

The reality behind falling net FDI

India's net FDI has declined sharply despite strong gross inflows, underlining the impact of disinvestment/capital repatriation; investor classes, modes of entry, and exit strategies can have important implications for technology transfer, industrial development, and external sustainability

ECONOMIC NOTES

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India's net foreign direct investment (FDI) has declined drastically in recent years. Critics see the weak net flows as a sign of weakness, while the Chief Economic Adviser points to the large inflows and rising manufacturing FDI as evidence of strength. He links weak net flows to profit repatriation and outward investment by Indian companies.

However, this debate overlooks a major issue. By focusing on overall numbers, both sides ignore the changing composition of international capital and the Balance of Payments (BoP) mechanisms that govern inflows and outflows.

For BoP purposes, net FDI is calculated as the difference between inflows and outflows after adjusting for the repatriation of capital. From the peak of \$44.0 billion in 2020-21, net FDI fell to less than \$1 billion in 2024-25. It recovered to \$7.6 billion in 2025-26. The corresponding gross inflow was \$94.6 billion.

It is necessary to note that India's liberal FDI policy, introduced in 1991, initially emphasised technology acquisition, export promotion, and foreign exchange conservation. Over time, policy increasingly prioritised attracting larger inflows, while concerns regarding future external payment obligations and investment quality receded.

Three types of FDI

FDI is often viewed as a uniform, long-term commitment that brings technology and management skills to the host country. FDI can fall into three different investor classes, each with distinct capabilities, strategies, and exit timelines.

The first category is real FDI (RFDI), consisting of traditional multinational enterprises with the technology, brands, and capabilities to establish production and services. These generally represent long-term commitments.

The second category comprises financial investors, including private equity funds, venture capital firms, sovereign wealth funds, and asset managers. Their main goal is capital growth and planned exits.

The third category includes diaspora investments and special purpose vehicles (SPVs). These involve capital raised abroad and funneled through offshore financial centres, sometimes including the round-tripping of Indian funds.

Data on remittance-level FDI from the past four years, from 2022-23 to 2025-26 up to December, show that RFDI made up 41.9% of "effective inflows." Financial investors followed closely with a 40.5% share, while the remaining 17.6% came from the diaspora and SPVs linked to India.

The business model of financial investors suggests future exits that result in large-scale capital repatriations. A notable example occurred in 2025 when Singapore's Temasek exited Schneider Electric India Ltd., earning \$6.4 billion on an investment of \$637 million made in 2020. Total recorded divestment in CY 2025 was \$52 billion, with 45 major foreign private equity and venture capital exits accounting for \$29 billion in outflows.

Based on an analysis of effective



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inflows, FDI in India's manufacturing sector has declined across three consecutive four-year periods. Most notably, RFDI into manufacturing accounted for only 10.6% of total effective inflows during the most recent four-year period.

Not fresh capital

A major blind spot in gross FDI figures is the mixing of new capital injections with corporate accounting changes, such as intra-group ownership reorganisations, mergers, share swaps, and the conversion of earlier non-equity instruments such as external commercial borrowings (ECBs) and convertible debentures.

While capital structures change, no new capital flows into the country. Approximately \$40 billion of the \$560 billion in equity inflows to India from 2014-15 to 2025-26 (up to December) fall into this category. Large transactions, such as Bosch and Meesho Technologies, can skew annual inflow and sectoral trends.

Disinvestment drives decline

Before looking at why net FDI is low or even negative in certain months, it is worth mentioning that the official narrative that profit repatriation depresses net FDI is misleading.

Under BoP conventions, profits sent as dividends are recorded as investment income in the current account. They increase the current account deficit (CAD) but do not change the reported net FDI flows. Instead, the primary reason for weak net FDI is disinvestment and capital repatriation, which appear in the financial account.

Likewise, the increase in Outward Foreign Direct Investment (OFDI) warrants closer examination rather than being attributed solely to corporate maturity. From 2023-24 to 2025-26, 45% of India's total outbound investment of

\$65 billion went into the "financial, insurance, and business services" (FIB) sector. Singapore and the UAE accounted for 27% and 11% of the total, respectively. These funds mostly go to holding companies and SPVs rather than directly to operational entities. For instance, TML Commercial Vehicles, a subsidiary of Tata Motors, invested \$405 million in a Singaporean FIB entity to acquire the IVECO Group in Italy.

Capital movements through the GIFT City further complicate this issue. OFDI to the City increased from \$246 million in 2023-24 to \$1.18 billion in 2025-26. Total OFDI and inward FDI through it until 2025-26 reached \$2.35 billion and \$1.40 billion, respectively, highlighting the growing two-way flows.

These cross-flow of investments by Indian entities, also from other locations, indicates that OFDI can represent both genuine corporate expansion and the return of capital that fled. Therefore, increasing OFDI may not necessarily indicate maturity, as Indian companies might seek resources and technology, while a few might recycle capital through different jurisdictions.

Understanding the outflow channels

From 2022-23 to 2025-26, total FDI inflows and related current and capital account outflows reached significant levels. While gross inward equity FDI totalled \$317.80 billion (\$230.60 billion excluding reinvested earnings), the outflows present a more complex scenario.

Disinvestment and capital repatriation (capital account) totalled \$178.9 billion, primarily driven by financial investors through secondary and strategic sales, IPO exits, and share buybacks. This also includes "offers for sale" by foreign promoters such as Hyundai and LG. The other type involves sell-offs by RFDI investors, such as Wistron which sold off to the Tatas.

Dividend remittances (current account) amounted to \$118.9 billion in profits paid out by MNE subsidiaries and affiliates, excluding reinvested earnings.

Attributable IPR payments (current account) totalled \$46.6 billion. These payments, made by MNE subsidiaries and affiliates for intellectual property (assuming they account for 75% of total IPR payments), can substitute dividends.

Additionally, \$250.0 billion was transferred by all entities for technical/service/consultancy payments. However, it is difficult to divide this amount between RFDI and domestic companies.

Even when excluding OFDI and technical service payments, outflows due to disinvestment, dividends, and IPR payments (royalties) totalled \$344.4 billion. Therefore, for every dollar of fresh inflow (excluding reinvested earnings), approximately \$1.50 flowed out. This situation has worsened over the past 12 years. The corresponding outflow per dollar entered was 56 cents from 2014-15 to 2017-18, rising to 70 cents from 2018-19 to 2021-22, before reaching the current high.

Need for informed debate

The above narrative shows how an incomplete view of FDI prevails in the public discourse. Different types of investors, entry methods, and exit strategies impact technology transfer, industrial growth, and external sustainability. The reporting of global FDI flows adds an additional layer of problems. Understanding these nuances is crucial for evaluating FDI beyond headline numbers.

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THE GIST

Real FDI accounted for 41.9% of effective inflows between 2022-23 and 2025-26, while financial investors contributed 40.5%, reflecting the growing role of private equity, venture capital, and sovereign wealth funds.

Real FDI into manufacturing has declined across three consecutive four-year periods, with manufacturing receiving only 10.6% of total effective inflows in the latest period.

Gross FDI figures include transactions such as intra-group ownership reorganisations, mergers, share swaps, and conversion of external commercial borrowings, even when no fresh capital enters the country.