

India's changing FDI story

In the last couple of months, we have seen large foreign direct investment (FDI) commitments into India by United States (US) technology giants in the artificial intelligence (AI) infrastructure domain. This has brought to the fore India's attractiveness as an FDI destination, especially for new-age sectors. In recent years, India has witnessed healthy gross FDI inflows across manufacturing and services. However, this has been accompanied by a sharp increase in the repatriation of profits and FDI outflows from India, resulting in a narrowing of net FDI flows.

Over the last five years, India's annual gross FDI inflows hovered between \$70 and \$85 billion, recording a compound annual growth rate of only around 2 per cent. However, the momentum has picked up, with gross FDI inflows surging by 18 per cent in FY25 and by 16 per cent in H1 FY26. Large domestic market, abundant skilled workforce, and steady economic growth have positioned India as an attractive investment destination among emerging markets. India has witnessed strong FDI in sectors such as semiconductors, electronics and electrical equipment, electric vehicle (EV) components, basic metals, and digital industries such as Cloud services and data centres.

Worldwide, cross-border FDI has been shrinking amid rising geopolitical tensions and growing concerns over supply-chain resilience. The ratio of global FDI flows to global GDP has dropped to 1.5 per cent post-pandemic (2020-2024) from an average of 2.7 per cent between 2010 and 2019. Moreover, over the past decade, the composition of global FDI is shifting, with Europe's share in outbound FDI declining and the US share remaining stagnant. However, there has been a sharp increase in China's share in FDI outflows. The decline in the share of Western economies in global FDI

flows has weighed on India, as these nations have traditionally been key sources of investment inflows into the country. In terms of inbound FDI, countries such as Vietnam and Mexico, along with resource-rich nations in Africa, have experienced significant growth.

While India has been facing tough competition from some smaller economies in attracting FDI, our assessment shows that the average risk-adjusted return on FDI investment in India remains quite attractive. We have estimated returns on inward FDI as the ratio of FDI equity income receipts to the total inward FDI stock, with a time lag (inspired by OECD

and Eurostat methodologies). The risk-adjusted return has been calculated as the ratio of the 10-year average return to its standard deviation. Our assessment indicates that the average risk-adjusted return on FDI investment in India over the past 10 years is around 7.3 per cent, ranking second only to Indonesia (10.6 per cent). The risk-adjusted returns for other emerging economies are 6.6 per cent for Mexico, 4.5 per cent for South Africa, and 4.3 per cent for the Philippines, according to our assessment.

Interestingly, while gross inflows to India have increased, there has been a sharp increase in profit repatriation and FDI outflows over the past two years, thereby weighing on the net FDI inflows. Net FDI flows (gross inflows - repatriation of profit - FDI outflows from India) have fallen from \$44 billion in FY20 to \$1 billion in FY25, and despite some improvement, the weakness has continued in FY26. Repatriation is not inherently negative as decisions to reinvest or remit profits reflect multinational firms' global strategies and capital allocation priorities.

Similarly, rising outward FDI is a sign of Indian companies expanding access to new markets and

technologies. Outward FDI investments have risen to an annual average of \$20 billion in the last three years from an average of \$8 billion in the pre-pandemic years (FY15-19).

According to the United Nations Conference on Trade and Development, there was a 20 per cent rise in greenfield project announcements by Indian investors in 2024. Indian companies are expanding their global footprint, especially in Europe, South America and Africa, investing across diverse industries such as telecommunications, automotive, mining, energy, defence, pharmaceuticals, ports and steel.

In a nutshell, the FDI narrative for India in recent years is that, even as capital is entering through gross FDI inflows, a significant portion is also exiting — either as repatriated profits or outbound investment — resulting in a narrowing of net FDI inflows. While inflows signal confidence in the opportunity provided by India, outflows reflect profit-taking and growing outward expansion by Indian firms. The steady expansion of Indian firms abroad underscores the evolution of India's global economic footprint, and this trend is likely to continue and gather further steam in the coming years.

Looking ahead, India needs to continue focusing on attracting stable and diversified FDI inflows. India's attractiveness as an FDI destination will be strengthened by continued reforms to its financial and regulatory frameworks and by a focus on improving infrastructure and reducing logistics costs.

Recent factor-market reforms — such as the introduction of the new and simplified labour Code — also represent a step in the right direction. Strengthening global economic linkages, broadening investment partnerships, and enhancing overall ease of doing business will be critical.

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The views are personal



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