	28647	9765345	0.29
2013-14	5029	11986532	0.04
2014-15	40923	13520013	0.30
2015-16	-3643	15263149	-
2016-17	7766	17632542	0.04

***Source*:** Handbook of Statistics on the Indian Economy

FPI inflows as a percentage of GDP are presented in this table. In the year 2007-08 the contribution of FPI is 2.39 percent and was nil in the year 2008-09. From 2009-10 to 2013-14 it shows no consistent trend. During 2015-2016 it again reached nil. On the whole FPI as a percentage of GDP cannot be considered as very significant.

Regression Analysis

H02: There is no impact of FPI on current account deficit and GDP in India.

Table 4: Regression Analysis of FPI and Current Account Deficit during 2007-08 to 2016-17

Model	R	R Square	Adjusted R square	Std. Error of The estimate	F	P Value	Sig / Non- sig
1	.999a	.998	.998	97286.89	5236.1	.000	Significant

Table 4 intimates the Regression Analysis of FPI and current account deficit The R2 value of 0.998 shows the significant contribution imposed by FPI to current account deficit. The F value (5236.1), which is higher than the table value with the p value (0.000), is significant at 5 per cent level. Hence, the null hypothesis is rejected and there is significant consequence imposed by FPI to current account deficit.

Table 5: Regression Analysis of FPI and GDP of India during the Year 2007- 08 and 2016-17

Model	R	R Square	Adjusted R square	Std. Error of The estimate	F	P value	Sig/Non- sig
1	.678a	.734	.788	79878.89	654.8	.000	Significant

Table 5 intimates the Regression Analysis of FPI and GDP of India. The R2 value of 0.734 shows the significant contribution imposed by Agriculture and Allied Products to GDP of India. The F value (654.8), which is higher than the table value with the p value (0.000), is significant at 5 per cent level. Hence, the null hypothesis is rejected and there is significant consequence imposed by FPI on GDP in India.

Suggestions

One of the significant findings of this study is that India too is not free from the risk of the FPI capital. Therefore it is necessary to take precautionary measures to protect the economy from the volatility of the FPI capital. The few existing regulations related to the FPI are incapable of checking this volatility in the event of the FIIs turned violently bearish. Therefore it is necessary to introduce at least a few more regulations related to the FPI. In this context if a lock in period is introduced for FPI investment, it can regulate sudden and excessive outflow of FPI capital to a certain extent. At present there is no such lock in period. Similarly the short selling by the FIIs also should be regulated.

Another finding of the study is the growing importance of the FDI in India and the gradual decline of the FPI as against the global trend. It is not wise to encourage FDI at the expense of the FPI for reasons well known. Therefore it is necessary to extend the policy relaxations now given to the FDI to the FPI also. Further liberalization of capital inflow should be in favour of the foreign direct investment rather than portfolio flows, since the latter is transient in nature. Similarly in order to attract the FPI capital into India, along with the present policy of relaxation of regulations steps should be taken to the strengthen of the macroeconomic condition, which can be achieved by reducing the official debt, increasing foreign exchange reserve, achieving high rate of GDP, employment and investment growth etc. The FPI policy relaxations should not be limited to the FIIs alone. It should be extended to other components of FPI especially to the GDR/ADR as it will be more helpful to the Indian companies to raise capital.

In the same way many of the advantages attributed to the FPI are on the assumption that there will be more or less even investments by the FPI in the primary as well as the secondary markets. But the reality is not this. Majority of the FPI investments usually take place in the secondary market. This tendency will deny many of the advantages of the FPI to the economy. Therefore it is also necessary to fix a quota/ratio for FPI in the secondary as well as primary market

Conclusion

India‘s move towards FPI which is a part of liberalization is essentially a move towards achieving economic growth.

Whatever may be hopes and fears about the FPI, the fact is that FPI has come to stay in the Indian economy. In the age of globalization especially in the age of liberalization a going back is neither possible nor feasible. Similarly it is not possible to shield against the volatility of the FPI through regulatory measures alone. What the country can do is to increase the foreign exchange reserve by concentrating in export trading activities to counteract possible and probable massive FPI withdrawals. Above all it is also very necessary to develop the economy and thereby keep the economy always highly attractive to foreign portfolio investment and entice them to cling to the Indian economy.

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