

Much-needed clarity on FDI guidelines by the government

In the current environment of global uncertainty and volatile capital flows, foreign investment remains critical for India's growth trajectory. Both Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) play an important role in supporting capital formation, technology transfer and integration with global value chains.

Over the past decade, India has made significant progress in rationalising policies governing these flows. Today, most sectors allow up to 100% foreign ownership under the automatic route, reflecting the country's broader effort to simplify investment frameworks and attract global capital.

However, an important shift occurred in April 2020 when the Government of India introduced the Press Note 3 (PN3) framework. Under this policy, any foreign direct investment originating from countries that share a land border with India, or investments where the beneficial owner is situated in such countries, requires prior government approval. The measure was introduced at the height of the COVID-19 pandemic, when global markets were under severe stress, with the objective of preventing opportunistic acquisitions of Indian companies at depressed valuations.

While the policy objective was understandable, the approval requirement has had a noticeable impact on investment flows over time. FDI inflows directly from China and Hong Kong, for instance, declined from about USD 858 million in FY20 to approximately USD 84 million in FY25, with China's share of total FDI inflows falling to roughly 0.17%. FDI routed through other countries, taken together, would likely have had a much larger impact. The operational challenges of the PN3 framework have also become increasingly visible. As of the first quarter of FY26, a total of 526 investment proposals had been submitted under the regime. Of these, 124 were approved, 200 were rejected and 202 remain pending, with nearly 40% of the applications pending for more than twelve weeks. The resulting delays in capital infusion have, in some cases, led to restructuring of transactions and working capital pressures, particularly for startups and manufacturing companies that depend heavily on timely equity funding.

A major difficulty in implementing PN3 has been the lack of clarity around the definition of beneficial ownership. If beneficial ownership were interpreted to include even a single share held by an investor from a land-border country, the automatic route would effectively become non-automatic for a large number of transactions. Unsurprisingly, this led to differing interpretations across market participants, with the most conservative view being that even minimal shareholding could trigger the approval requirement. Another area of uncertainty related to whether the requirement should apply only to direct investments or also to indirect investments. In many private equity and venture capital structures, the direct investor is the General Partner entity, while the fund itself may have multiple Limited Partners located across different jurisdictions. This created ambiguity over whether the beneficial ownership test should apply only at the level of the investing entity or also extend to the underlying investors within the fund structure.

Recognising these challenges, the government has now moved to bring greater clarity and predictability to the framework. On 10 March 2026, the Cabinet approved amendments to the FDI policy aimed at facilitating investment flows while retaining appropriate screening safeguards, particularly to support startups, deep-tech sectors and manufacturing supply chains. A key element of the reform is the alignment of the definition and determination of beneficial ownership with the framework under the Prevention of Money Laundering Rules, 2005, which is widely recognised and already used by the investment community.

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Under the proposed approach, the beneficial ownership test will be applied at the level of the investor entity. Investments where beneficial ownership from land-border country investors is non-controlling and up to 10% may be permitted under the automatic route, subject to sectoral caps, entry routes and other applicable conditions. Such investments will also require mandatory disclosure and reporting by the investee entity to the Department for Promotion of Industry and Internal Trade to ensure transparency and regulatory oversight. This clarification is particularly important for investments routed through global private equity and venture capital funds, where minority participation from investors across several jurisdictions is common.

In addition, the government has proposed a time-bound approval mechanism for investments exceeding the 10% threshold in certain strategic sectors. A definitive approval timeline of 60 days has been proposed for investments involving manufacturing expansion and joint ventures in sectors such as capital goods manufacturing, electronic capital goods and components, and polysilicon and semiconductor inputs used in solar cells. As long as the majority shareholding and control of the Investee entity will be with resident Indian citizen(s) and/or resident Indian entity(ies) owned and controlled by resident Indian citizen(s), at all times. The list is currently indicative, with a detailed sectoral notification expected to follow.

These changes are expected to provide greater clarity and predictability for investors and Indian businesses alike. By reducing regulatory friction for low-risk minority investments linked to land-border country investors, the amendments could help revive investment flows routed through global funds while still preserving necessary safeguards. At the same time, faster approvals for critical manufacturing sectors could facilitate higher FDI inflows and technology transfer, particularly in capital-intensive industries and electronics supply chains.

In effect, the government appears to have struck a pragmatic balance between national security considerations and the need to ensure that India continues to remain an attractive destination for global capital. Clearer rules around beneficial ownership and approval timelines should help strengthen investor confidence while supporting domestic capacity expansion and deeper integration into global value chains.

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