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A Study of Recent Trends in Foreign Portfolio Investment in India

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Abstract

This paper analyses the determinants of portfolio flows to India for the period 2015 to 2016. The study reveals that as on March 31, 2016, there were 8,717 FPIs registered as compared to 8,214 on March 31, 2015 and an analysis of FPI net investments reveals that there were negative net investments in both equity and debt segments during 2015-16.

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1. INTRODUCTION

In economics, Foreign Portfolio Investment (FPI) is the entry of funds into a country where foreigners deposit money in a country's bank or make purchases in the country's stock and bond markets, sometimes for speculation.

In March 2016, FPIs were permitted to invest in units of the Real Estate Investment Trust (REIT), the Infrastructure Investment Trust (InvIt) and Category III AIFs. Further, FPIs have also been permitted to acquire NCDs/bonds, which are under default either fully or partly in the repayment of the principal on maturity or principal instalment in case of an amortising bond. SEBI has mandated, inter-alia that an FPI will not hold more than 25 per cent stake in a Category III AIF.

Sustained capital inflows -portfolio and direct - is a *sine qua non* for any economy. In particular, the challenge is creating favourable conditions for continuous inflow of foreign capital, retaining it and utilising it for productive purposes like infrastructure and other investment needs. The new policy initiatives in the FY16 Budget are also aimed at projecting to the world that India is attracting larger foreign investments. The FPI regime commenced with effect from June 1, 2014 wherein the existing FIIs, sub-accounts and QFIs were merged to form a new investor class termed as foreign portfolio investor (FPI).

The Indian rules for foreign portfolio investments (FPIs) have undergone several regulatory changes designed to ease investment in the last few years. FPIs primarily consist of securities and other financial assets passively held by foreign investors, generally for short-term speculation. Foreign portfolio investment differs from foreign direct investment in that it does not give the investor direct ownership of financial assets.

Prior to January 2014, FPIs were divided into foreign institutional investors, qualified foreign investors, and sub-accounts. Responding to market pressure, in January 2014, the Securities and Exchange Board of India (SEBI) notified new rules which were designed to bring India in line with international norms and establish a simplified regulatory framework for foreign investors who fit the FPI framework. The new rules merged foreign institutional investors, qualified foreign investors, and sub-accounts together to form the new foreign portfolio investor class. The rules took effect on June 1, 2014

2. REVIEW OF LITERATURE

Kumar et al (2006) investigated the FIIs and mutual funds participation in the Indian secondary market. The study tried to establish the relationship between the investment trends by the major institutional investors and the stock market movements. The author outlined the major developments in Indian stock market which were responsible for the rising trends in the FII flows. **Rajput & Thaker (2008)** tried to measure the relationship amongst all these variables and their predictive power. This research was undertaken especially under the light of third generation reforms initiated in India. The study observed that in a more globalized world, ER, FII and Stock Index were the important economic variables and reflected the underlying strength and stability of business and economy as a whole **Sehgal and Tripathi (2009)** made a genuine attempt to analyze the investment strategies of FIIs. The period under consideration was from 2000 to 2006. The study exclusively investigated the question that while investing, what investment strategies had been used by FIIs. It tried to find answer as to whether it was trading strategy or herding strategy or positive feedback strategy used by FIIs. It also tried to investigate whether these trading strategies were found suitable in the Indian economic environment.

3. OBJECTIVES OF THE STUDY

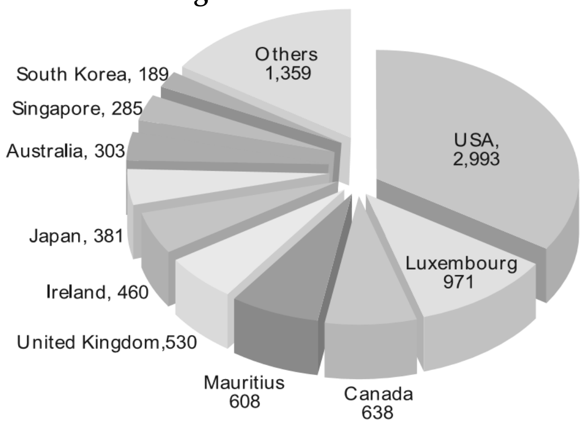
To study the recent trends in Foreign Portfolio Investment (FPI) in India

3.1 India's Withholding Tax for Non-residents

The SEBI divided FPI into three categories based on risk:
Category I (low risk) includes government and government-related investors such as central banks, governmental agencies, sovereign wealth funds, and international or multilateral organizations or agencies.
Category II (moderate risk) includes regulated entities such as mutual funds, investment trusts, insurance companies, banks, asset management companies, portfolio managers, and university endowments.
Category III (high risk) includes all investors not eligible under Category I and II such as charitable societies, charitable trusts, foundations, corporate bodies, individuals, and family offices.
Under the regulations, total investment by each FPI is restricted to 10 percent of the issued equity capital of the company. However, aggregate FPI investment in an Indian company is capped at 24 percent, unless specifically authorized by that company's board of directors. FPIs are not generally allowed to invest in unlisted shares.
In July 2015, the Indian government instituted composite caps to increase the aggregate limit of 24 percent up to the sectoral cap/statutory ceiling provided in the consolidated foreign direct investment policy. These rules abolished sub-limits on different categories of investment and instead created overall caps for foreign direct and foreign portfolio investment. FPIs may now invest up to the sectoral cap in any company as long as the investment has been authorized by the company's board of directors, and, if necessary, approved by the Indian Government.
Again, in September 2015, the Government of India responded to investor concerns by affirming that FPIs are not liable for minimum alternative tax (MAT) in India if they have no permanent establishment or place of business in India. The clarification was a welcome announcement to FPIs who had been issued notices seeking payment of MAT.
Sustained capital inflows -portfolio and direct - is a sine qua non for any economy. In particular, the challenge is creating favourable conditions for continuous inflow of foreign capital, retaining it and utilising it for productive purposes like infrastructure and other investment needs. The new policy initiatives in the FY16 Budget are also aimed at projecting to the world that India is attracting larger foreign investments. The FPI regime commenced with effect from June 1, 2014 wherein the existing FIIs, sub-accounts and QFIs were merged to form a new investor class termed as foreign portfolio investor (FPI).
As on March 31, 2016, there were 8,717 FPIs registered as compared to 8,214 on March 31, 2015. There were 19 registered custodians and 18 registered designated depository participants (DDPs) as on March 31, 2016. Based on the country of incorporation, the number of FPIs registered were the highest from USA (2,993), followed by Luxembourg (971), Canada (638) and Mauritius (608). The Countries like Philippines, Bahamans, Israel and Brazil each had only one registered FPI.

(Chart 2.21) In terms of AUC as well, FPIs from the USA had the maximum assets under custody (₹ 6,87,853 crore), followed by Mauritius at ₹ 4,31,729 crore, Singapore at ₹ 2,50,903 crore and Luxembourg at Rs 1,91,218 crore

3.2 Chart 1: Country-wise number of registered FPIs



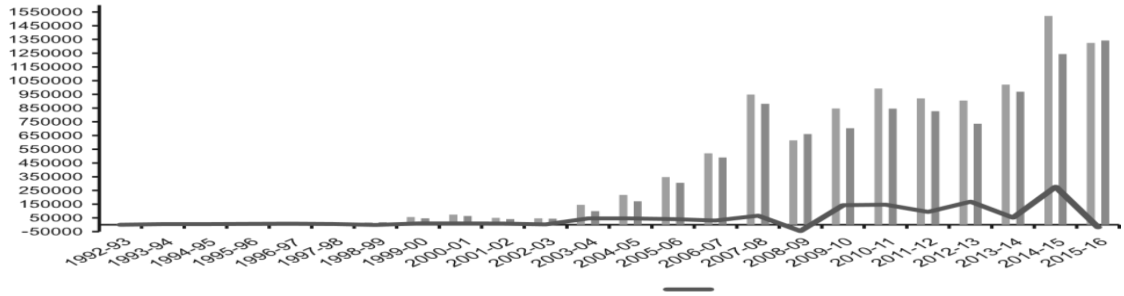
During 2015-16, FPI investments in India saw a great decline as compared to the previous year with the net investments being negative for the first time since 2008-09. India witnessed negative FPI net investments of ₹ 18,175 crore during 2015-16 as compared to positive net investments of ₹2,77,460 crore in 2014-15. In US$ terms, the negative net investments amounted to US$ 2,523 million in 2015-16 compared to positive net investments of US$ 45,698 million in 2014-15. The combined gross purchases of debt and equity by FPIs decreased by 14.9 per cent to ₹ 13,24,418 crore in 2015-16 from ₹ 15,21,346 crore in 2014-15. The combined gross sales by FPIs increased by 7.4 per cent to ₹ 13,42,593 crore in 2015-16 from ₹ 12,43,886 crore during the previous year.

Table 1: Investments by FPIs

Year *1*	Gross Purchase (₹ crore) 2	Gross Sales (₹ crore) 3	Net Investment (₹ crore) 4	Net Investment (USD million) 5
2014-15	15,21,346	12,43,886	2,77,460	45,698
2015-16	13,24,418	13,42,593	-18,175	-2,523

Source: SEBI Report 2015-16

Chart 2: Country-wise number of registered FPIs

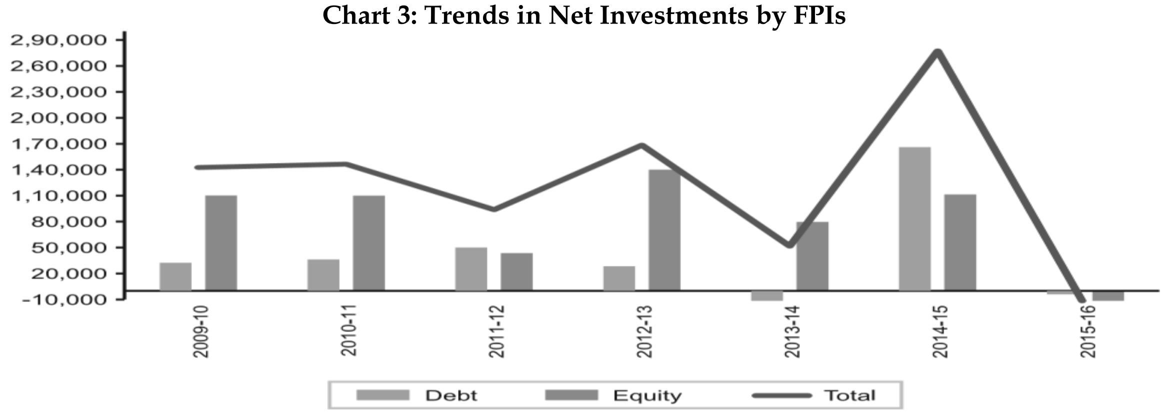


An analysis of FPI net investments reveals that there were negative net investments in both equity and debt segments during 2015-16. FPI negative net investments in debt were also observed in 2013-14. During 2015-16, the announcement of increase in FPI limits in debt securities increased buoyancy in the market. The market however, continued to lose some of its gains after October 2015, owing to fresh concerns about global cues, as well as some domestic concerns. Before 2015-16, the last time when FPI net investments in equity was negative in 2008-09, at the time of a global melt-down on account of the sub-prime mortgage crisis. The FY 2015-16 was the first instance since 1992 where FPI net investments in equity and debt were both negative.

Table 2: Segment-wise Net Investment by FPIs (₹ crore)

Year	Net Investment by FPIs		
	Equity	Debt	Total
2014-15	**1,11,333**	**1,66,127**	**2,77,460**
2015-16	**-14,172**	**-4,004**	**-18,176**

Chart 3: Trends in Net Investments by FPIs



During 2015-16, the highest net investments were registered during October, 2015 (Rs 22,350 crore) followed by March, 2016 (₹ 19,667 crore). Net investments in the equity segment were highest during March, 2016 (₹ 21,142 crore) while net investments in the debt segment were highest during October, 2015 (₹ 15,701 crore).

Details regarding the debt investment limits allocated to FPIs through the auction mechanism during 2015-16 are given in Table 3.

Table 3: Allocation of Debt Investment Limits to FPIs

S. No.	Date of Auction	Debt Limits allocated through auctioned (₹ in crore)
1.	April 06, 2015	431
2.	April 27, 2015	507
3.	May 18, 2015	2,684
4.	June 08, 2015	654
5.	June 29, 2015	2,451
6.	July 20, 2015	403
7.	August 10, 2015	556
8.	August 31, 2015	561
9.	September 21, 2015	661
10.	October 12, 2015	5,600
11.	November 02, 2015	852
12.	November 23, 2015	332
13.	December 14, 2015	497
14.	January 04, 2016	7,396
15.	January 25, 2016	3,476
16.	February 15, 2016	3,011
17.	March 08, 2016	4,681
18.	March 28, 2016	5,035

Source: SEBI Report, 2015-16

Pursuant to the announcement of the medium term framework for FPI limits in government securities announced by RBI in its fourth bi-monthly policy statement for FY 2015-16, the limits for FPI investments in debt securities are being announced/fixed in rupee terms. A separate limit for investments FPI is released every quarter.

4. Finding of the Study

1. The study finds that during 2015-16, FPI investments in India saw a great decline as compared to the previous year.
2. An analysis of FPI net investments reveals that there were negative net investments in both equity and debt segments during 2015-16.

5. Conclusion

Foreign capital has a key role to play in the economic development of India. There are several ways in which capital flows and economic growth are related. With the ease in registration requirements and clarity on taxation being brought in for FPIs, the new FPI regime is likely to boost portfolio investments in India by foreign investors. Granting of permanent registrations to FPIs shall not require them to approach the DDPs time and again for the same, thus, providing them a more supportive environment for investment in India. Meanwhile, with the delegation of work to DDPs, SEBI can now focus on more important issues at hand requiring its attention and perform its regulatory role more effectively. It can be argued that the shift to the new regime, for all classes of investors that have been merged, shall be a comfortable one particularly because a buffer period has been given to them to operate without needing them to immediately comply with the formalities and process for conversion to and operation as FPIs.

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