Foreign Portfolio Investment (FPI)

Meaning

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.

Foreign portfolio investment 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 number of exports and imports of goods and services.

Advantages of FPI

1. There is a substantial increase in the secondary market depth and breadth due to the presence of such investors.

2. The Capital Market acquires an institutional character since global liquidity is channelled into local markets in a planned manner through research and analytical studies. These funds transiate into diversified investments against predefined risk parameters.

3. These investments increase demand for the shares of target companies thereby increasing their PE Ratios. This helps such companies to raise capital at lower cost.

4. International investors are provided with an avenue for investment diversification, wealth protection and at a macro level an opportunity for cross country hedging in terms of currencies, industries and geographical locations.

5. The growth in FPI in recent years can be attributed to better investor protection regulations in developing countries, liberalization in the terms of access to such markets and better macro-economic fundamentals of emerging economies.

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6. They provide a buffer for financing the Balance of Payments deficits thereby helping to preserve the foreign currency reserves of the host entry.

Disadvantages of FPI

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.

What is Foreign Direct Investment (FDI)?

FDI is investment by non-resident entities like MNCs to carryout business operations in India with management of investment, production of goods or services, employing people and marketing their products. In FDI, both the ownership and control of the firm is with the investor. The foreign investor usually takes a considerable stake or shareholding in the company and exerts management influences completely or partially, depending on his shareholding.

Differences between FDI and FPI

While both FDI and FPI involve putting money into a foreign country, the two investment options differ considerably. Following are some of the key differences between these two:

Parameters	FDI	FPI

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Definition	FDI refers to the investment made by foreign investors to obtain a substantial interest in the enterprise located in a different country.	FPI refers to investing in the financial assets of a foreign country, such as stocks or bonds available on an exchange.
Role of investors	Active Investor	Passive Investor
Type	Direct Investment	Indirect Investment
Degree of control	High Control	Very low control
Term	Long term investment	Short term investment
Management of Projects	Efficient	Comparatively less efficient
Investment has done on	Physical assets of the foreign country	Financial assets of the foreign country
Entry and exit	Difficult	Relatively easy
Leads to	Transfer of funds, technology, and other resources to the foreign country	Capital inflows to the foreign country
Risks Involved	Stable	Volatile