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# Private Sector Participation in India's Defence Industry: Journey So Far, Challenges and Way Ahead

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## Introduction

Post independence, India has created a huge defence industrial infrastructure in the country, primarily in the domain of public sector; however, it still imports more than 60 percent of its defence requirements from foreign countries. India is yet to become self-sufficient in terms of advanced hi-tech weapon systems, platforms to include fighter aircraft, battleships, carriers, submarines, armoured fighting vehicles, etc. and is largely dependent on imports for procurement of these weapon systems. The import of defence equipment offers a huge opportunity to the domestic industry for planning import substitution[1]. Defence Public Sector Undertakings (DPSUs)/ Ordnance Factories (Ord Fys) were raised with the expectations to create self-reliance in defence manufacturing, however, their contribution has been dismal in this regard. They are also marred with the problems of low value addition and overreliance on foreign sources, for producing the so-called indigenised products. Further, there has been a

## *Key Points*

1. Post-independence, India created a huge defence industrial infrastructure in the country, primarily in the domain of public sector, however, it still imports more than 60% of its defence requirements from foreign countries.
2. As per SIPRI data, the value of imports of defence equipments by India for the period 2013-16 was approximately Rs 82,496 crores. India accounts for 14% of entire global arms imports and has the dubious distinction of being the largest importer of arms in the world.
3. DPSUs/Ord Fys were raised with the expectations to create self-reliance in defence manufacturing, however the long-cherished goal of achieving minimum 70% self-sufficiency in defence production is still elusive.
4. There has been a very limited participation of the private sector (less than 5%) in the overall defence production as well as in the field of defence research and development.Growth of domestic manufacturing industry (public as well as private) is considered essential for achieving self-reliance in defence sector.
5. Indian private sector has already demonstrated its competence in the fields of automobile, IT and service sectors at the global level. The government seems to be trying to replicate the same model by inducing private sector in defence manufacturing.
6. So far, the private sector has to largely remain contented with the supply of components, and sub-systems to the public sector. There seems to be lack of trust amongst the decision makers for placing big ticket orders on the private firms like manufacturing of weapon platforms, fighter aircrafts, submarines, armoured fighting vehicles, battle ships, etc.
7. It appears that the existing big players of public sector (DPSUs/ Ord Fys/DRDO) want the private sector firms to primarily play the role of second-fiddle or a subordinate to them and thus, not become the lead integrator or manufactures of the weapon platforms themselves.

very low emphasis on R&D in the field of defence. The high import of defence equipment is not considered to be good for the growth of domestic defence industry as it loses out the opportunity for participation. On analysing the domestic Defence Industrial Base (DIB), one thing which stands out alarmingly is that so far there has been a very limited participation of the private sector (less than five percent) in the overall defence production as well as in the field of defence research and development.

## Indian Defence Sector

Some of the significant aspects of the Indian defence sector are enumerated below:

- India has the third largest armed forces in the world. It is the world's fifth largest spender on defence. India's annual defence budget for the financial year 2018/19 is Rs 295,511 crores (at BE stage). It spends approximately 35 percent of its defence budget on capital acquisition.
- India imports nearly 60 percent of its military hardware requirements from the global arms manufacturing countries[2]. As per Stockholm International Peace Research Institute data, the value of imports of defence equipment and weapon systems by India for the period 2013–16 was approximately Rs 82,496 crores. India accounts for 14 percent of the entire global arms imports and has the dubious distinction of being the largest importer of arms in the world.
- Though India does have a very vast DIB in the country, the long-cherished goal of achieving minimum 70 percent self-sufficiency in defence procurement is still elusive. Currently, India's self-reliance is hovering around just 35–40 percent[3].
- India is mostly involved in the licensed production or manufacturing of defence equipment based on the transfer of technologies (TOTs) obtained through the purchase of main equipment/systems in the past from the Original Equipment Manufacturers (OEMs).
- It is considered that the growth of domestic manufacturing industry (public as well as private) is essential for achieving self-reliance in the defence sector as well as strategic autonomy.
- Further, the defence sector has the potential to become a net foreign exchange earner and also leads the country towards self-reliance. Nearly $14 billion worth of defence offset obligations are expected to be discharged in India by the foreign OEMs by the year 2028. In addition, the Indian defence sector has the potential to add about 1 million direct and indirect jobs.
- The Indian private sector has already demonstrated its competence in the fields of automobile, information technology (IT) and service sectors at the global level. The government seems to be trying to replicate the same model by inducing the private sector and foreign OEMs to invest in the defence manufacturing[4].

## Private Sector Participation

### *Foreign Direct Investment (FDI)*

Though the government has taken a large number of initiatives for attracting foreign investments in the recent past, the flow of FDI in the defence sector so far has been subdued. As per the data revealed by Ministry of Defence (MoD), a total of 36 proposals for FDI/joint ventures have been approved for manufacturing of defence equipment (both in public and private sector) till December 2017. FDI amounting to Rs 25.84 crores has been received in the defence industry sector from April 2000 to September 2016[5], which is negligible in view of the total FDI coming to India during the same period.

### *Reasons for Low participation by Private Sector in Defence Production*

It is largely perceived that so far the environment has not been very conducive for active participation of private sector in defence production. Only a few big orders have been placed on a handful of large firms.

The private sector has to largely remain content with the supply of components, subsystems and low-tech items to the public sector. Further, there seems to be lack of trust among the decision-makers as far as placing orders on the private firms for development/manufacturing of big-ticket projects such as weapon platforms, fighter aircraft, submarines, armoured fighting vehicles, battleships, etc. are concerned. The primary reasons envisaged for nonparticipation by the private sector in the defence industry include the decades of insulation, prejudices and old mindsets against them among the decision-makers. Further, due to the complexity of procurement procedures and clouts wielded by the public sector companies within the MoD/Government of India, the new entrants find the whole regime to be highly forbidding.

### *Concerns of Private Sector*

The private sector apprehends that there is no level playing field between government-owned public sector units and them, as far as pricing of an individual item/equipment and price-related competition is concerned. The apprehension comes with the premise that the DPSUs/Ord Fys enjoy patronage of government and have comparatively easy access to public money. Further, it is argued that the public sector does not have to take into account the cost of capital, land, fixed assets like plant and machinery and so forth while quoting price for equipment, as these expenditures have already been incurred by the government over the years. Further, the public sector can afford to underquote for an item as some part of the cost can be provisioned by them through some other projects being handled by them. However, such freedom is not enjoyed by the private sector[6].

## Steps Taken By Government to Promote Defence Production

To ensure self-reliance, no doubt the government is heading in the right direction by laying emphasis on Make in India[7]. However, it is the implementation of such schemes that needs to be ruthlessly ensured. Some of the significant steps taken by the government in the recent past are listed here.

### *Launch of 'Make in India' Programme*

Defence is one of the key sectors identified by the government under 'Make in India' policy. It aims to boost the share of manufacturing in the country's gross domestic product from 16 percent to 25 percent and create 100 million additional jobs. Needless to say, this appears to be the most comprehensive effort taken by the government in the last few decades to reverse the huge import dependence[8]. The programme aims to facilitate investments and innovations in the defence manufacturing sector. However, this 'Make in India' programme needs to be effectively exploited in the defence manufacturing sector.

### *Release of New Defence Procurement Procedure (DPP) 2016*

The new DPP-2016 encourages participation of the domestic industry in defence procurements. The new category 'Buy—Indigenously Designed, Developed and Manufactured (IDDM)' has been introduced in the DPP-2016. Preferential treatment has been given to the 'Buy (Indian-IDDM)', 'Buy (Indian)' and 'Buy and Make (Indian)' categories over the 'Buy (Global)' category. For high-end technology equipment, the private sector is encouraged to partner with foreign OEMs and form joint venture/partnership/technology transfer arrangements.

### *Promulgation of Strategic Partnership (SP) Policy*

The government has promulgated the policy on SP as part of the DPP-2016. The SP model envisages an active role for the private sector in defence manufacturing and lays down various measures to enhance co-operation between the private sector as well as the public sector in order to strengthen the domestic DIB in the country. It also promotes the formulation of joint ventures, partnership and TOT between the Indian private sector and the global OEMs. Though the policy is yet to be fully implemented and made operational.

### Other Important Measures Taken by the Government

- The government has opened the defence sector for FDI up to 100 percent. For cases up to 49 percent, FDI is permitted under the automatic route, whereas above 49 percent, FDI is permitted with the government's approval for cases involving access to modern technology.

- The erstwhile requirement of having the single largest Indian ownership of 51 percent equity in a joint venture has been removed.
- The erstwhile condition of 3 years lock-in period for equity transfer in case of FDI in defence, has been done away with.
- The system of providing preferential treatment to the DPSUs has been done away with. At present, public and private sectors are being treated equally as far as the applicability of taxes are concerned.
- The government is trying to facilitate ease of doing business by reducing license raj and red-tapism.
- The system of grant of industrial licence has been revised and now the industrial licenses are being granted for a period of 15 years in place of the erstwhile 3 years.

## Recommendations and the Way Ahead

In view of the aforesaid, it is considered that the necessary actions must be taken by the government to ensure that India develops the required capacity and capability to become self-reliant in defence production. Some of the significant recommendations and way forwards are listed in the succeeding paragraphs[9].

**Full Thrust to Indigenisation:** The government should provide full thrust to indigenisation and Make in India schemes. Various government agencies involved in policy formulation as well as decision-making should keep the issue of self-reliance in the field of defence as the centre of their efforts. Though the government has issued various policies to boost the indigenous production of defence equipment such as the ease of doing business, grant of ILs, SP policy and so forth, the implementation of these schemes is the most important aspect at present. Needless to say, time bound implementation of various policies issued by the government is the key for the success of these schemes. The political leadership needs to be strong and cautious of the existing red-tapism in the government machinery and the ways/means employed by the vested interest in blocking such progressive schemes. The country should be ready to accept few challenges/ hiccups in the short term, however, it should not accept a delay in implementation of these schemes and pursue them in earnestly.

**Review of the Existing Government Policies and Procedures:** It is worth examining that in spite of the government taking a large number of reforms in the defence manufacturing sector, no substantial progress has been made and still there is a miniscule participation of the private sector in defence production. To address this issue, the government should undertake a third-party neutral review of the various existing government policies, procedures and guidelines related to this aspect. The review committee should also consult all the stakeholders of India's defence sector and seek their views on the subject and thereafter, come out with recommendations for improving the defence manufacturing in the country. The neutral or independent review of the policy is the most important aspect of the policy planning as it will generate more realistic feedback than any committee comprising of representatives of the ministries or government-owned organisations.

**Encourage Active Participation of Private Sector in Defence R&D and Defence Production:** It needs no further emphasis that without the active participation of the private sector in the field of defence research and development as well as defence production, India cannot achieve its goal of becoming self-reliant in the defence sector and this realisation has already dawned on the mindset of the present political dispensation. However, the ground progress in this regard has been abysmally slow. The DPSUs/Ord Fys/Defence Research and Development Organisation (DRDO) still view the private sector as the supplier of raw material/ components/sub-systems and not as a lead integrator who is ready to compete with them on a level playing field. Needless to say that the private sector should be encouraged by the government for taking an active part in defence research and development as well as defence manufacturing within the country. If required, the government should provide them appropriate incentives, tax relief, funding and hand-holding for the initial period of 10–15 years. The nomination of two defence industrial corridors by the government is the right step in this direction, however, creation of defence specific special economic zones (SEZ) may be considered on the lines of IT or pharma SEZs. Further, the private sector must be allotted some big ticket contracts to boost their confidence and morale[10]. If needed, some hand-holding or incentives can be provided to the private sector initially till the time adequate competency is developed in the defence sector.

**Encourage FDI in Defence Industrial Sector:** Needless to say that FDI in the defence sector is most desirable as there is an urgent need for large-scale capital infusion in this sector. Moreover, FDI will also help in getting the latest hi-tech modern technologies from the developed countries. Though it is easier said than done, the government needs to clear various issues related to defence to attract the FDI. Moreover, the private sector as well as FDI will seek certainty of government orders to some extent in order to make it commercially viable.

**Encourage Public–Private Partnership:** There is a need to encourage the interaction and real-term partnership between the public sector companies/organisations and the private sector. The strengths and weaknesses of both need to be acknowledged and jointly worked on, for removal of the same. The specific capabilities and expertise of the private sector need to be harnessed and be given due consideration. Though there should be fair competition between the two in the larger national interest, however, initially at least for some years, there should be demarcation of manufacturing responsibilities between the private sector as well as public sector, in order to provide hand-holding to the private sector.

**Co-opt Academia and Research Institutes:** The DRDO should co-opt the academia, universities like Indian Institutes of Technology, Indian Institute of Science and other technical institutes in defence research activities to harness their skills, knowledge and potential. In addition, there is a need to establish a knowledge bank, which can be the repository of all the research work being done in the field of defence. Further, the know-how available with the Indian technical diaspora must be harnessed for research and development purpose.

**Making Research Work Available to Private/Civil Sector:** The research work (not of high-security nature) undertaken by the defence establishments should be made available for the usage by the private/civil sector. This will make the technological know-how grow further and its benefits can be reaped by various other sectors, apart from generating revenue for the defence establishments.

**Creation of Exclusive Economic Zone (EEZ):** There is a need for creation of EEZs catering specifically for the defence industry. It will provide the desired concerted push towards the growth of the defence industry. Designation of two defence clusters (one in Uttar Pradesh and other in Tamil Nadu) is a right step in this regard, however, more such efforts are required.

**Loosening of Bureaucratic Control:** As far as possible, the government should avoid being the manufacturer/controller of the defence sector. Rather, it should be the regulator and facilitator for the growth of the defence industry within the country.

**Strategic Partnership (SP) Model**: The government has launched this wonderful and well-intended policy after prolonged deliberations and consultations. But there is a need for quick implementation and operationalisation of this policy. The government should move ahead quickly and nominate the OEMs and their strategic partners in the concerned four sectors, that is, fighter aircraft, helicopters, submarines and the armoured fighting vehicles, as early as possible. Any further delay in implementing this policy would be against the ethos of the Make in India initiative.

**Sense of Competition:** There should be a healthy competition among the public sector as well as the private sector. There is a need to bridge the long-standing trust gap between the private industry and the government. Therefore, the government should ensure a level playing field for the private industry, DRDO, DPSUs and Ord Fys.

**Participation of Industry Bodies in Defence Acquisition Council (DAC):** There should be a permanent invitee from the Indian industry bodies like CII, FICCI to the DAC. It will help in gaining a valuable insight into the technical competence of the private sector and will also enable the DAC to make an important decision as to whether to develop the item indigenously or procure ex import.

## Conclusion

India should try to build up capacities and capabilities of its domestic defence industry both in the public sector as well as the private sector. Active participation of the private sector in defence production and defence reserach and development is considered essential for arranging a large amount of capital as well as state-of-the-art, modern technology from OEMs. The vast potential and experience of the private sector especially in the fields of IT, automation, artificial technology, finance, operations and management practices, must be tapped and used in the defence industry. Though the present government is giving a lot of thrusts on indigenisation as well as on 'Make in India' in the defence sector through various policy initiatives, but any tangible results are yet to be visible in the defence sector. The ultimate objective of the government should be to ensure that the requirements of the defence forces for modernisation as well as upgradation of weapon systems/equipment are met indigenously.

## Notes

1. "Defence Manufacturing," http://www.makeinindia.com/sector/defence-manufacturing, accessed on January 19, 2018.
2. Elizabeth Raj, "Indian Defence and Aerospace Private Companies to watch Out For," (July 24, 2017), https://www.arshaconsulting.com/en/blog/posts/2017/july/indian-defence-and-aerospace-private-companies-to-watch-out-for
3. Laxman Kuumar Behera, *Indian Defence Industry: An Agenda for Making in India*, (IDSA, New Delhi: Pentagon Press, 2016), preface.
4. Source: Address by Mr Subhas R. Bhamre, MoS for Defence at CDM, Secunderabad in January 2017.
5. Source: Annual Report 2016–17, MoD and FDI Statistics on http:/www.dipp.nic.in.
6. Based on interaction with Industry reps during various seminars and conclaves.
7. Dalip Bhardwaj, "Make in India in Defence Sector: A Distant Dream," Observer Research Foundation, (May 07, 2018).https://www.orfonline.org/expert-speak/make-in-india-defence-sector-distant-dream/
8. Raj, n. 2.
9. Source: Based on personal interaction with representatives of private industry and many serving and retired officers of armed forces having experience of defence procurement.
10. Bhardwaj, n. 7.



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