Reality Behind Falling Net FDI

Mains: *GS-III – Economy*

Why in News?

India's net foreign direct investment (FDI) has declined drastically in recent years; the critics see the weak net flows as a sign of weakness.

What about FDI & its types?

- **FDI** – It refers to an ownership stake in a foreign company or project made by an investor, company, or government from another country.
- FDI is generally used to describe a business decision to acquire a substantial stake in a foreign business or to buy it outright to expand operations to a new region.
- FDI is often viewed as a uniform, long-term commitment that brings technology and management skills to the host country.
- **3 types of FDI** – FDI can fall into three different investor classes, each with distinct capabilities, strategies, and exit timelines.
- **Real FDI (RFDI)** – It generally represents long-term commitments, which consist of traditional multinational enterprises with the technology, brands, and capabilities to establish production and services.
- **Financial Investors** – This category comprises financial investors, including private equity funds, venture capital firms, sovereign wealth funds, and asset managers with a main goal of capital growth and planned exits.
- **Diaspora & SPVs** – This category includes diaspora investments and special purpose vehicles (SPVs).
- These involve capital raised abroad and funneled through offshore financial centres, sometimes including the roundtripping of Indian funds.

What are the key trends of FDI flows in India?

- **Debate on Net FDI** – Critics argue that weak net flows show India's vulnerability.
- In contrast, the Chief Economic Adviser points to the large inflows and rising manufacturing FDI as strength.
- He links weak net flows mainly to profit repatriation and outward investment by Indian companies.
- **Overlooked Issue** – Both sides focus too much on overall numbers.
- What they miss is the changing composition of international capital and the Balance of Payments (BoP) mechanisms that govern inflows and outflows.
- **Net FDI** – For BoP, the net FDI is calculated as the difference between inflows and

outflows after adjusting for the repatriation of capital.

- Net FDI Trends – From the peak of $44.0 billion in 2020-21, net FDI fell to less than $1 billion in 2024-25.
- It recovered to $7.6 billion in 2025-26. The corresponding gross inflow was $94.6 billion.
- **Policy Evolution** – India's *liberal FDI policy*, introduced in 1991, initially emphasised technology acquisition, export promotion, and foreign exchange conservation.
- Over time, policy increasingly prioritised attracting larger inflows, while concerns regarding future external payment obligations and investment quality receded.
- **Composition of Inflows** – Data on remittance-level FDI from the past four years, from 2022-23 to 2025-26 up to December, show that
    - **Real FDI (RFDI)** - 41.9%
    - **Financial investors** - 40.5%
    - **Diaspora & SPVs** - 17.6%
- **Financial Investor Exits –** The business model of financial investors suggests future exits that result in large-scale capital repatriations.
- **Example** – In 2025, Singapore's Temasek exited Schneider Electric India Ltd., earning $6.4 billion from a $637 million investment made in 2020.
- Total recorded divestment in CY 2025 was $52 billion, with 45 major foreign private equity and venture capital exits accounting for $29 billion in outflows.
- **Manufacturing FDI Decline** – Based on an analysis of effective inflows, FDI in India's manufacturing sector has declined across three consecutive four-year periods.
- Most notably, RFDI into manufacturing accounted for only 10.6% of total effective inflows.
- **Not Fresh Capital** – The Gross FDI figures is the ixing of new capital injections with corporate accounting changes, such as
    - Intra-group ownership reorganisations,
    - Mergers, share swaps,
    - Conversion of earlier non-equity instruments such as external commercial borrowings (ecbs) and convertible debentures.
- In such cases, no new money enters India — it's just a change in capital structure.
- **Scale of the Issue** – Approximately $40 billion of the $560 billion in equity inflows to India from 2014-15 to 2025-26 (up to December) fall into this category.
- Large transactions, such as Bosch and Meesho Technologies, can distort annual inflow and sectoral trends.

What about the disinvestment & OFDI trends?

- **Disinvestment Drives Decline** – The common claim that profit repatriation depresses net FDI is misleading.
- Under BoP conventions, profits sent as dividends are recorded as investment income in the current account.
- They increase the current account deficit (CAD) but do not change the reported net FDI flows.
- Instead, the primary reason for weak net FDI is disinvestment and capital repatriation, which appear in the financial account.
- **Outward FDI (OFDI)** – India's outward investments need closer scrutiny rather than

being attributed solely to corporate maturity.
- From 2023–24 to 2025–26, India invested $65 billion abroad, of this 45% went into *financial, insurance, and business services* (FIB).
- *Singapore & UAE* accounted for 27% and 11% became top destinations.
- These funds mostly go to holding companies and SPVs rather than directly to operational entities.
- **Example** – Tata Motors' subsidiary, TML Commercial Vehicles, invested $405 million in a Singapore FIB entity to acquire Italy's IVECO Group.
- **GIFT City Flows** – Capital movements through GIFT City add complexity.
- OFDI to the City increased from $246 million in 2023-24 to $1.18 billion in 2025-26.
- Total OFDI & inward FDI through it until 2025-26 reached $2.35 billion and $1.40 billion, respectively, highlighting the growing two-way flows.
- **Implications** – OFDI can represent both genuine corporate expansion and the return of capital that fled.
- But it can also mean capital recycling, where funds leave India only to return via different jurisdictions.
- Therefore, increasing OFDI does not always indicate corporate maturity; it may also indicate resource-seeking or roundtripping of capital.

What are the trends associated with the outflow channels?

- **FDI Inflows** – Between 2022–23 and 2025–26, India received
  - Gross inward equity FDI - $317.8 billion
  - Excluding reinvested earnings - $230.6 billion
- **Capital Account Outflows** – Disinvestment and capital repatriation (capital account) totalled $178.9 billion.
- It is primarily driven by financial investors through secondary and strategic sales, IPO exits and share buybacks.
- This includes
  - "Offers for sale" by foreign promoters such as hyundai and LG.
  - Sell-offs by RFDI investors, such as wistron which sold off to the tatas.
- **Current Account Outflows**
- **Dividend Remittances –** Amounted to $118.9 billion in profits paid out by MNE subsidiaries and affiliates, excluding reinvested earnings.
- **IPR payments (royalties)** – Totalled $46.6 billion; these payments are made by MNE subsidiaries and affiliates for intellectual property (assuming they account for 75% of total IPR payments), can substitute dividends.
- **Technical/Service/Consultancy Payments** – $250 billion was transferred, it is difficult to divide this amount between RFDI and domestic companies.
- **Net Effect** – Even excluding OFDI and technical service payments, outflows due to disinvestment, dividends, and IPR payments reached $344.4 billion.
- **Trend Over Time** – Therefore, for every dollar of fresh inflow (excluding reinvested earnings), approximately $1.50 has flown out; this situation has worsened over the past 12 years.
- The corresponding outflow per dollar entered was 56 cents from 2014-15 to 2017-18, rising to 70 cents from 2018-19 to 2021-22, before reaching the current high.

What lies ahead?

- The above narrative shows how an incomplete view of FDI prevails in public discourse.
- Different types of investors, entry methods, and exit strategies impact technology transfer, industrial growth, and external sustainability.
- The reporting of global FDI flows adds an additional layer of problems.
- Understanding these nuances is crucial for evaluating FDI beyond headline numbers.

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Reference

The Hindu | The reality behind falling net FDI

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