TOPIC OF THE WEEK

APR'18 (19 to 25)

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Week: 19th to 25th April 2018

Topic: Foreign Portfolio Investment - FPI

Foreign portfolio investment (FPI) consists of securities and other financial assets passively held by foreign investors. It does not provide the investor with direct ownership of financial assets and is relatively liquid depending on the volatility of the market. Foreign portfolio investment differs from foreign direct investment (FDI), in which a domestic company runs a foreign firm, because although FDI allows a company to maintain better control over the firm held abroad, it may face more difficulty selling the firm at a premium price in the future.

BREAKING DOWN 'Foreign Portfolio Investment - FPI'

FPI is part of a country's capital account and shown on its balance of payments (BOP). The BOP measures the amount of money flowing from one country to other countries over one monetary year. It includes the country's capital investments, monetary transfers, and the list of exports and imports of goods and services.

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Differences between FPI and FDI

FPI lets an investor purchase stocks, bonds or other financial assets in a foreign country. Because the investor does not actively manage the investments or the companies that issue the investments, he does not have control over the securities or the business. However, since the investor’s goal is to create a quick return on his money, FPI is more liquid and less risky than FDI.

In contrast, FDI lets an investor purchase a direct business interest in a foreign country. For example, an investor living in New York purchases a warehouse in Berlin so a German company can expand its operations. The investor’s goal is to create a long-term income stream while helping the company increase its profits.

The investor controls his monetary investments and actively manages the company into which he puts money. He helps build the business and waits to see his return on investment (ROI). However, because the investor's money is tied up in a company, he faces less liquidity and more risk when trying to sell his interest.

The investor also faces currency exchange risk, which may decrease the value of his investment when converted from the country's currency to U.S. dollars, and political risk, which may make the foreign economy and his investment amount volatile.

Example of Foreign Portfolio Investment

In June 2016, the United States received approximately 84% of total remittances, which was the majority of outflows for FPI. The United Kingdom, Singapore, Hong Kong and Luxembourg rounded out the top five countries receiving FPI, with approximately 81% of the combined share. Net inflows from all countries were $451 million. Outflows were approximately $1.3 billion. Approximately 84% of investments were in Philippine Stock Exchange-listed securities pertaining to property companies, holding firms, banks, telecommunication companies, food, beverage and tobacco companies.

FPI Investment Limit in Government Securities Hiked (India)

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- In a move that could temporarily soften bond yields, the Reserve Bank of India, in consultation with the Government, hiked the foreign portfolio investors (FPI) investment limit in Central government securities (G-Sec) from 5% of outstanding stock now to 5.5% in FY 2019 and 6% in FY 2020.
- The hike comes in the wake of 99.31% of the upper FII investment limit in G-Secs of Rs1, 91,300 crore getting utilized.
- The FPI investment in State Development Loans (SDLs) has been left unchanged at 2% of outstanding stock of securities

Challenges:

1. Political Risk represented by the possibility of change in the political environment resulting in change in investment norms and repatriation regulations.
2. Emerging markets which are the beneficiaries of most FPI traditionally suffer from low retail participation which results in inadequate liquidity which results in price volatility.
3. Due to the unpredictable nature of such funds there is a tendency to shift from one market to another at

short intervals. Volatility arising out of FPI inflows and outflows has adverse effects on the host country economy.

4. Emerging economics tend to have depreciation prone currencies. This exposes the foreign investor to exchange rate risk on both principal and returns.

Benefits and Future of FPI:

Portfolio Diversification:

Foreign portfolio investment gives investors an opportunity to engage in international diversification of portfolio assets, which in turn helps achieve a higher risk-adjusted return. The global stock market operates in such a way that the factors that drive the London Stock Exchange at any given time are different from those that prevail in Taiwan, for example. This means that an investor who has stocks in different countries will experience less volatility over the entire portfolio.

International Credit:

Investors who have foreign investment portfolios have a broader credit base because they can access credit in foreign countries where they have significant investments. This is advantageous when credit sources available at home are expensive or unavailable due to various factors. The ability to get credit on favorable terms and as quickly as possible can determine whether a business executes a new project or not.

Benefit from Exchange Rate:

International currency exchange rates keep changing. Sometimes the currency of the investor's home country may be strong, and sometimes it may be weak. There are times when a stronger currency in the foreign country where an investor has a portfolio may benefit the investor.

Access to a Bigger Market:

Home markets in the United States have become very competitive, as there are many businesses offering similar services. Foreign markets, however, offer a less competitive and sometimes larger market. A business may make more sales selling shoes in one African country than in the entire U.S., for instance.

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Suggested Reading:

- ✓ http://www.bms.co.in/what-are-the-advantages-and-disadvantages-of-fpi/
- ✓ https://www.investopedia.com/terms/f/foreign-portfolio-investment-fpi.asp
- ✓ https://www.investopedia.com/ask/answers/061515/what-are-advantages-foreign-portfolio-investment.asp
- ✓ https://economictimes.indiatimes.com/markets/stocks/news/fpi-entry-to-help-deepen-rate-futures-market/articleshow/63143868.cms
- ✓ https://www.indianeconomy.net/splclassroom/what-is-foreign-portfolio-investment-fpi-who-is-a-foreign-portfolio-investor/