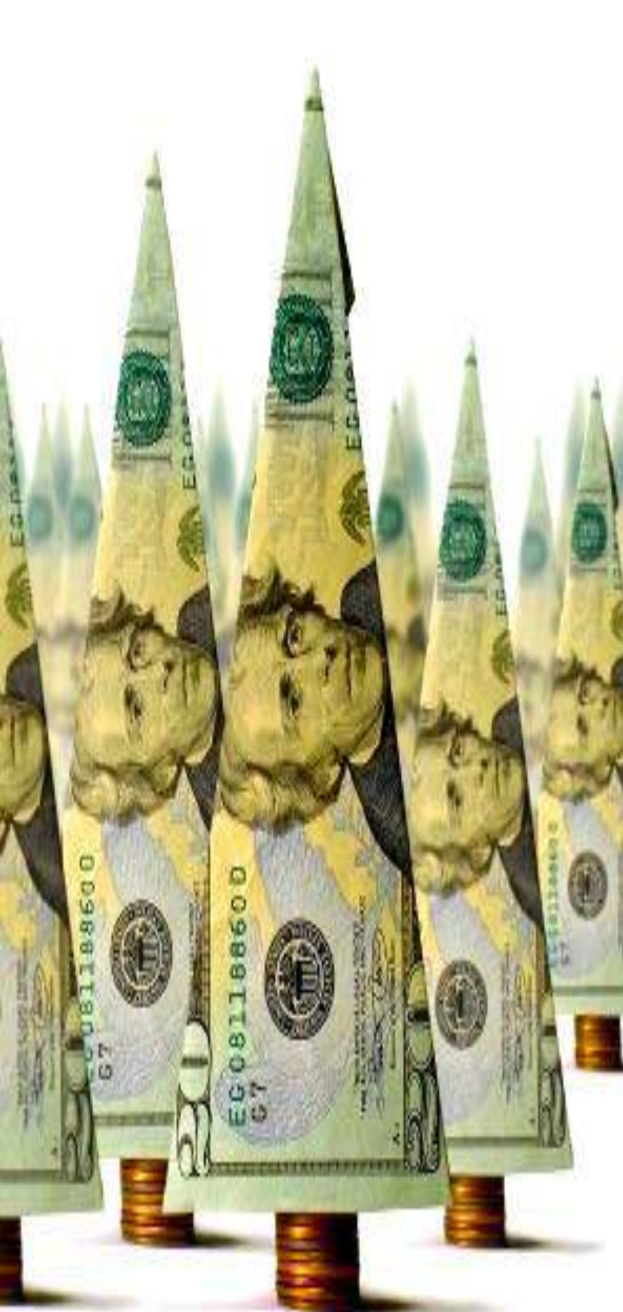

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FOREIGN PORTFOLIO INVESTMENT (*FPI*)

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FPI

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Foreign Portfolio Investment

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- **FPI** denotes all those investors or investment companies that are not located within the territory of the country in which they are investing.
- In economics **FPI** is the entry of funds into a country where foreigners make purchases in the country’s stock and bond markets, sometimes for speculation

- FPI is positively influenced by high rates of return and reduction of risk through geographic diversification. The return on FPI is normally in the form of interest payments or non-voting dividends.
- FPI is presently includes foreign pension funds, mutual funds, charitable/endowment funds etc. as well as asset management companies and other money managers operating on their behalf.

- It is the passive holding of securities such as foreign stocks, bonds, or other financial assets ,none of which entails active management or control of the securities issued by the investor.
- Select an optimal portfolio where the risk- return trade-off is optimal .
- Any FII or QFI who holds a valid certificate issued by DPs' shall be deemed to be a FPI till the expiry of the block of 3 years

Eligibility Criteria

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The Applicant being

- Person not resident in India
- Resident of country whose security Market regulator is signatory either to IOSC MMOU or Bilateral MOU with the Board
- A Bank , a resident of country whose central bank is a member of bank for International settlements
- Not a NRI
- Legally permitted to invest in securities outside the country of its incorporation or establishment or place of business

- Authorized by its MOA and AOA or equivalent doc or agreement to invest in its own behalf or on behalf of its client
- Sufficient Experience, Good track record, professionally competent , financially sound and has a good reputation of fairness & Integrity
- The grant of certificate to the applicant is in the interes of the development of the securities market
- Criteria specified in Schedule II of SEBI(Intermediaries)Regulations 2008
- Any other criteria specified by the board from time to time

Categories of FPI

Category I

- Central Banks
- Govt Agencies
- Sovereign wealth funds
- International or multilateral organisations or agencies

Category II

- Broad based funds such as Mutual funds, Investment trusts, Insurance/ Reinsurance companies
- Persons such as Banks, AMC, Investment Managers/ Advisors , Portfolio Managers

- Broad based funds which are not appropriately regulated but whose Investment managers does, provided he is itself registered as FPI and shall be responsible and liable for all the acts.
- University funds and Pension funds
- University related endowments already registered with the board as FIIs or sub accounts.

Categories III

- FPI All others than category I & II such as endowments, charitable societies/Trusts, foundations, corporate bodies, trust, individuals and family offices

Starting Up

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- In 1992, India opened up its economy and allowed foreign portfolio investment in its domestic stock market

- Since then ,FPI has emerged as a major source of private capital inflow in our country

Optimum Portfolio

- There is a balance between risk and return.
- Return is maximum with a given level of risk or risk is minimum with a given level of return.

Measurement Of Risk

- Risk is measured by the dispersion of alternative returns around the average/expected return.
- Expected return is based on probability.

- Expected value,

$$\bar{A} = P_1A_1 + P_2A_2 + \ldots\ldots\ldots\ldots + P_nA_n$$

P= Probability

A= Actual return

Example :1

There is
- 40% probability for $ 300 return
- 20% probability for $ 500 return
- 40% probability for $ 800 return

$\bar{A}$ = 0.4*300 + 0.2*500 + 0.4*800 = $ 540

- Dispersion from the expected value is measured in terms of standard deviation.

Example : 2

Variance = $0.4(300-540)^2 + 0.2(500-540)^2 + 0.4(800-540)^2$

SD (σ) = 224.5

Total Risk= Systematic Risk + Unsystematic Risk

Measurement of Return

- The portfolio return is the weighted average of the expected return from different securities existing in the portfolio.

Portfolio Return

$$R_p = R_A W_A + R_B W_B$$

R = Return

W = Relative share of investment

A&B = Two securities

Advantage of FPI

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- Enhanced flows of equity capital
- FIIs have a greater appetite for equity than debt.. It improve capital structures.
- Managing uncertainty and controlling risks.
- FPI inflows help in financial innovation and development of hedging instruments.
- Improving capital markets.

- FPIs as professional bodies of asset managers and financial analysts enhance competition and efficiency of financial markets.
- FPIs can help in the process of economic development and improve corporate governance.

How FPI flow can help an economy?

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Foreign Portfolio Investment

Share Prices Up

Liquidity Up

Cost of Issuing down

Capital becomes cheaper.
Listed firms issue more stock
New listings.

More Equity issued.

More Supply, Liquidity, Demand,

Local demand increases.

Foreign demand also increases due to improved access.

More Players and Efficiency Encourages:
a. intermediaries, brokers and underwriters.
b. buyers, mutual funds, insurance companies and individuals.
c. issuers: additional equity issues.

FDI versus FPI

FDI	FPI
1. It is long-term investment	1. It is generally short-term investment
2. Investment in physical assets	2. Investment in financial assets
3. Aim is to increase enterprise capacity or productivity or change management control	3.Aim is to increase capital availability
4. Leads to technology transfer, access to markets and management inputs	4. FPI results in only capital inflows

5. FDI flows into the primary market	5. FPI flows into the secondary market
6. Entry and exit is relatively difficult	6. Entry and exit is relatively easy
7. FDI is eligible for profits of the company	7. FPI is eligible for capital gain
8. Does not tend be speculative	8. Tends to be speculative
9. Direct impact on employment of labour and wages	9. No direct impact on employment of labour and wages
10. Abiding interest in management.	10 Fleeting interest in management.

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Regulations regarding Portfolio Investment by FIIs

- RBI has granted permission to SEBI registered (FIIs) invest in India under Portfolio investment scheme.
- All FIIs and their sub-accounts taken together cannot acquire more than 24% of the paid up capital of an Indian economy

Regulations regarding Portfolio Investments by NRIs/PIOs

- NRIs/PIOs can purchase/ sell shares / convertible debentures of Indian companies on stock exchanges.
- An NRI or PIO can purchase shares upto 5% of the paid up capital of Indian company.
- All NRIs/PIOs taken together cannot purchase more than 10% of the paid up value of the company.

Regulations regarding Foreign venture Capital investment

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- A foreign venture capital investor may make investment in a venture capital fund for an Indian venture capital undertaking as per the terms and condition of SEBI.

American Depository Receipt (ADR)

- A negotiable certificate issued by a U.S. bank representing a specified number of shares (or one share) in a foreign stock that is traded on a U.S. exchange.
- ADRs are denominated in U.S. dollars, with the underlying security held by a U.S. financial institution overseas.
- ADRs help to reduce administration and duty costs that would otherwise be levied on each transaction.

GDR (Global Depository Receipt)

A **global depository receipt** (**GDR**), also known as **international depository receipt** (**IDR**), is a certificate issued by a depository bank, which purchases shares of foreign companies and deposits it on the account. They are the global equivalent of the original American depository receipts (ADR) on which they are based.

Characteristics of GDR

- It is an unsecured security
- It may be converted into number of shares
- Interest and redemption price is public in foreign agency
- It is listed and traded in the stock exchange

Conclusion

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- FPI does not involve the control of foreign enterprise . Rather , the purpose of the investor is to maximize risk-adjusted return.

- Select an optimal portfolio that gives the maximum return with a given level of risk or carries minimum of risk with a given level of return.

- The optimal international portfolio represents a situation where the risk-adjusted return on the international portfolio is greater than the risk- adjusted return on the domestic portfolio alone by the greatest amount.

Thank You