FDI IN INDIAN DEFENSE SECTOR

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FOREIGN DIRECT INVETMENT

FDI refers to investment made by a person resident outside India:

- Into the equity instruments of an unlisted Indian company; or
- Into 10% or more of the post-issue paid-up equity capital (on a fully diluted basis) of a listed Indian company.

Investment below 10% in a listed company is typically classified as Foreign Portfolio Investment (FPI), not FDI.

EVOLUTION IN DEFENCE SECTOR

India's Foreign Direct Investment (FDI) policy framework in the defence sector has witnessed a remarkable transformation over the past two decades. It has progressed from a heavily restricted, public sector-dominated industry to a progressively liberalised investment regime. This evolution signifies a strategic realignment by India, aimed at achieving self-reliance in defence production while simultaneously addressing national security concerns and the imperative for advanced technology and capital inflows. The shift from absolute public sector control to permitting up to 100% foreign investment in select cases marks one of the most significant and decisive policy turnarounds in the history of India's economic liberalisation.

TIMELINE

Pre-2001:

- Defence manufacturing was an exclusive domain of the Public Sector — led by Ordnance Factory Board (OFB) and Defence Public Sector Undertakings (DPSUs). No private or foreign investment allowed.

2001 Breakthrough:

- → Private sector participation allowed.
- → FDI permitted up to 26% via Government Route, subject to strict licensing and national security conditions.

2013 Technological Gateway:

- → Press Note 6 of 2013 allowed FDI above 26% on a case-by-case basis for proposals bringing state-of-the-art technology.

2014 Expansion:

- → Press Note 7 of 2014 raised FDI composite cap to 49% via FIPB route.
- → Above 49% permitted with Cabinet Committee on Security (CCS) approval for projects with cutting-edge technology.

2016 Automatic Route Introduction:

- → Press Note 5 of 2016 allowed FDI up to 49% via Automatic Route (without government approval).
- → Above 49% continued under Government Route.

2020 Breakthrough Liberalisation:

- → Press Note 4 of 2020 raised automatic route limit to 74% for new industrial licensees.
- → FDI beyond 74% and up to 100% allowed via Government Route.
- → Part of the Atmanirbhar Bharat Abhiyan economic revival package.

First 100% FDI Approval (2022):

- → SAAB approved to set up a 100% foreign-owned manufacturing facility for rockets in India — establishing the practical application of the liberalised policy.

FDI Inflow Milestone:

- → Cumulative FDI inflow of over ₹5,077 crores as of 2024.
- → Post-2020 liberalisation has seen sharp acceleration in foreign investment in the sector.

Compliances for Defense sector under FDI Policy,2020

Regulatory bodies for approval

Items requiring Industrial Licence under the Industries (Development & Regulation) Act, 1951, and/or Arms Act, 1959 for which the powers have been delegated by Ministry of Home Affairs to DPIIT.

Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959.

For (1) Department of Defence Production, Ministry of Defence has the power to grant approval. For (2) Ministry of Home Affairs

Automatic Route

Automatic up to 74%; beyond 74% under the Government route if it leads to access to modern technology or other specified reasons.

Companies not seeking an industrial license or those already approved for FDI in defense

Up to 49% FDI:
Requires a declaration to the Ministry of Defence within 30 days if there is a change in shareholding or stake transfer.

Beyond 49% FDI:
Requires Government approval.

License applications

It will be reviewed by DPIIT (Ministry of Commerce & Industry) in consultation with the Ministry of Defence and Ministry of External Affairs.

Security Clearance

Foreign investment in the sector is subject to security clearance by the Ministry of Home Affairs and as per guidelines of the Ministry of Defence.

Self-Sufficiency Requirement:

Investee companies must be self-sufficient in product design & development

Must have maintenance & life-cycle support facilities in India

National Security Considerations:

Government reserves the right to review any foreign investment affecting national security

CHALLENGES

Disparate Treatment for Existing Licensees

In the defence sector, any increase in FDI up to 49% that results in a change in shareholding, including secondary transfers to new foreign investors or existing investors increasing their stake, must be reported to the Ministry of Defence. The term "change in shareholding" is broadly interpreted to include such scenarios. Furthermore, any FDI beyond 49% up to the revised limit of 74% requires prior government approval. As a result, the recent FDI amendments do not significantly ease the investment process for existing foreign investors under the automatic route.

Homogeneous Class

The current FDI rules treat defence manufacturing as a single category, despite its complexity. While 74% FDI under the automatic route may be suitable for areas like missiles and components, sectors like aerospace defence, which require high R&D and have high entry barriers, should allow 100% FDI to attract global players and proprietary technology.

Security Clearance Conundrum

Under the automatic route, foreign investors undergo security clearance only after investing, during the Arms Act licensing stage. A negative security report at this point can unwind the entire deal, discouraging foreign investment.

IMPACT

Post-reform, the defence sector reported FDI inflows worth ₹5,077 crore, reflecting growing interest from foreign investors.

Defence exports have grown significantly, rising from ₹686 crore in FY 2013-14 to ₹21,083 crore in FY 2023-24.

Two Defence Industrial Corridors—one in Tamil Nadu and another in Uttar Pradesh—have attracted significant investments (₹11,794 crore in Tamil Nadu alone by 2024), boosting regional development and manufacturing capacity.

India's domestic defence production reached a record ₹1.27 lakh crore in FY 2023-24, marking a 16.7% increase from the previous year.

Private sector contribution increased to 20.8% of total defence output.

Conclusion

FDI in defence should be viewed as an enabling tool rather than a solution in itself, and its success shouldn't be judged by the volume of inflows. Unlike other sectors, defence FDI is limited globally due to strategic concerns, and no country has achieved self-reliance in defence solely through foreign investment. While opening up the sector helps reduce entry barriers, India must focus on strengthening its indigenous capabilities and developing advanced technologies in-house to truly build a self-sufficient and robust defence industry.

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