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The Dynamics of FDI and FPI in India's Economy: A Correlational Study

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Abstract
Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) play distinct yet complementary roles in India's economic development. FPI is short-term and volatile, enhancing liquidity in financial markets, while FDI is long-term and supports sustainable growth through capital formation, technology transfer, and employment generation. Despite their individual contributions, FPI and FDI operate independently, driven by different factors. Policymakers must adopt differentiated approaches: FPI can be promoted through market stability and regulatory transparency, whereas FDI requires structural reforms and an investment-friendly environment. This paper also suggests directions for future research, focusing on sector-specific impacts, the influence of policy changes, and the role of macroeconomic conditions in shaping these investment inflows.

1. Introduction

Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) are crucial components of global economic dynamics, especially for emerging economies like India. These two types of investment play distinct roles in shaping a country’s economic growth and development. While both are forms of foreign capital inflows, their objectives, structures, and impacts differ significantly.

FPI refers to investments made by foreign entities in the financial markets of a host country, such as stocks, bonds, or other financial assets, with the primary aim of short-term capital gains. FPI is often seen as volatile due to its speculative nature, earning it the moniker of "hot money." On the other hand, FDI involves investments that aim to create or expand business operations, often through the establishment of factories, infrastructure, or acquisition of existing businesses. These investments are typically long-term and more stable, contributing to economic growth, job creation, and technological advancements.In India, both FPI and FDI have seen significant inflows over the years, contributing to the development of the country’s financial markets and industrial sectors. However, despite these contributions, the relationship between FPI and FDI remains complex, with studies indicating a weak and statistically insignificant correlation between the two, suggesting that their impact on the economy is driven by different factors.

2. Types of Foreign Portfolio Investment

Foreign Portfolio Investment encompasses the deployment of capital by international entities within the financial markets of foreign nations. Its underlying motive typically revolves around procuring transient speculative gains, with little intention to foster enduring commitments within the host economy. As a consequence of its capricious nature and being bereft of perceived productivity, certain scholars have branded FPI as "hot money." This appellation arises from its intrinsic volatility, rendering it unsuitable for classification as productive capital. Although FPI yields capital gains, it fails to engender active involvement in the administration or authoritative oversight of the invested company. The advantages associated with this form of investment primarily include liquidity and profits stemming from capital appreciation and dividend incomes.

2.1 Foreign Institutional Investors (FIIs)

FIIs, being institutions domiciled beyond the confines of the host nation, allocate their surplus liquid capital or substantial fund reservoirs to the stock markets of foreign emerging economies, endeavouring to amass speculative gains. These entities encompass a consortium of banks, pension funds, insurance companies, major mutual funds, and hedge funds.

2.2 Foreign Currency Convertible Bonds (FCCBs)

FCCBs represent financial instruments, namely bonds, which are issued by publicly listed companies in foreign markets. Their objective resides in generating foreign exchange liquidity to facilitate overseas expansion initiatives or domestic technological advancements. These bonds proffer a twofold advantage, manifesting in the form of interest denominated in foreign currency and the option to convert the bonds into equity shares subsequent to a predetermined temporal interval, at a prearranged rate.

2.3 Global Depository Receipts & American Depository Receipts (GDR/ADR)

Global Depository Receipts and American Depository Receipts constitute negotiable financial instruments that embody equity participation in the capital of foreign enterprises. They enable investors from any nation to trade or invest in the shares of companies situated in alternative jurisdictions. Global Depository Receipts encompass bank certificates or financial instruments that are traded internationally through an intricate network of banks. These certificates represent the shares of the underlying companies, which are held by branches of foreign banks. Conversely, American Depository Receipts are confined to the American markets and are issued by United States banks, signifying ownership in foreign entities. ADRs are traded on U.S. stock exchanges akin to conventional shares.

3. Objectives

1. To examine the definitions, objectives, and key characteristics of Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) in India.
2. To analyse the trends and impacts of FPI and FDI inflows on India's financial markets and economic growth.
3. To investigate the correlation between FPI and FDI, and assess the statistical significance of their relationship.
4. To evaluate the risks, returns, and macroeconomic implications of FPI and FDI for India's development

4. Review of Literature:

Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) play significant roles in the economic development of India, though their impacts differ. Research indicates that FDI is crucial for long-term capital formation, technology transfer, and job creation, contributing to sustainable growth in sectors like manufacturing and infrastructure (Chatterjee & Subramanian, 2020)[1]. On the other hand, FPI, while providing liquidity to the financial markets, tends to be more volatile and is heavily influenced by global financial trends (Banga, 2017)[2]. Studies suggest that FDI often complements FPI, with both contributing to a diversified and robust investment landscape, although the interaction between the two can be complex and dependent on policy changes (Sharma & Chander, 2019)[3]. Moreover, policy reforms in India have been instrumental in attracting both FDI and FPI, particularly in the wake of liberalization in the 1990s, with each investment type offering unique benefits (Joshi & Desai, 2021)[4]. Consequently, while FDI remains a more stable source of growth, FPI continues to be an important factor in boosting India's capital markets (Reddy & Kumar, 2022)[5].

5. Hypothesis

Null Hypothesis (H_0): There is no significant relationship between Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) in India.

Alternative Hypothesis (H_1): There is a significant relationship between Foreign Portfolio investment (FPI) and Foreign Direct Investment (FDI) in India.

Table 1 Yearwise Net Foreign Portfolio Investment in India

Financial Year	FPI Net Investments - Financial Year (in USD Million)											
	Equity	Debt			Hybrid	Mutual Funds					Alternative Investment Funds (AIFs)	Total for the FY
	Equity	Debt-General Limit	Debt-VRR*	Debt-FAR**	Hybrid	Equity	Debt	Hybrid	Solution Oriented	Other	AIF	
1992-93	0	0	0	0	0	0	0	0	0	0	0	0
1993-94	0	0	0	0	0	0	0	0	0	0	0	0
1994-95	0	0	0	0	0	0	0	0	0	0	0	0
1995-96	0	0	0	0	0	0	0	0	0	0	0	0
1996-97	0	0	0	0	0	0	0	0	0	0	0	0
1997-98	0	0	0	0	0	0	0	0	0	0	0	0
1998-99	8912	-14	0	0	0	0	0	0	0	0	0	8898
1999-00	2356	117	0	0	0	0	0	0	0	0	0	2473
2000-01	2222	-62	0	0	0	0	0	0	0	0	0	2160
2001-02	1696	144	0	0	0	0	0	0	0	0	0	1840
2002-03	528	37	0	0	0	0	0	0	0	0	0	565
2003-04	8752	1254	0	0	0	0	0	0	0	0	0	10006
2004-05	9940	412	0	0	0	0	0	0	0	0	0	10352
2005-06	10999	-1635	0	0	0	0	0	0	0	0	0	9364
2006-07	5589	1232	0	0	0	0	0	0	0	0	0	6821

2007-08	**13242**	**3199**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**16441**
2008-09	**-10324**	**486**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**-9838**
2009-10	**6746**	**4387**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**11133**
2010-11	**24295**	**7932**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**32227**
2011-12	**9012**	**9911**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**18923**
2012-13	**25833**	**5214**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**31047**
2013-14	**13441**	**-4566**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**8875**
2014-15	**18370**	**27328**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**45700**
2015-16	**-2008**	**-515**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**-2523**
2016-17	**8467**	**-867**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**7600**
2017-18	**3960**	**18504**	**0**	**0**	**1**	**0**	**0**	**0**	**0**	**0**	**0**	**22465**
2018-19	**123**	**-6127**	**0**	**0**	**505**	**0**	**0**	**0**	**0**	**0**	**0**	**-5499**
2019-20	**1291**	**-6430**	**1002**	**0**	**1096**	**0**	**0**	**0**	**0**	**0**	**0**	**-3041**
2020-21	**37028**	**-6720**	**4499**	**0**	**1373**	**0**	**0**	**0**	**0**	**0**	**0**	**36180**
2021-22	**-18468**	**269**	**1708**	**0**	**474**	**0**	**0**	**0**	**0**	**0**	**0**	**-16017**
2022-23	**-5114**	**-1137**	**766**	**0**	**-25**	**0**	**0**	**0**	**0**	**0**	**0**	**-5510**
2023-24	**25272**	**14594**	**-359**	**0**	**1536**	**0**	**0**	**0**	**0**	**0**	**0**	**41043**
2024-25 **	**-209**	**5931**	**1026**	**2811**	**713**	**5**	**107**	**-3**	**0**	**-44**	**0**	**10337**
Total	**201951**	**72878**	**8642**	**2811**	**5673**	**5**	**107**	**-3**	**0**	**-44**	**0**	**292022**

***Debt-VRR Debt Voluntary Retention Route**
**** Debt-FAR Debt Holdings under Fully Accessible Route**
Source:- www.nseindia.com

Figure 1. Annual Net FPI in India

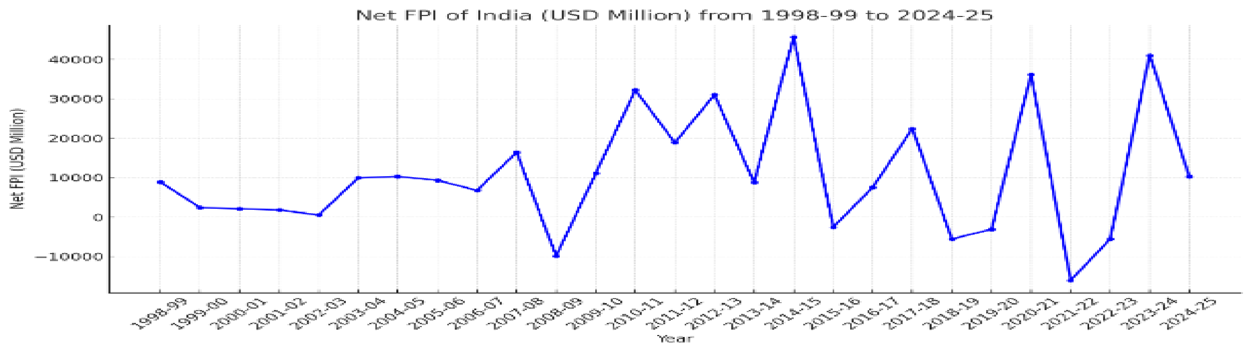

Table 2 Analyzing the Correlation between FPI and FDI in India

Descriptive Statistics			
	Mean	Std. Deviation	N
FPI	10834.04	15863.101	26
FDI	38291.88	27395.722	26

Table 3 Analyzing the Correlation between FPI and FDI in India

Correlation			
		FPI	FDI
FPI	Pearson Correlation	1	.082
	Sig. (2-tailed)	_	.691
	N	26	26
FDI	Pearson Correlation	.082	1
	Sig. (2-tailed)	.691	_
	N	26	26

Foreign Direct Investment (FDI) in India, as presented in Tables 1.2 A and 1.2 B, provides insights into the statistical relationship between these two forms of capital inflows. Descriptive statistics reveal that the mean value of FPI over the observed period is 10,834.04 million USD, with a standard deviation of 15,863.10, indicating a relatively high variability in FPI inflows. In comparison, FDI has a higher mean of 38,291.88 million USD with a standard deviation of 27,395.72, suggesting even greater fluctuations in direct investments. The Pearson correlation coefficient between FPI and FDI is 0.082, with a p-value of 0.691, indicating a very weak positive correlation that is not statistically significant at conventional levels ($p > 0.05$). This result suggests that there is minimal linear association between FPI and FDI, implying that changes in FPI levels are unlikely to predict changes in FDI levels in India over this period

6. The Disparities Between FPI and FDI: A Comprehensive Overview

Distinct Investment Goals

FPI is primarily motivated by short-term financial returns, as investors buy stocks, bonds, and other financial assets to profit from price fluctuations. In contrast, FDI is aimed at establishing or expanding business operations, leading to long-term investments in physical assets such as factories or infrastructure. These differing goals mean that the two types of investment are driven by different factors and objectives.

Varying Time Horizons

The time horizon for FPI is typically short-term, as investors seek to capitalize on market movements or fluctuations in asset prices. FDI, however, is a long-term commitment, with investments directed towards building businesses, creating jobs, and fostering economic growth over an extended period. This distinction in investment duration means that the two types of investment often respond to different economic cycles and market conditions.

Sectoral Differences

FDI is concentrated in sectors that require physical infrastructure and long-term planning, such as manufacturing, real estate, and services. FPI, on the other hand, is directed more toward financial markets, including equities, bonds, and securities. Since these sectors rarely overlap, the factors driving investments into each type of asset are quite different, leading to low correlation between FPI and FDI.

Macroeconomic Influences:

FPI is more sensitive to global macroeconomic trends, such as interest rates, exchange rates, and stock market performance. As a result, it tends to react quickly to changes in global risk sentiment. FDI, however, is influenced by a country's economic fundamentals, such as GDP growth, infrastructure development, and labour market -conditions, which are less volatile and more stable in nature. This disvergence in the factors influencing FPI and FDI further weakens their correlation.

Government Policy and Regulation

Different government policies and regulations target FDI and FPI separately. For instance, countries often provide incentives such as tax breaks or special economic zones to attract FDI, while FPI is influenced by capital market reforms, interest rate policies, and fiscal measures that impact financial markets. As these policies affect the two types of investment in distinct ways, they may not move in tandem, reducing the correlation between FPI and FDI.

Risk and Return Profiles

FPI is generally considered less risky due to its high liquidity and the ability to enter and exit markets quickly. Investors in FPI seek higher short-term returns based on market movements. FDI, by contrast, is a more stable but riskier form of investment, often requiring significant time and capital commitment. The differing risk-return profiles mean that changes in one type of investment do not necessarily mirror changes in the other.

Global Economic Conditions

FPI is highly sensitive to global economic conditions, such as changes in interest rates, investor sentiment, and geopolitical risks. FPI investors tend to pull out of markets during times of economic uncertainty. FDI, however, is less affected by short-term economic shifts and is more dependent on long-term growth prospects, political stability, and infrastructure development. This fundamental difference in sensitivity to global conditions explains why FPI and FDI may not move in the same direction.

Market Perception

FPI is driven by market perceptions, investor confidence, and the desire for short-term returns. These investors are more concerned with immediate market conditions and liquidity than with the underlying health of the economy. FDI, however, is based on a broader assessment of a country's economic fundamentals and growth prospects over the long term. As a result, the two types of investment react differently to changes in market perceptions.

Liquidity Differences

FPI is characterized by high liquidity, meaning investors can quickly buy or sell assets in response to changes in market conditions. This flexibility allows FPI to respond rapidly to short-term economic or market changes. FDI, on the other hand, involves long-term investments that are difficult to liquidate quickly, requiring significant commitment and a stable economic environment. These liquidity differences create separate dynamics for FPI and FDI, which can lead to weak correlation.

External vs. Domestic Influences

FPI is often driven by external factors, such as global market performance and international risk sentiment, as investors seek the best returns from foreign financial markets. FDI, however, is more influenced by domestic factors, including the country's political stability, legal framework, infrastructure, and growth prospects. Since these factors can vary independently, FPI and FDI may not respond to the same economic or political signals, further weakening the correlation between them.

7. Conclusions

Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) play distinct yet complementary roles in India's economy. While FPI is short-term and volatile, primarily boosting market liquidity, FDI is long-term, fostering industrial growth through capital formation, technology transfer, and job creation.

The weak correlation between FPI and FDI (Pearson coefficient of 0.082, p-value of 0.691) suggests they are driven by separate factors and operate independently. .

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