

Cracks in FDI architecture

Most money is coming from financial investors, and in services



The crucial issue related to foreign direct investment (FDI) is the design, rather the architecture of the fast-rising and high outflows. An analysis shows that the imbalance between inflows and outflows is not due to a single policy error or a sudden loss of investor confidence. It reflects deeper structural shifts linked to the nature of FDI, India's liberalisation trajectory, and evolving character of global capital. Several factors contribute to the existing trends and patterns, which include disinvestments by the Indian state and foreigners.

A leading factor to the large outgo of FDI lies in the inflows. Since the mid-2000s, the composition of foreign investors has changed. A growing share of ownership is by global financial investors like private equity and hedge funds, which generally operate with defined exits, and seek multiple-fold returns within short timeframes. The major exceptions are sovereign wealth funds and pension funds, who may have a longer-term view on investments. Since India opened infrastructure sectors, the financial investors slowly gained over MNCs.

Our earlier estimates for the period between 2005-06 and 2013-14 suggest that financial investors accounted for 26.9 per cent of the inflows compared to 47.8 per cent by the MNCs. At 58.2 per cent, the share of financial investors was the highest in construction and real estate. According to our ongoing study, between 2014-15 and 2018-19, the share of financial investors in equity inflows was 29.2 per cent compared to the MNCs' share of 58.9 per cent. Hence, the MNCs became more dominant in the 2000s and 2010s.

However, over the next five years, 2019-20 to 2023-24, the financial investors, with a share of 44.9 per cent, left the MNCs (41.4 per cent) behind. More importantly, the former's share in non-manufacturing activities jumped from 33 per cent to 47 per cent in the second half of the decade. This changing nature implies that the incoming investments were more likely to culminate in exits, and sizable repatriations, both due to the mindset and thinking of financial investors, and their penchant for non-manufacturing segments.

The next big draft for the outgo is dividends paid by the payments by foreign subsidiaries and associates in India to overseas parents, and other investors. Between 2021-22 and 2024-25, this figure (excluding reinvested earnings) jumped from \$17.6 billion to \$33.1 billion. Reinvested earnings remained stable at around \$20 billion, which suggests that the

foreign investors prefer to remit dividends rather than retain them in India. In other words, they do not reinvest much.

In a short span of four years, royalty payments almost doubled from \$9 billion in 2021-22 to \$17.3 billion in 2024-25, or a cumulative figure of \$51.9 billion, most of which was paid to foreign parents and affiliates. According to the Reserve Bank of India's Survey of Foreign Collaboration, royalties or royalties-cum-technical fees were the most preferred form of payments for technology in foreign collaborations. Most partnerships are between the subsidiaries and affiliates. Unaffiliated firms account for 28 out of the 255 collaborations.

Evidence suggests that the bulk of payments originate from foreign-affiliated entities. In some cases, royalties function as intra-group transfer mechanisms to supplement dividend remittances. Thus, combining dividends and royalties may provide a better picture of the MNCs' returns on investments (ROIs) rather than a comparison with dividends. In fact, ROI will be better captured by combining the capital gains part of the overall annual and regular repatriations.

In the recent past, large MNCs such as

Hyundai Motor India, Orkla India, and LG Electronics listed the shares on the Indian stock exchanges, and the foreign parents sold a part of their holdings through the offer-for-sale (OFS) route. When this happens in IPOs (Initial Public Offerings), the proceeds go abroad, and not to the Indian subsidiaries. Only the ownership changes. A portion of the sold stakes of the foreign owners may be purchased by foreign portfolio investors.

Another factor for the FDI outflows is the complete exit (not a part sale through OFS) of MNCs from the Indian subsidiaries. For example, the Tata Group took over Wistron from its foreign shareholders for \$128 million in early 2024. Other exits include Daiichi Sankyo, Citibank (consumer banking business), Akzo Nobel, Thyssenkrupp Electrical Steel, and Metro. If such deals involve overseas share transfers, as in the case of Holcim-Ambuja one, they are not reflected in FDI outflows. But if the transactions happen in India, they do.

Internal restructuring of the ownership patterns, as opposed to OFS and complete sellout, may result in simultaneous outgoes and inflows of FDI. This includes cases when, within MNC groups, one of the MNCs sells, and other arms buys. Both transactions

match each other. While we are not sure how these are treated in the statistics, there is a possibility that they may inflate inflows and repatriations.

But as mentioned in yesterday's column, India faces a paradox. While the developed nations resort to technology protectionism, India largely counts the quantum of FDI inflows. The external account reflects the claims generated by the past inflows. This may be described as an emerging FDI trap. For every dollar that enters, multiple streams of payments gradually emerge over time, which reduce the contribution to the national savings. Such concerns were flagged repeatedly. Since a large component of incoming FDI is in the services sector, and by financial investors, most of it cannot directly generate surpluses on the trade front. But policy favours maximising inflows over long-term balance.

The Economic Survey (2025-26) adopts a pragmatic tone. It states that India "depends on foreign capital flows to maintain a healthy balance of payments," and candidly admits that "when they run drier, rupee stability becomes a casualty." It notes that a nation that runs persistent current account deficits, and depends on foreign savings must pay a risk premium to global capital. This is a significant shift. It is a rare case when official thinking recognises that external capital is a supplement, not a substitute, for domestic resource mobilisation.

More importantly, the Survey points towards the real solution, which is to transform India into a surplus-generating economy, and strengthen domestic financial systems as a buffer against volatile global flows. Durable reduction in the cost of capital will come from correcting the savings-investments imbalance, and building manufacturing export capacity. The European Union's efforts to strengthen its financial markets aims to make it easier for firms to raise long-term capital within the continent. Resilience needs to be rooted in strong domestic savings, technological upgrading, and manufacturing. Openness is sustainable when it strengthens internal capacity. FDI is, of course, welcome.