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# The Role of FDI in India's Manufacturing Sector: Incentives, Opportunities, and Barriers

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## ABSTRACT

*This research paper explores the pivotal role of Foreign Direct Investment (FDI) in the growth and transformation of India's manufacturing sector, with a focus on recent trends, challenges, and future opportunities. It highlights the positive impact of FDI facilitated by government policies, including the "Make in India" initiative, which aims to boost the country's manufacturing capabilities and position it as a global hub. The study underscores the significant contributions of FDI to enhancing production capacity, technological advancements, and job creation. However, it also identifies key challenges, such as regulatory hurdles and inadequate infrastructure, that continue to limit the sector's full potential. In the context of recent global economic shifts, including the impacts of the COVID-19 pandemic and evolving trade policies, the paper examines how these factors influence FDI inflows and the strategic positioning of India's manufacturing industry. According to recent data from the Reserve Bank of India, FDI inflows into the manufacturing sector increased by 15%, making it the highest ever, in the fiscal year 2021-2022, reflecting the sector's expansion and continued attractiveness. The paper concludes with recommendations for policy reforms aimed at creating a more conducive environment for FDI, essential for the sustained growth and competitiveness of India's manufacturing sector.*

**Keywords**: Foreign Direct Investment (FDI), Manufacturing Sector, Growth, Economy, Government Policies

## 1. Introduction

As an emerging economy, the government, driven by the desire to manage national resources optimally through a planning and approval process, introduced licensing requirements. Today,

  

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this industry makes up a staggering 16-17% of India's GDP and provides jobs to about 12% of the entire workforce. The essence of this sector can also be witnessed through its ripple effect where every job created in manufacturing leads to 2-3 more jobs in the service sector. Seeing the industry's promise, India's government, led by Prime Minister Narendra Modi, kicked off the "Make in India" (MII) program on September 25, 2014 with the aim to boost the manufacturing sector's share of GDP to 25%. MII is a broad campaign involving the attraction of investments across 25 key sectors, including electronics, cars, and medical supplies. It encourages joint efforts and new ideas and offers a plethora of opportunities for both local and overseas investors. Some of the key objectives of the program are to make the rules simpler, upgrade infrastructure, and offer incentives for domestic production. The Production Linked Incentive (PLI) scheme, for example, has played a key role in propelling local manufacturing in 13 sectors, where financial incentives are given to companies that produce in India.4 It's also expected to have a big impact on India's share of global manufacturing exports. This approach has especially been fruitful in electronics, as the country strives to become an important player on the world stage for manufacturing. In addition to government initiatives, Foreign Direct Investment (FDI) has also been an essential ingredient for the growth of India's manufacturing sector. Namely, from 2014 to 2023, FDI equity inflows into manufacturing went up significantly, most of which are captured by Maharashtra, Karnataka, and Gujarat due to their strategic locations, pro-business state policies, solid infrastructure, and skilled workforce, highlighting their entrepreneurial structure. Not to forget, Punjab and Haryana, who have consistently been mentioned as the bread baskets of the nations due to their richness in soil and land, creating a dynamic agricultural market. Not only did FDI help develop traditional sectors in the country, but led to new ideas and better technology. Given the current trend, India's manufacturing sector seems to offer a promising future with the continued reforms, global partnerships, and government initiatives. In addition to the sector's ability to create jobs, its ripple effect on the services sector shows how crucial this sector is for achieving widespread economic growth. Hence, as India keeps improving its standing as a global manufacturing center, this sector will be key to the country's economic progress and its aim to compete on the world stage.

## 2. Deregulation

Over time, the downside of the approval process was introduction of restrictive and non-competitive practices, dubbed as the license-permit raj. Acknowledging the inefficiencies in the planning and approval process, to allow for competitive pricing, reduce monopolies, inject technological innovation and improve manufacturing efficiencies the government decided to open the segment to global competition and investment. India’s manufacturing sector continues to struggle with complex regulations, poor infrastructure, and competition from lower-quality, low-cost domestic producers. Although these unorganized manufacturers often serve a different,

  

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more price-sensitive segment, the broader industry must improve product quality. Historically, factors like weak industry standards, unionized labor prioritizing quantity over quality, and less discerning local consumers led to higher rejection rates. The government is addressing these issues by easing FDI rules—most sectors now permit 100% FDI through the automatic route—encouraging investments that can drive modernization and competitiveness. However, improved quality also demands better skills and training. Expanding vocational institutions that teach advanced manufacturing techniques (like Six Sigma) and building a qualified talent pool can help India move up the value chain and produce higher-value products.

### 3. FDI Incentives in the Manufacturing Sector

There is no denying that FDI has been instrumental in the growth and modernization of India's manufacturing sector after India opened its economy in 1991. As mentioned earlier, prior to that, India's manufacturing scene had protective policies and depended largely on state-owned companies. The changes brought about by Prime Minister P.V. Narasimha Rao and Finance Minister Manmohan Singh at that time, however, opened doors to global investors leading to more FDI. These changes were not only catalysts for growth in manufacturing, but they also set the stage to advance technology, build infrastructure, and create new jobs. Projects such as MII and the PLI Scheme have pushed up FDI even more in manufacturing making India a rising global center for production. Namely, from 2000 to 2023, global investors allocated about $148.97 billion into Indian manufacturing, which went up by 55% between 2014 and 2023.[5] Most importantly, however, these investments have helped build up important industries such as automobiles, medicine production, electronics, and clean energy.

The automobile industry, for example, has grown at an enormous pace due to foreign investment. Renowned conglomerates such as Suzuki, Hyundai, and Ford have built large factories in India. Maruti Suzuki, a team-up between India's Maruti and Japan's Suzuki, shows how well foreign investment can work in this field. Maruti Suzuki now sells about 40% of all passenger cars in India making it a major player in the country's car market.[6] Along with offering quality products to people in India and promoting competition, Suzuki’s commitment to invest $1.4 billion in 2022 into Gujarat to propel electric cars production and batteries helps elevate India even further in the global electric car market.[7]

  

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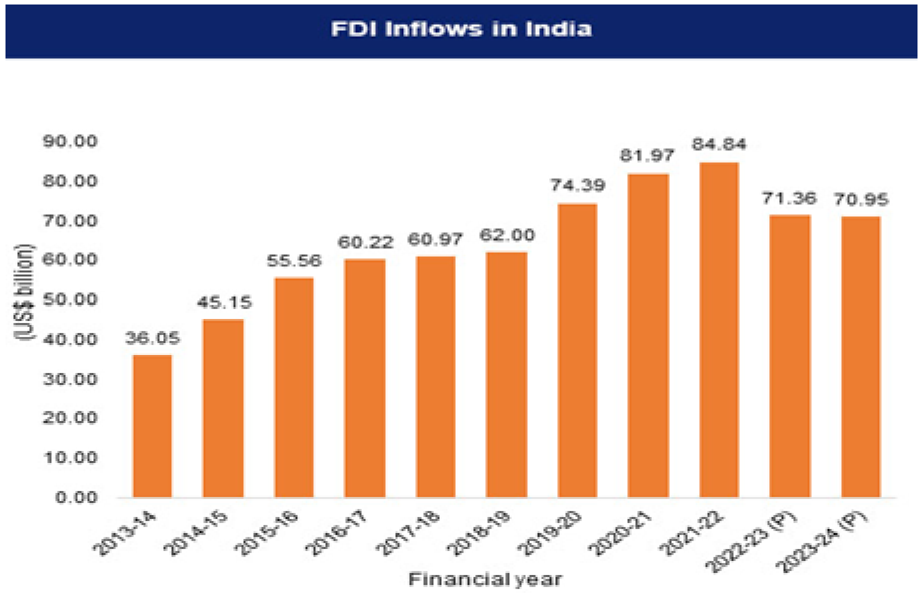


In addition to automobiles, India's drug industry has grown significantly through FDI. Great examples of that growth include names as Pfizer and AstraZeneca that have built factories in India. The outsourcing of production by these companies allows them to produce vaccines, drugs, and other medical supplies for use in India and to sell overseas at cheaper costs and favorable conditions. From 2000 to 2022, the pharmaceutical sector alone received close to $20

billion in foreign cash, which made up about 5-6% of all the money coming into the manufacturing industry.[8]In addition to contributing to India's manufacturing output, these investments and production that followed made the country one of the top exporters of medicine in the globe. Another important role of FDI has been the import of cutting-edge technology and know how from overseas companies to local producers through new production methods and automation to India's manufacturing sector. They have helped boost productivity, quality control, and cost-effectiveness in manufacturing. For example, Toyota and Honda have brought in top notch production methods like Just-in-Time and Lean Manufacturing. These approaches have cut production costs and boosted efficiency tremendously. The know-how these companies brought has allowed Indian manufacturers to go toe-to-toe with global competitors helping India export more. Also, Foxconn, one of the largest contract electronics makers, invested significantly in India to build mega-plants in Tamil Nadu and Andhra Pradesh. These facilities streamline production at a significantly higher pace and supply gadgets for tech giants like Apple and Xiaomi, giving jobs to over 25,000 people.[9]In addition, Foxconn's commitment of building a $500 million factory in the Indian state of Telangana further solidifies the technology and advanced know-how importation to the country. With the favorable conditions offered by

  

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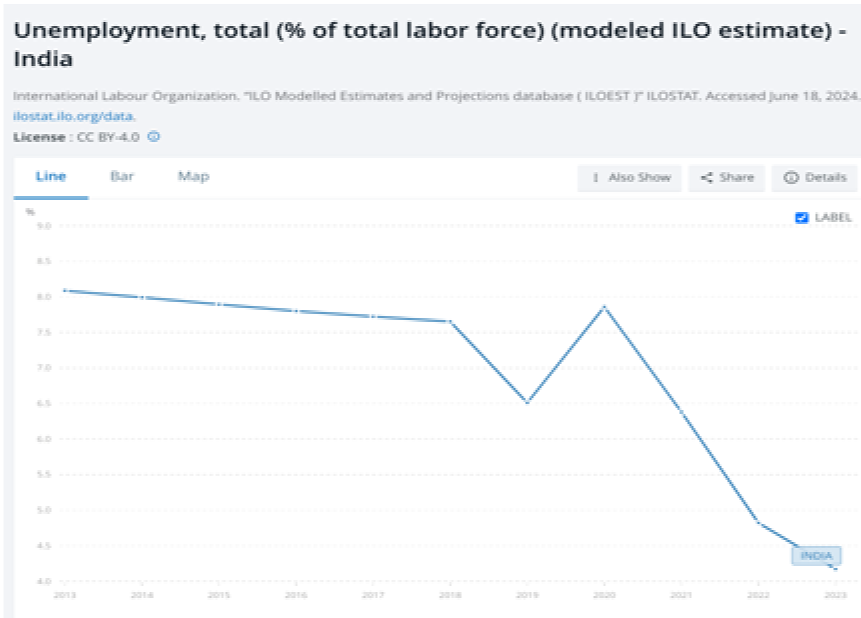
PLI schemes, therefore, India's consumer electronics exports shot up to $1 billion in 2023, a 100% jump from 2020.[10]




It's worth mentioning that some localities in India benefited tremendously from the inflow of FDI. Namely, Gujarat stands out as a top destination for foreign investment in manufacturing. Its prime location and many ports make it ideal for car, chemical, and green energy industries. Mundra Port, one of India's largest, helps global trade and allures foreign firms to set up their branches in India. Till now, global brands like Suzuki, Tata Motors, and Adani have invested immensely into Gujarat creating many jobs and boosting the local economy. Maharashtra is another area that received significant foreign attention. Namely, Mumbai, India's financial hub in Maharashtra, attracts FDI for drugs, electronics, and chemicals production. Pune, another key city in Maharashtra, has turned into a hotspot for car and tech companies, with Volkswagen, Mercedes-Benz, and Cognizant opening factories and offices there. Karnataka Bengaluru, has also gotten a fraction of foreign investment to become a world-class tech and electronics manufacturing center. Giants like Intel, Dell, and Bosch have built big factories and research centers in the city helping the state's economy grow and create more jobs.

FDI has played a key role in helping India's manufacturing sector grow and modernize. It has an influence on bringing in much-needed financial resources, cutting-edge technologies, and better infrastructure. Projects like Suzuki investing into Gujarat and Foxconn setting up electronics factories show how FDI can change regional and national economic growth. With programs like Make in India and the PLI Scheme still drawing in foreign money, India is in a good spot to become a global manufacturing center in the years ahead.

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### 3. Opportunities for FDI in the Manufacturing Sector

India's manufacturing sector has many new areas that offer promising opportunities for FDI. Renewable energy, electric vehicles, and advanced manufacturing are set to grow fast because of worldwide trends and support from local policies.

In the renewable energy sector, the country aims to fight climate change and cut down its use of non-renewable energy. Namely, India plans to generate 450 GW of renewable energy by 2030, which has drawn many foreign companies.[16] Total and Iberdrola, for example, stand out as investors in India's solar and wind energy projects helping the country move towards clean energy. The Ministry of New and Renewable Energy reports that in between 2020 - 2023, India pulled in USD 6.1 billion in FDI for renewable energy.[17] As more people want renewable energy, this opens doors for more cash inflow to make solar panels, wind turbines, and better batteries.

EVs represent another sector that has high potential in India. The Indian government's efforts to promote EV adoption and aim for 30% electric mobility by 2030 have created a favorable climate to attract foreign investment.[18] Global car makers like Tesla and Hyundai are interested in India's EV market, which is predicted to account for 40% of the total market by 2030.[19] This change will allow investors to direct their funds to battery production, EV part manufacturing, and charging stations. With India's expanding middle class and government incentives to buy EVs, this sector seems promising as pointed out by the Indian Brand Equity Foundation.

One substantial change that occurred is the lowering of the corporate tax rate to 15% for new companies. This rate is now one of the world's lowest tax rates, and for investors committed to manufacturing, this presents a great opportunity. In addition, in 2017, India brought in the Goods and Services Tax (GST), which allows investors to do business across different states in India and diversify investment plans.[20]

The creation of Special Economic Zones (SEZs) has played a key role in drawing FDI. These areas give perks like tax breaks, duty-free imports, and cheaper infrastructure to entice foreign firms to build factories. For example, the Mundra SEZ in Gujarat has pulled in $7.3 billion in FDI in the fiscal year 2023-24 into fields such as chemicals, cars, and clean energy.[21] The Reserve Bank of India also reports that SEZs made up 30% of India's total exports in 2021 showing how crucial they are as centers for foreign manufacturing companies. [22]

Recent global events showed that geopolitical changes and supply chain diversifications have an impact on FDI inflow into India's manufacturing area. Namely, COVID-19 highlighted the dangers of putting too much reliance on one manufacturing center, China, leading global firms

  

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to spread out their supply chains. India, with its enormous workforce, better infrastructure, and low costs, has turned into a key spot for companies trying to lower these risks.

India's rising role in worldwide supply chains stands out in the electronics manufacturing field. Stark examples include Apple and Samsung that have grown their production sites in India to cut back on Chinese supplier reliance. To put things into perspective, Apple tripled its output in India in 2021 driven by supply chain diversification, while Samsung launched one of the world's biggest mobile phone plants in Noida, Uttar Pradesh.[23] These steps show a long-term pledge to India as a key manufacturing hub.

Also, it is worth mentioning that geopolitical tensions between China and Western nations have boosted India's standing as another option for manufacturing. A study by the United Nations Conference on Trade and Development found that the majority multinational companies want to spread out their supply chains, with India being a top choice for investment.[24] India's stable political climate, along with its key location in South Asia, gives foreign investors a safe and productive base to set up manufacturing.

**4. Barriers for FDI in the Manufacturing Sector**

For years, FDI has been seen as key to India's economic growth, especially in the manufacturing sector. Although the prospects for investment are positive in the long-run, foreign investors often face challenges due to India's complex regulations that they need to follow. One major problem often observed is the bureaucracy in the government approval process. The World Bank's *Ease of Doing Business Report 2020* put India at 63rd place, noting that the red tape still

holds back investment to the country, which is associated with additional costs for foreign investors.[11] Another issue that troubles investors is the constant change of policies. While India has implemented initiatives, such as MII and CPL and PLI to attract FDI, frequent policy alterations create uncertainty for investors and affect their investment decisions. For instance, in 2019, India raised import fees on electronic parts, which upset supply chains and increased costs for foreign firms like Apple. These sudden changes force companies to adapt quickly to the dynamic market, but at the same time, they can hurt their long-term plans and profits. Also, the government approval process to conduct business in India is of complex nature. Even though the Foreign Investment Promotion Board, which was responsible for approving FDI, was abolished in 2017, some sectors still need government approval first, causing confusion and delays. Investors need multiple approvals from different government offices, including state governments and the Ministry of Commerce and Industry. These requirements can slow the process down, making India's rules some of the most complex and time-consuming in the world for foreign investors.

  

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India's relatively poor infrastructure poses challenges when attracting more FDI in manufacturing. A McKinsey Global Institute report indicates that India's manufacturing output could grow up to 60% if it fixed infrastructure issues, especially in transport and energy.[12] One key problem is the poor transportation network. Despite efforts to improve infrastructure, like the Bharatmala project to build 34,800 kilometers of roads, many parts of India still have damaged road and rail links. This can greatly increase the cost of moving goods. The World Bank reports that these costs make up 14% of India's GDP, compared to 8% in the U.S. and 9% in Germany.[13] Another issue with India’s infrastructure that detracts FDI is the unreliable power supply. The World Economic Forum ranked India 101st out of 141 countries for energy infrastructure, pointing out frequent blackouts and high electricity costs as major hurdles for foreign manufacturers.[14] For example, power-hungry industries like steel and aluminum face significant disruptions from power shortages that can drive up operating costs. The International Energy Agency reports that India's power grid is one of the most less efficient in the world, with about 20% of power lost in transmission. The transportation of goods around through ports is another hurdle that faces investors. India's ports are often jammed, making ships wait a long time to unload. The Jawaharlal Nehru Port in Mumbai, one of India's biggest, is known for slow cargo clearance that can take days instead of the global average of 24 hours.

Foreign investment in India faces stiff competition from local manufacturers. While some domestic companies may benefit from government support—whether through policy measures or incentives—success in the local market often hinges on understanding specific customer needs. For example, home-grown brands like Tata Motors and Mahindra & Mahindra dominate by producing vehicles that are smaller, more fuel-efficient, and rugged, better suited to the local environment than many foreign offerings. This dynamic illustrates the hurdles foreign investors must overcome when entering India’s manufacturing sector.

Another issue is that many people prefer locally made products. The Atmanirbhar Bharat—or Self-Reliant India—initiative encourages the production and consumption of locally made goods, potentially putting foreign companies at a disadvantage. However, this approach is not without flaws, as India’s two largest imports—oil and gold—cannot be produced domestically. While “Make in India” policies are acceptable to foreign firms if they can manufacture and sell in the country under fair conditions, ensuring a level playing field is challenging. Factors such as high capital costs, underdeveloped financial infrastructure, and a fragmented supply chain ecosystem pose significant hurdles for foreign investors aiming to establish a competitive presence in India’s manufacturing sector. The government's PLI plan, aimed at boosting local manufacturing in areas like electronics, drugs, and textiles, further strengthens Indian companies. A report by CRISIL suggests that India’s Production Linked Incentive (PLI) scheme could add $520 billion to local manufacturing output by 2025, potentially intensifying

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competition. For foreign companies that rely heavily on imports, this presents a challenge. However, those willing to produce locally can, like Coca-Cola's acquisition of ThumsUp, adapt to the market, leverage domestic resources, and compete effectively, provided they can navigate the operational and financial complexities of manufacturing in India.[15]

## 5. Conclusion

The manufacturing sector in India has changed tremendously, and FDI has had a notable influence on its growth since the economy opened up in 1991. Programs like MII and the PLI scheme have helped India attract FDI and give a boost to industries such as automobiles, pharmaceuticals, electronics, and clean energy. FDI coming into India went up by 55% from 2014 to 2023 reaching $148.97 billion, and the states like Maharashtra, Karnataka, and Gujarat have gotten the most out of this because of their strategic locations and infrastructure. Even with progress, issues such as complex regulatory frameworks, infrastructure deficits, and domestic competition still slow down FDI growth to a certain extent, while the red tape adds to costs. Old transportation networks and unreliable power also make logistics harder for foreign investors. Finally, local companies that are subsidized by the government make it difficult for foreign firms to break into the Indian market. New opportunities, however, are popping up in renewable energy, electric vehicles, and advanced manufacturing. As India aims to have 450 GW of renewable energy by 2030 and pushes for more EV use, conglomerates like Total, Hyundai, and Tesla are directing their investments into the country. Also, worldwide shifts like political tensions and the COVID-19 outbreak have led to the diversification of supply chains, making India a key spot for manufacturing for firms such as Apple and Samsung. With positive government reforms like reduced corporate tax rates and the setting up of Special Economic Zones, India looks set to stay an appealing spot for FDI. This lays the groundwork to grow over time and become a key player in global manufacturing.

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