

India's private defence companies



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“ Our endeavour must be to meet the twin imperatives of technological relevance and cost effective delivery. Given the expansion of our private sector, both in technical and financial terms, we are at the threshold of a future in which the private sector contributes to the national cause of high technology defence. There is need for a new institutional framework to involve the private sector, to ensure continuous dialogue as well as to provide incentives for risk taking. We should encourage substantial investment in production capabilities and also in defence related R&Ds.”[1]

Manmohan Singh, PM of India

Introduction

The history of involvement of private industry in defence production in India goes back to 1991[2] which was followed by government initiatives in 1998 to establish close interaction of MoD and services with the Confederation of Indian Industries (CII). The constitution of ‘ Group of Ministers[3]’ committee tasked to examine the Kargil debacle, the policy reforms implemented by the government since 2001[4] and the constitution of Kelkar committee in 2004[5], were primarily aimed at overhauling the acquisition process and promoting indigenous development to achieve 70% defence requirements from indigenous sources by 2010. The major fall out of these was the Defence Procurement Procedures, DPP 2002, DPP 2004, DPP 2006 and DPP 2008[6].

The dramatic differences between technologies used in commercial and military systems in the past have narrowed down with the changing pace of the scientific innovation in the commercial sector especially in the fields of nano-technology, robotics, computer simulation, and stealth technology. As a result, military organizations in developed countries have turned to commercial sector for dual-use technologies and new breakthrough scientific discoveries especially with the decline in the defence spending in post Cold-War era for reasons economic as well as political.

Emerging Private Sector

In the last two decades, the Private Sector has expanded immensely[7]with the DPSUs outsourcing more than 30% and OFs outsourcing 80%. The private sector can produce much more efficiently in a much less time frame and hence their role in Indian defence industry cannot be underestimated despite their constraints. Various private sector companies have ventured into the defence sector and have been issued license by the government. These companies have already taken up production of defence equipment by entering into joint venture (JV) with many foreign companies. Some of these are[8]:-

- Mahindra & Mahindra Ltd, New Delhi.
- Larsen & Toubro Ltd, Mumbai.
- Max Aerospace & Aviation Ltd, Mumbai.
- HBL Power Systems Ltd, Hyderabad.
- Ramoss India, New Delhi.
- Tata Motors Ltd, Mumbai.
- Alpha Phazotron Radar Equipment & Systems Pvt Ltd, Bangalore

EADS's helicopter subsidiary Eurocopter is associated with HAL since 1962, manufacturing more than 600 Alouette 3 and Lama (known as Cheetah and Chetak locally) helicopters. EADS has plans to set up pilot training facilities in India for the civil and military segments and plans to invest \$7-8 billion (\$9.5-11 billion) over the next 10 years.

In Nov 2009, Mahindra Group created Mahindra Defence Systems in India[9] which is a JV with BAE Systems. Mahindra Group has simultaneously acquired majority stakes in two Australian defence companies, Aerostaff Australia and Gippsland Aeronautics, signalling its entry into the defence and aerospace business. Tata has entered into JV with AgustaWestland to assemble the AW119 in India.

Honeywell Aerospace[10], which provides integrated avionics, engines, systems and service products for the aerospace industry, is one example. The US Company has a design and development centre in India that it hopes to expand in the coming years. Airbus has set up the Airbus Engineering Centre India in Bangalore where local engineers help develop capabilities in modelling and simulation, covering areas such as flight management systems and aerodynamics, to help in the design and production of aircraft such as the A380 and the A350. It is also working with Indian IT firms such as CADES, HCL, Infosys, Quest and Satyam to offer support across various aircraft programmes.

India has an inherent edge over several other nations because of higher skills and lower costs of production. This makes India an ideal contender for joint ventures. HAL has entered into joint ventures with many overseas

aviation system companies to undertake design and development of new systems in India. Some of these are the BaeHAL, HAL Edgewood, HELBIT etc. Many other software and hardware giants involved in the aviation hardware and software development especially in the embedded and real time system domain have also established their facilities in Bangalore. Some of these are GE Intelligent Systems, Honeywell, etc.

Given their rapid growth over the last decade, it is perhaps no surprise that Indian software companies such as HCL, Infosys, Infotech, Tata Consultancy Services and Wipro have been active in the aerospace industry for several years. Increasingly, they are benefiting from the engineering services outsourcing programmes. This will help India evolve from IT and low-end business process outsourcing work to high-end design services. Overseas companies view the Indian companies as long-term partners and not as mere suppliers/vendors[11].

Initiatives

The initiatives undertaken by government towards promoting involvement of private sector industries towards high end defence requirements are:-

Opening up of defence sector (in 2001) for 100% participation by Indian private sector and upto 26% FDI.

Provision of the offset clause in DPP for any procurement from a foreign vendor beyond 300 crores.

Introduction of a procurement clause 'Buy and Make (Indian)'. This clause is expected to create a positive impact on the private sector industry and could

encourage formation of joint ventures or alliances for co-production with Indian companies.

Issue of RFP to Indian private sector and the companies having a greater say in negotiations, in obtaining technology from foreign Original Equipment Manufacturers (OEM) as well as in co-production.

Sharing of information on long term perspective plan with the Indian industry and the involvement of the domestic industry in acquisition planning.

Funding R&D cost to the extent of 80 per cent by the Government.

Non starters

Inspite of the various measures taken, there has been no remarkable change in the current state of indigenisation. Only a few of India's top private sector companies are involved in certain small value defence contracts. It needs to be realised that the goal of self reliance would remain a pipe dream if it is to be achieved by just banking on public sector alone.

The involvement of private sector is mandatory to harness the best technology available and reduce imports. Considering the measures taken over the last two decades, India presently is far from achieving the indigenous figure of 70%. Equipment worth \$50 billion has been bought from foreign suppliers in the last decade with the expenditure likely to touch \$100 billion in the coming decade. The reasons to these are:-

A number of defence-industry seminars, conferences and exhibitions have been held in the recent years but old mindsets, complex procurement

procedures and clout wielded by the public sector have been acting as major deterrents to any meaningful participation of the private sector.

In spite of policy reforms of 2001, at the Defence-Expo 2010 the foreign defence majors were still lined up to display their wares. Hence, the efficacy of the initiatives of 26% FDI needs to be given a relook.

While we trust foreign suppliers (essentially because there are few alternatives) governed as they are by their respective national laws that have in-built sanction mechanisms to restrict supplies in various situations, we have not extended the same trust quotient to Indian Industry.

As on date the private sector is at a distinct disadvantage as against OFs and DPSUs. The OFs and DPSUs have a non-competitive edge, because of its close proximity to the MoD.

In all deals under TOT, default agency that receives the benefit is always a DPSU, even if a private sector company is better placed in terms of know-how to absorb the technology and the available infrastructure.

The private sector is also inhibited by technical limitations primarily due to its late entry into the defence industry and needs to institutionalise joint ventures with established foreign defence majors. However, the FDI cap of 26% is an impediment.

Way Ahead

The role of the Department of Defence Production thus needs to be drastically retooled to evaluate India's requirements not in a public sector context but a larger India paradigm. Essentially the initiatives needed are:-

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- De-licensing. The licensing system needs to be given a relook or done away with for manufacturing of defence equipment by private companies except for very critical products.
- Foreign Direct Investment. FDI limits should be enhanced to 49% for all defence production with sensitive content and in non-sensitive areas raised to 76 or even 100 per cent. This would obviate the need for government to defray 80 per cent of the R&D costs.
- Private Equity Participation Government must seriously consider private equity participation in the defence-related public sector to unlock their potential and maximise returns on sovereign investment over the decades
- Developmental Partners. During development phase suitable industrial entities needs to be identified to participate in the activity as developmental partners.
- Limited Series Production (LSP). After joint development, the industry partners needs to be co-opted for execution of LSP that can meet the service requirement.
- Bulk Production Bulk of production needs to be outsourced to private players in a phased manner over several years. This could ease the problem of available OFs and DPSUs while at the same time utilise the resources available in these public establishments.
- Spin-offs The spin-offs from the defence technology need to be exploited in the commercial domain by effecting required repackaging/modification.
- Marketing. Scope also exists for industry to seek potential market for these products in India/Abroad with due approvals. Also the

collaboration of private companies needs to be exploited for marketing of the products.

- Tax benefits. The government needs to provide a level playing field to private industry in terms of excise and custom exemptions for imports of certain components to be utilised in defence equipment.
- Promoting Interactions. DRDO has been actively promoting private industries participation in its entire gamut of activities by regularly interacting with the interested players as well as with organizations such as CII, FICCI, ASSOCHAM. DRDO has organized several DRDO-Industry meets to appraise industry veterans about opportunities awaiting them in Defence R&D. This would definitely help in exploiting the available expertise in industry.
- Sponsored Research. Government needs to look into orient the fresh brains in the IITs, NITs and other educational institutions in India towards R&D of the projects in hand as well as perspective projects. This can be taken up through Sponsored Research as well as industrial consultancy.
- Public Private Partnership. There is a need to promote public private partnership as the public sector has excellent infrastructure, manufacturing facilities and a highly experienced task force. It will be a waste of national resources if these assets are duplicated by the private sector. The private sector, on the other hand, can bring in latest technology, managerial practices, marketing skills and financial management. Therefore, a well-blended fusion of both will result in synergising of their strengths through economies of scale and prove mutually beneficial.

- Joint Ventures. The Brahmos project, which is the governmental level collaboration between the GOI (Bharat) and Russia (Moscow), is one good example of implementing organisational level change. The same needs to be followed up in other projects in pipeline.