

FPIs - Increase in Selling and Concerns

Mains: GS III - Economy

Why in News?

Recently the outflow of foreign portfolio investors are high and raised serious concerns.

What is FPIs?

- **FPI** - Foreign Portfolio Investors (FPIs) are non-resident individuals, institutions, or entities that invest in a country's financial assets—such as stocks, bonds, and mutual funds—without seeking direct ownership or managerial control.
- They offer appreciation high liquidity and enable international diversification, primarily investing for short-to-medium-term capital.
- **Recent trend** - Foreign Portfolio Investor (FPI) outflows from India since October 2024 have been persistent and significant, amounting to over \$45 billion in 18 months.
- **Concerns** - This sustained selling has raised concerns about India's attractiveness as an investment destination.
- Despite strong domestic inflows, FPIs continue to remain net sellers.
- Understanding this phenomenon requires an analysis of valuation concerns, shifting global dynamics, structural challenges, and evolving investor perceptions.

FPI- Foreign Portfolio Investment	FII- Foreign Institutional Investment
<ul style="list-style-type: none"> • Investment by non-residents in Indian securities, such as shares, bonds, etc. • Includes FII, QFI, and other small investors • Less stable and more volatile • Short-term investment horizon 	<ul style="list-style-type: none"> • A subset of FPI that involves investment by institutions, such as pension funds, mutual funds, etc. • A part of the FPI category • More active and influential • Long-term investment horizon

What are the scale and persistence of FPI outflows?

- **Exceeding previous level** - The magnitude of FPI selling is notable, even exceeding

- levels seen during the Global Financial Crisis in terms of market capitalisation impact.
- India has underperformed emerging markets (EMs) by nearly 5,000 basis points, and foreign ownership has dropped to a 15-year low.
 - **Deeper change** - This trend reflects a deeper shift rather than short-term volatility.
 - While domestic institutional investors (DIIs) have provided stability, the absence of foreign capital inflows has affected overall market sentiment and relative performance.
 - **Valuation concerns** - A primary driver of FPI selling is India's elevated valuation relative to other emerging markets.
 - Even after recent corrections, Indian equities trade at a nearly 50% premium to EM averages.
 - From an investor's perspective:
 - Paying ~20x earnings for 10-15% growth appears unattractive.
 - Comparable or higher growth opportunities exist in other markets at lower valuations.
 - Valuation multiples reflect expectations of:
 - Sustained growth
 - High return on equity (RoE)
 - Predictability of earnings
 - The recent compression in multiples indicates declining confidence in either the pace or duration of India's growth story.

What are the changing global investment landscape?

- **Earlier scenario** - India was perceived as the "only game in town" among emerging markets.
- However, this narrative has shifted significantly.
- **Re-emergence of competing markets** - China is regaining investor confidence due to policy stability and leadership in sectors like EVs, AI, and renewables.
- Taiwan dominates semiconductor manufacturing, making it indispensable.
- South Korea is witnessing corporate governance reforms, improving investor sentiment.
- Brazil offers opportunities in commodities and cyclical sectors.
- India is no longer the sole large, liquid, growth-oriented EM option. Increased alternatives have led to portfolio rebalancing.
- **Growth concerns and sectoral stagnation** - A key concern among FPIs is that India's earnings growth may be structurally capped at 10-15%.

What are the Sectoral Challenges?

- **IT services** - Facing disruption from Artificial Intelligence (AI).
- **Private banks** - Competition from revitalized public sector banks.
- **Consumer staples** - Viewed as overvalued with limited growth upside.
- **Pharmaceuticals** - Transition challenges towards biosimilars.
- With traditional sectors stagnating and new-age sectors underrepresented, investors question the sustainability of higher earnings growth.
- **Innovation deficit and technological leadership** - Global investors increasingly prioritize innovation-driven economies.

- India faces a perception challenge in this regard:
 - Lack of dominance in sunrise sectors like AI, robotics, or advanced biotechnology.
 - Limited global market share in high-tech manufacturing.
 - Even in traditional strengths like IT and pharmaceuticals, India is not seen at the cutting edge of innovation compared to global peers.
- This raises concerns about the quality and durability of long-term growth.

What are the concerns and challenges?

- **China-Plus-One Strategy** - India was expected to benefit significantly from global supply chain diversification under the “China-plus-one” strategy.
- However, progress has been slower than anticipated:
 - Manufacturing investments from multinational corporations (MNCs) remain limited.
 - Foreign Direct Investment (FDI) inflows have stagnated.
- Structural issues such as regulatory complexity, land acquisition challenges, and infrastructure gaps continue to hinder large-scale manufacturing expansion.
- **Ease of Doing Business and Regulatory Concerns** - Investor perception of India as a difficult market persists:
 - Complex tax structures and retrospective taxation concerns
 - Regulatory unpredictability
 - Compliance burdens
- While these challenges were previously overlooked due to strong returns, they have now become significant deterrents in a lower-return environment.
- **AI Disruption and India’s Economic Model** - Artificial Intelligence poses a structural challenge to India’s services-led growth model:
 - India’s IT sector relies heavily on billable human hours.
 - AI-driven automation threatens this cost advantage.
 - If productivity gains from AI reduce demand for outsourced services, India’s core export sector could face long-term pressure.
- **Cyclical vs Structural Factors** - It is important to distinguish between cyclical and structural drivers:
 - **Cyclical factors**
 - Global capital rotation towards North Asia.
 - Short-term earnings acceleration in AI-linked sectors abroad.
 - Temporary sentiment-driven outflows.
 - **Structural factors**
 - High valuation premium.
 - Limited innovation leadership.
 - Slower-than-expected manufacturing growth.
 - Regulatory bottlenecks.
- While cyclical factors may reverse, structural issues require policy and corporate intervention.

What should be done?

- **Policy measures** - Simplifying regulatory frameworks.
- Enhancing ease of doing business.
- Providing stable and predictable tax policies.
- **Economic strategy** - Accelerating manufacturing under global supply chain shifts.
- Promoting high-tech industries and innovation ecosystems.
- Increasing R&D investments.
- **Corporate actions** - Greater capital expenditure (capex).
- Focus on productivity and technological adoption.
- Expansion into emerging sectors.
- **A contrarian perspective** - Despite current negativity, there are reasons for cautious optimism:
 - Domestic flows remain robust, providing market stability.
 - India's macroeconomic fundamentals—demographics, consumption base, and digital infrastructure—remain strong.
 - Negative sentiment itself may act as a contrarian indicator for future inflows.
- The argument that India cannot innovate or sustain growth may be overstated, as structural reforms and private sector dynamism could revive the growth narrative.

What lies ahead?

- FPI selling in India is driven by a combination of high valuations, shifting global opportunities, and structural concerns regarding growth and innovation.
- While the country is no longer the default choice among emerging markets, its long-term fundamentals remain intact.
- Addressing regulatory bottlenecks, fostering innovation, and accelerating manufacturing growth are critical to restoring investor confidence.
- Although near-term challenges persist, India's economic trajectory still holds promise, making the current phase one of recalibration rather than decline.

Reference

[Business Standards| FPI Selling](#)