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OCTOBER 2025

Commencing Business in India: Different Modes of Entry

There are diverse avenues for a foreign entity to establish its presence or commence business in India. Typically, the mode of entry is contingent on the business goals of the foreign entity in India (subject to foreign exchange laws and other sector-specific laws/regulations).

The different avenues include both incorporated and unincorporated entities.

Unincorporated entities include liaison offices, branch offices, and project offices, each tailored to specific business requirements. On the other hand, incorporated entities include joint ventures, wholly owned subsidiary companies, and limited liability partnerships (LLPs), each with unique advantages and considerations.

Option A: Branch Office, Liaison Office, or Project Office (Unincorporated Entities)

When a foreign entity intends to set up only a business outpost in India to carry out limited activities such as consultancy, market research or networking, or to carry out short-term projects, then setting up a 'Branch Office' (BO), 'Liaison Office'(LO), or a 'Project Office'(PO) may be a suitable strategic choice. These entities are merely extensions of the foreign entities in India and are tailored for targeted and limited operations. The activities which a BO, PO, or an LO is permitted to carry out in India (as well as the process for establishing these entities) are prescribed under regulations issued by the Reserve Bank of India

Branch Office (BO): Designed for versatility, a BO is permitted to engage in export/import of goods, professional or consultancy services, research work and promotion of technical or financial collaborations between parent/group companies and Indian entities. It can also act as a buying/ selling agent of the parent company, contribute to IT or software development, provide technical support to the products supplied by parent/group companies, and represent a foreign airline/shipping company.

Liaison Office (LO): Serving as a representative entity, an LO is authorised to represent the parent company/ group companies in India. Its functions extend to promoting export from and import into India, promoting technical/ financial collaborations between parent/group companies and companies in India and acting as a communication channel between the parent company and Indian companies.

Project Office (PO): A Project Office (PO) is an establishment in India that serves as a representative hub for a foreign company undertaking a project in the country and is valid only for the tenure of such project. Subject to approval from the authorized dealer bank, a foreign company can establish a PO in India through the automatic route, provided specific conditions are met, including the requirement of a contractual agreement with an Indian company for project execution.

Option A is viable for foreign entities that intend to only probe the Indian market or carry out limited operations in India. For carrying out full fledged business and commercial activities, other options (discussed below) are relevant.

Option B: Commercial Collaboration with local partners

When the objective is to supply or procure goods or services to/from India, sans creating any equity stake in an Indian entity, Option B comes into play. In this scenario, the foreign entity may structure commercial collaborations with a local Indian partner. Common examples of such non-equity arrangements include contracts for franchising, licensing, distribution, import/export of service, SaaS, and technology transfer. However, these structures must be devised with particular attention to the requirements prescribed under sector-specific regulations. Basis the sector-specific regulations and the complexity of the business plan, these arrangements can range from simple two-party contracts, with relatively standard terms, to complex multi-party arrangements with multiple contracts and parties.

Option B allows a foreign entity to derive profit from the Indian market at an arm's length with limited legal risk or compliance. However, the foreign entity will have nearly no control over the business, or customers in India and will be significantly dependent on the India-partner for monetising the network and goodwill established in India by its products or services.

Option C: Full-fledged Business in India with Equity Stake (Incorporated Entities)

If the intention is to carry out a full-fledged business in India with equity stake in the Indian entity, an analysis will be required under Indian foreign exchange laws to determine permissibility and extent of such investment

The first step of this analysis is to check whether the sector in which the investment is to be made is a 'prohibited sector' under the foreign direct investment policy of India ("**FDI Policy**").

The FDI Policy lists such prohibited sectors (such as lottery and gambling businesses, tobacco, and railway operations).

If the proposed investment is not prohibited under the FDI Policy, the next step is to identify the applicable investment route. The FDI Policy prescribes two investment routes for foreign direct investment - **automatic route** and **approval route**. The available route depends on the sector/industry in which the investment is to be made.

Investments in sectors that fall under the automatic route do not require approval from the Government of India. These sectors include manufacturing, e-commerce, single brand retailing, construction development, petroleum and natural gas and agriculture.

For sectors that fall under the approval route, prior approval of the Government of India is required before the investment. These sectors include multi brand retail trading, telecom services, defence and broadcasting.

For certain permitted sectors, irrespective of the automatic or approval route, are subjected to sectoral caps and/or certain FDI linked performance conditions. These conditions may include sourcing, lock-in periods, minimum capitalisation, operational/structural criteria.

Therefore, business plans require a careful viability analysis under foreign exchange laws prior to any further steps.

Once the viability analysis under foreign exchange laws is complete, there are various possible modes of entry that are available under Option C. The appropriate mode depends on the level of ownership and control required by the foreign entity.

Mode 1

For a foreign entity seeking maximum control over its operations in India, Model 1 entails incorporating a wholly owned subsidiary company in India. The incorporation process takes approximately 6-8 weeks, and the foreign entity would need to nominate at least one 'resident' Indian director on the board of the Indian subsidiary. 'Resident' means a person who resides in India for a total of at least 182 days in a given financial year. The remaining board members can be foreign nationals. The operations and internal governance of the company would have to be in accordance with the Companies Act 2013 and other applicable corporate laws. Further, the business of the company would have to be conducted in accordance with sector or industry specific regulatory laws.

Mode 1 allows maximum control over the business in India. Further, it allows the foreign parent company to maintain confidentiality over business information, control the local network and operations, and in the long run, achieve high efficiency and reduced costs. Given the fact that India is not just a manufacturing or business hub but also a significant market for final products (across several sectors), this is viable option for foreign entities looking to make long term gains from the Indian market. However, the benefits come at a cost as Mode 1 entails regulatory approvals at entry-stage and continuous compliance discipline during operations. It also entails the natural business and legal risks which arise out of running a full-fledged operation.

Mode 2

For those intending to collaborate with an existing Indian entity on a new venture, with shared ownership and control, then a foreign entity may invest in an existing Indian company or incorporate a new joint venture company with an Indian partner.

While this mode provides a degree of control, it necessitates sharing operational and compliance responsibilities with the Indian partner. Mode 2 enables the foreign entity to leverage the local network, logistics, and know-how of the partner company. However, the natural risk is that the Indian partner would have access to operations, confidential information, proprietary technology, business information, client contacts and other sensitive information.

An alternative viable mode of entry under Mode 2 is investing in a limited liability partnership (LLP) by capital contribution. Compared to private limited companies, LLPs allow greater managerial and organisational flexibility with lesser compliance obligations.

Conclusion

The Indian government is working across sectors to reform laws to improve the ease of doing business. Recent reforms in data privacy laws and upcoming reforms in employment laws are examples of this. Infrastructure (both digital and physical) is also improving at a rapid rate.

All of these make India one of the most attractive investment destinations in the world. However, entry in the Indian market should be carefully planned by calibrating the pros and cons of each approach discussed above, with the intended business objectives. Evaluating the business project under foreign exchange laws and sector-specific regulations at the inception stage is a key step towards an efficient (and painless) India-entry strategy.

India's regulatory framework may appear complex at first, and compliance can seem challenging. However, the initial cost and effort invested in achieving and maintaining full compliance can result in significant post-entry benefits, such as smooth, uninterrupted operations, mitigation of legal and operational risk, and reduced expenses. This would prime the new business venture for a healthy start, with a focus solely on maximizing the gains from the market.