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Industrial Licensing: A Critical Factor in Galvanising Indian Defence Industrial Base

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India is rapidly accelerating on the path of economic progress and is predicted to be the fastest-growing major economy in 2018–2019. Nations across the world have come to recognise India as an 'emerging economic powerhouse'. However, a nation is truly accepted as a formidable power when it possesses both economic and military might.

An essential prerequisite for a militarily strong nation is indigenisation and self-reliance in the defence sector, which ultimately contributes in building strategic military capabilities. For indigenous manufacturing of defence equipment, possession of a robust and vibrant defence industrial base is an inescapable requirement.

For the period 2012–2016, Stockholm International Peace Research Institute (SIPRI) identified 155 countries that imported major weapon systems and military equipment. The Asia-Oceania accounted for 43 percent of all arms imports and India earned the dubious distinction as the 'world's biggest arms importer' with its share pegged at 12.8 percent in the five-year period[1].

India is dependent on imports despite having a large defence industrial base of state-owned companies that include 41 ordnance factories and nine defence PSUs. In real terms, barely 40 percent of India's capital procurement is from indigenous sources.

Key Points

1. Participation of private industry in the defence sector was permitted by the government in 2001, in its quest to achieve self-reliance and indigenisation in defence.
2. Several measures have been taken by the government to create a conducive environment for the private sector to enter defence design, development and manufacturing. These measures include 'online' filing of the application for granting industrial license, withdrawal of excise duty exemption to Ordnance Factories Board (OFB) and Defence Public Sector Units (PSUs) to encourage the private industry and provide them a level playing field.
3. More than 342 industrial licenses were issued by the Department of Industrial Planning and Policy (DIPP)/ Ministry of Commerce and Industry (MoC&I) between 2001 and June 2016. From July 2016 to May 2017, the authority for issuing industrial licenses lay with the Ministry of Home Affairs, till it was delegated back to the DIPP. Change of authority had an adverse impact on the process of grant of industrial licenses for defence manufacturing.
4. A list of defence items was finalised and put into the public domain in June 2014. Further refinement in consultation with the armed forces is recommended in view of insights gained in the past few years.
5. Establishment of separate industrial corridors for the Ministry of Micro, Small and Medium Enterprises (MSMEs) is recommended to encourage their participation in the defence sector.
6. Role of "Standing Committee for Grant of Industrial Licenses" in the Ministry of Defence (MoD) may be enhanced to effectively facilitate and monitor private sector participation in the defence sector.

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Industrial Licensing: A Critical Factor ...

For a big country like India, the overwhelming reliance on foreign imports from Russia, the United States, Israel and France is highly undesirable. India has been successful in development of the Integrated Guided Missile Development Programme (IGMDP), the fourth generation fighter aircraft 'Tejas', main battle tank (MBT) 'Arjun' and multibarrel rocket launch (MBRL) system 'Pinaka'. However, successes in the indigenous design, development and manufacturing are very few. Certain projects, namely development of multispectral camouflage nets (MSCN), carbine machine (twin grip, a member of the Indian Small Arms System (INSAS)) and 'Nag' anti-tank missile have been unsuccessful, leaving the armed forces in an unenviable position. The indigenisation efforts in the defence sector under the government's flagship initiative, 'Make-in-India' launched in 2014, thus, assume greater significance.

India, which boasts of the third largest armed forces in the world, has the proportion of defence equipment with regards to 'state of the art', 'matured' and 'obsolescent' equipment in the ratio of 15, 35 and 50 percent, respectively. The armed forces and the government, both are making serious efforts towards upgrading the country's defence hardware and procuring new equipment. The modernisation, upgradation and maintenance of the existing equipment has been planned to be carried out rapidly by the three services in the next few years. As an emerging economic superpower, India's spending, in absolute terms, on defence in the next 10–15 years, is likely to be on an upward trajectory and would inevitably provide immense opportunities to the domestic defence industry.

Background

Defence sector in India was solely the domain of defence PSUs, OFB and Defence Research and Development Organisation (DRDO) till 2001. However, post Kargil War, the government decided to open the gates for defence manufacturing to private industries. Thus, in 2001, the government permitted 100 percent Indian private sector participation in defence manufacturing[2] with the aim to galvanise the country's 'defence industrial base' for achieving indigenisation and self-reliance. A strong defence manufacturing sector assures enhanced security, as it reduces dependence on foreign suppliers, provides opportunity to create intellectual property (IP), develop domestic technological capabilities which often have significant civil applications and provide a platform to tap export markets.

It is assessed that the opening up of the defence sector for private industry will, over time, boost the overall industrial growth in India and also generate new avenues for employment of skilled manpower. Since the introduction of the policy, several measures have been taken by the government to ease the process of obtaining industrial license by the private companies for manufacturing of defence products. The Defence Production Policy—2011 was promulgated and it reiterated the strategic and economic importance of self-reliance in the area of defence. The new 'Defence Production Policy—2018' is expected to be issued by the government in the next few months. The outdated redundant policies with excessive bureaucratic controls, to a limited extent, have been largely done away with and some efforts have been made to create a conducive business environment. The measures have had a significantly positive impact on the environment and numerous private companies have embarked on the path to set up industrial units for design, development and manufacturing of defence products.

Salient Aspects of Industrial Licensing (IL) Policy

The Industrial licensing (IL) policy has been reviewed in an incremental manner to boost participation by the private industry for manufacturing in the defence sector. A simplified and reasonably transparent procedure for obtaining IL for manufacturing of defence products has been put in place. The application form for IL has been simplified and is available on the DIPP website[3]. Some of the salient aspects of the policy are discussed in the subsequent text.

Amendment to the List of Compulsory Licensing Items

Consequent to the government decision in 2001 for private sector participation, a necessary amendment to Schedule II of 477 (E) containing a list of compulsory licensing items, was carried out vide Govt notification in January 2002 by substituting, for the words 'arms, ammunition, parts and accessories, thereof', the words 'arms, ammunition and allied items of defence equipment; parts and accessories thereof'.

Interim Adoption of Wassenaar Arrangement Munitions List (WAML)

In April 2013, the government decided to adopt the Wassenaar Arrangement Munitions List (WAML) as the 'defence items list' for licensing purposes under the Industries Development and Regulation (IDR) Act, 1951. The adoption of WAML as an interim measure ensured availability of a range of defence items to enable processing of applications for granting ILs as an interim measure.

Review of Interim List

In October 2013, a committee was constituted in the MoD/Department of Defence Production (DDP) to review the 'Defence Products List' for licensing purpose.

The committee had representation from all stakeholders, including the Armed Forces.

List of Defence Items

The 'List of Defence Items' was finalised by the MoD in 2014. The defence items requiring IL were reduced by 60 percent in comparison to the earlier range of items in vogue, during various deliberations. The list was promulgated by DIPP, MoC&I vide Press Note No 3 (2014 Series) dated June 26, 2014[4]. During refinement, most of the components, parts, sub-systems, testing equipment, production equipment, castings and forgings were removed from the list, so as to reduce the entry barriers for the industry, particularly small and medium segments.

The trimmed list of defence items was aimed at encouraging new players to enter the defence sector and boost investment. Some of the broad categories of defence equipment which will now require IL are:

- arms and ammunition of all types
- defence aircraft and space craft
- tanks and other armoured fighting vehicles including protective materials
- warship equipment, and so forth.

Dual use items having military as well as civilian applications, other than those specifically mentioned in the list, were exempted from the requirement of IL from the defence angle.

Finalisation of the 'List of Defence Items' was by far the most significant and a bold step taken by the government, in consultation with the Armed Forces.

Any private company willing to manufacture an item included in the notified Defence Products List, is required to apply and obtain IL from the DIPP/MoC&I. Any item not mentioned in the list can be manufactured by the industry without an 'IL for defence items' from the government, provided all other conditions are fulfilled under the relevant rules.

Selling of Defence Products

To make the entry of private sector industry in the defence sector a viable business proposition, manufactured products are permitted to be sold to the defence forces, government organisations/agencies under the control of Ministry of Home Affairs (MHA), state government, PSUs, and other valid defence-licensed companies without approval of the MoD[5].

Validity of IL

The IL granted under the IDR Act by DIPP for the defence sector is initially valid for 15 years, further extendable up to 18 years[6]. The enhanced validity was aimed at facilitating ease of doing business.

Commencement of Production

The licensee company is required to report the commencement of production as per conditions of the license. Partial commencement of production is treated as commencement of production of all the items included in the license. Thereafter, no further extension is required and the license becomes valid for all time.

Removal of Restriction on Annual Capacity

As yet another positive measure, the restriction of annual capacity for defence sector in the IL was removed.

Withdrawal of Excise Duty Exemption

To establish a level-playing field between the Indian private and public sectors, the exemption in excise duty to the OFB and defence PSUs was withdrawn with effect from June 01, 2015[7]. As per the revised policy, all Indian industries (public and private) are subjected to the same kind of excise duty levies. This step has proved to be of major significance in sending positive signals to the environment.

Security Manual for Licensed Defence Industries

The license holders are required to follow the security guidelines notified in the Security Manual[8] available on the MoD/DDP website, based on the products (for which an IL stands granted to a company) and their categorisation.

Outsourcing and Vendor Development Guidelines

To promote participation of the private sector, particularly SMEs for defence manufacturing, 'Outsourcing and Vendor Development Guidelines' for defence PSUs and the OFB[9] were formulated and circulated for adherence. The guidelines mandate that each defence PSU and ordnance factory is required to have a short-term and long-term outsourcing and vendor development plan to gradually increase the outsourcing from the private sector, including SMEs. The guidelines also include vendor development for import substitution.

Defence Exports Strategy

Recognising the need for promotion of defence exports to make the Indian defence industry economically sustainable, 'Strategy for Defence Exports'[10] outlining various steps to be taken, was formulated and placed in the public domain. As per the policy, the export of defence products manufactured by both the public and private industry is permitted, post obtaining a 'No Objection Certificate' (NOC) from the MoD.

Requirement of IL to become Indian Offset Partner (IOP)

Possession of IL by an Indian company, to qualify to become an Indian Offset Partner (IOP), is not a prerequisite under the Defence Offset Guidelines[11]. It is mandatory only if it is required under the licensing requirements/ guidelines, for the items covered under 'Defence Items List' issued by DIPP[12].

Procedure for Grant of IL

Obtaining IL from DIPP/MoC&I is the first step for a private sector company to enter into design, development and production of defence products.

The application seeking IL, till 2014, was required to be submitted, in the prescribed format to the Secretariat for Industrial Assistance (SIA) under DIPP. However, all applications since May 2014 are required to be filed by the interested companies 'online' on the website of DIPP through an e-biz portal, avoiding the human interface and reducing paperwork involved in the process. Online filing has been made mandatory with effect from May 15, 2014[13]. Application for IL is no longer accepted in hard copy.

On receipt of the application, DIPP circulates it to the Administrative Ministry (MoD in this case), State Government(s) concerned and MHA.

The MoD takes into account the recommendations/ comments of all stakeholders including the Armed Forces on each proposal received for consideration. As a logical follow-up step, the applicant company may be asked to make a presentation to the standing committee on 'private sector participation in defence'.

The MoD then forwards its recommendations to the Licensing Committee in DIPP/MoC&I. Security clearance from MHA and comments of the concerned state government are considered while taking the final decision to grant or decline the IL to the applicant company. Specific approval of the MoD is necessary, in case the foreign holding in the equity structure of the applicant company exceeds 49 percent.

Status of application is made available on the DIPP website to enable the applicant company to monitor progress and make necessary arrangements for the next step in the process, in advance, to mitigate any delay in achieving timely fructification of its endeavour to enter the defence sector.

Timeline

In terms of Rule 15[14] of the Registration and Licensing of Industrial Undertakings Rules 1952, IL applied for is required to be issued by DIPP within a period of three months from the date of receipt of application or the date on which additional information under rule 9 is furnished by the applicant company, whichever is later. The Licensing Committee in DIPP which finally considers and decides the applications for grant of IL does so in light of the comments received by them from concerned ministries/ departments. The inter-ministerial process includes consultation with MoD, MHA and the concerned State Government. The whole process has been streamlined to cut down avoidable delays by way of fixing the time frame for the receipt of comments from all concerned agencies. The Armed Forces HQ, DRDO, Directorate General of Quality Assurance (DGQA) and other stakeholders are provided two weeks' time for forwarding comments on all IL cases. In case a stakeholder is not able to analyse the case and consequently, if the recommendations/ comments get delayed beyond the stipulated period, it is normally deemed that there are no comments to offer.

Current Status of ILs

A total of 342 ILs have been granted for design, development and production of a wide range of items that include armoured fighting vehicles, artillery guns, missiles and their launchers, fighter aircrafts, helicopters, small arms, naval vessels, radars, surveillance equipment and munitions from 2001 till June 2016[15]. Out of these, 216 ILs were issued till May 2014, while the remaining 126 licenses were granted in the next two years, from June 2014 till June 2016. The processing of applications for the grant of ILs was carried out in a routine manner till May 2014. However, from June 2014 onwards, the encouragement offered to the private industry to invest in the design, development and production of the defence weapon systems, equipment and munitions is, thus, unmistakably evident.

Issues

The IL policy, procedure and its implementation still have certain issues that would need immediate attention. Some of these are discussed in the subsequent text.

Time taken to Process Applications

The average time taken to process applications and issue ILs for the period from July 2015 to June 2016 was more than six months. The delay in processing of applications by various Central Ministries and State Governments acts as an avoidable impediment against private sector participation in defence production. The delay may be, thus, attributable to delayed receipt of recommendations from the Central Ministries and State Governments.

Common Licence for Arms and Ammunition

Many companies had sought and were granted a common license, both for the manufacture of arms and

corresponding ammunition. The reason for permitting design, development and manufacture of a range of weapons and their ammunition to eventually facilitate production by a single company is well understood. However, no condition has been stipulated on licensee companies to establish plants for the production of arms and ammunition at different locations. Production/ stocking of weapons and corresponding ammunition in the same plant/location is against the basic security parameters and therefore, not advisable. A case in point pertains to establishment of the Ordnance and Ammunition factories under the OFB. Separate facilities have been created, at different geographical locations, to manufacture arms and ammunition.[16] Few examples will adequately illustrate the point. The small arms are manufactured in Ishapore, tanks in Heavy Vehicle Factory Avadi, infantry combat vehicles in OF Medak; while the ammunition is produced in Ammunition Factory Khadki (Pune), High Explosive Factory Khadki (Pune) and Cordite Factory Aruvankadu (Tamil Nadu).

Even the stocking is required to be carried out in different facilities. Indian Army's Armament Depot is located at Jabalpur (Madhya Pradesh) while the ammunition stocks are placed at Pulgaon (Maharashtra). In field areas too, the arms and ammunition are required to be stocked by service units at separate facilities. The establishment of different production as well as stocking infrastructure for arms and ammunition is necessary to ensure security by physical separation of facilities.

Monitoring Production by Companies

Many companies, who have been granted IL for production of defence items, have begun partial production. Mahindra Defence Systems, MKU, Zen Technologies, Alpha Design Technologies, Bharat Forge are some of the leading companies in the defence sector. However, there is likelihood that certain companies who have been granted IL for the design, development and manufacturing of defence items, may not have made any headway. There is, thus, feasibility of attempts, by such companies, to import weapons/equipment or their systems/subsystems from friendly foreign countries and then market the same to the Armed Forces, Police/ Paramilitary Forces as indigenous products. Hence, the methodology to measure indigenous content in weapons/equipment needs to be worked out in detail.

Adherence to Security Manual

Security Manual[17] for 'Indian Licensed Defence Companies' in the private sector, in pursuance of paragraph 12 of Press Note No 2 (2002 series) was issued by DIPP in April 2013. The licensed defence companies are required to put in place adequate safety and security procedures before the production commences, subject to verification by authorised government agencies.

As a substantial number of licenses for defence manufacturing have been issued post the launch of 'Make-in-India' initiative by the government in 2014, ensuring adherence to the security architecture by all licensee firms is of utmost importance, for which a system of verification must be put in place. Needless to emphasise that any laxity on this account could pose serious security concerns for the nation.

The Security Manual also puts an extra strain on the SMEs who may not be able to participate in the design, development and manufacture of higher category defence items, due to the requirement of stringent security arrangements like having watchtowers, perimeter walls/ fences, chief security officer, and so forth.

Review of List of Defence Items

Post initial promulgation of the list of defence items by the MoD, pruning of the list was carried out and certain categories were removed from the list. On closer examination, it is noted that software specially designed for military equipment for Electronic Counter Measures (ECM), Electronic Counter-Counter Measures (ECCM), Surveillance, Intelligence, Command and Control Systems, Communication Equipment and Secrecy Devices does not form a part of the defence items list. Such software should essentially be considered as defence items.

Certain items including training simulators, laser protection equipment that is, eye and sensor protection are part of the system. These items have no significant operational role and can be removed from the list.

Bullet proof jackets and bullet proof helmets were deleted from the list and hence, can now be manufactured by the private sector industry without seeking IL from the defence angle. There is a real possibility of militant organisations and terrorists resorting to the purchase of bulletproof helmets and jackets for use without much hassle. The degree of difficulty that the security forces are likely to face in such eventuality wherein terrorists get equipped with body protection against small arms, can well be imagined. Hence, body armour or protective garments of level III (NIJ.0101.06 July 2008 or national equivalent and above) need to be re-included in the list.

Change of Authority for Grant of Licence

From 2001 to June 2016, the ILs were issued by DIPP to the private industry for the design, development and manufacture of defence products. However, with the promulgation of 'The Gazette of India: Extraordinary'[18] by

MHA on July 15, 2016, the authority for granting a license for the manufacture and proof test of all items falling under type I, II and III (i.e. small arms, light weapons and items configured for military use, respectively) lay with the MHA. All applications from July 2016 onwards were required to be submitted directly to MHA and not DIPP. This change of authority put a question mark on the validity of 342 ILs that had already been issued by the DIPP for more than one and a half decade. The fog over the entire issue was cleared only after 10 months on May 19, 2017 when the MHA vide their Notification No 1447[19] delegated the powers to grant licences for the manufacture and sale of arms and ammunition to the Secretary DIPP, who would be subject to supervision and control of MHA in regard to exercise of the delegated power. The powers delegated to DIPP can be revoked by the Central Government.

The enhanced role of MHA in granting ILs for arms and ammunition has not accrued any significant advantage to promote participation of the private industry in defence manufacturing. It has, rather, become an additional link in the existing bureaucratic chain. The process of granting ILs for defence manufacturing was affected so adversely that only one IL for defence manufacturing has been granted from July 2016 till Jan 2018[20], while 23 licenses were approved in the preceding six months from Jan to Jun 2016.

Recommendations

To resolve the issues discussed in preceding paragraphs and give further boost to the participation of private sector in the defence items manufacturing, certain recommendations discussed as under may be considered for immediate implementation.

Transparency with Respect to Status of Applications

The applicant company should be able to check the status of the application 'online'. The stage at which the application is under consideration should be available and clearly stated. This would facilitate the private industry to have enhanced confidence about transparency in the entire procedure. Transparency needs to be ensured by the government and experienced by the environment.

Adherence to Timelines in Processing of Applications

All applications for granting IL should be processed by all stakeholders to include MHA, state government, MoD and MoC&I within the stipulated time frame. The final decision should be communicated to the applicant within three months from the date of 'online filling' of the application, in accordance with the laid down timelines. Delay in processing indicates inefficiency and is definitely not desirable.

Conditional Common Licence for Arms and Ammunition

In all cases wherein the applicant company has sought a common license for the design, development and manufacture of a weapon system and its corresponding ammunition, conditional licensing should be carried out. The concerned company should be responsible to ensure physical separation of the production and stocking facilities for weapons and corresponding ammunition. However, integrated research facilities may be established by the companies both for arms and ammunition as per their convenience. For production and stocking of ammunition, adherence to the regulations and advice of the Centre for Fire, Explosive and Environment Safety (CFEES)[21] should be made mandatory for the private sector as well. This measure would enhance the safety aspects to a significant degree.

Adherence to Security Manual

For a country like India which has internal security issues in many states, it is of utmost importance that all measures as per the Security Manual are ensured. MHA, the concerned ministry, is required to evolve a system for verification of the existence/implementation of the required security architecture in the premises of all licensed defence companies. Such verification should be completed by the security agencies prior to commencement of production of weapons/ammunition by the companies.

Industrial Corridor for MSMEs

Establishment of industrial corridors specifically for the MSMEs would give immense boost to their participation in the defence sector. Such facility would also, to an extent, mitigate the extra strain on the MSMEs due to the requirement of stringent security arrangements as per the Security Manual.

Review List of Defence Items

There is an immediate requirement to review the list of defence items and consider inclusion of the following points:

Software, specifically developed for military use in equipment designed/manufactured for ECM, ECCM, surveillance, intelligence, command and control systems, military communication and secrecy devices, should be made part of the list. Methodology needs to be evolved to ensure that development of such sensitive software and their export is effectively monitored.

Training simulators, laser protection equipment for eye and sensor protection, parachutes and gliders for personal use should be removed from the list of defence items as these have insignificant operational usage.

Personal protective clothing to include bullet proof jackets and helmets (level III and above) should be included as a part of the list. Immediate collection of data of private sector companies that are manufacturing the items that provide protection against small arms fire/splinters should be collected and analysed. Such companies should be brought under the ambit of defence products manufacturers. Licenses to affected companies should be granted in accordance with the laid down procedure. Details of sales made, if any, to private entities within the country should be analysed from the security point of view.

Notwithstanding the above, a thorough review of the list in consultation with the armed forces is strongly recommended.

Enhance Role of Standing Committee

The role of the standing committee in the MoD, for granting ILs, should be enhanced to include the following:

Periodic monitoring of progress made by private companies, post granting ILs for defence products manufacturing, till the actual production begins.

Facilitate private companies to focus on design, development and manufacture of those weapons systems, equipment and assemblies/sub-assemblies that are proposed to be procured, in accordance with Long-Term Integrated Perspective Plan (LTIPP), in the next few years by our Armed Forces.

Act as a central agency for facilitating the use of government-owned testing facilities that are available with DRDO, OFB, defence PSUs and Armed Forces, by the private industry.

Initiate pro-active action and organise periodic interactions, preferably on a monthly basis, with licensed defence companies and facilitate their participation in the bidding process for defence acquisitions, both capital and revenue. This would enhance confidence in the private industry about the sustainability of their projects and attract investments in the defence manufacturing sector.

Analyse all cases of change of ownership of private sector-licensed defence companies from the security angle. Any change of ownership should be permitted post the recommendation of MoD.

Recommend cancellation of ILs of those companies wherein no progress is evident in terms of infrastructure creation or the design/development/manufacture of the defence items for ten years.

Analyse cases of enhanced foreign direct investment (FDI) (beyond 49 percent) for the production of modern weapons and equipment in consultation with the armed forces. In all cases, the recommendations of the Armed Forces namely, Army/Navy/Air Force HQ, as applicable, should be binding. Modern technology, which could not be developed by the DRDO for the past 'Five Years', should be considered for FDI beyond 49 percent.

Avoid Change of Authority/Procedure

Closer interaction between various ministries could have averted a situation wherein the consideration of cases for granting ILs to applicant companies for entry into the defence sector was virtually suspended between July 2016 and May 2017 due to change of authority/procedure. Needless to reiterate that the incident created uncertainty in the environment about the sincerity with which the flagship initiative of 'Make-in-India in defence sector' was being pursued by the government. The enhanced role of MHA in terms of supervision and control over granting ILs is recommended to be revoked as the system in vogue prior to July 2016 had worked well. The additional link in the bureaucratic chain, without accrual of any significant advantage to the government, needs to be done away with at the earliest. All licenses for defence products, in accordance with the existent procedure in vogue, are considered only after the receipt of favourable recommendations from the MHA and the respective State Government. Adoption of this recommendation will indeed send a positive signal to the environment and would be 'in-line' with the government's aim to enhance the 'ease of doing business' in the country.

Conclusion

Opening the doors for the private industry participation in the defence sector in 2001 was indeed a landmark decision taken by the government. Granting industrial licenses for the design, development and manufacture of a complete range of defence products by the private sector is the first step to enter the coveted field that was earlier reserved only for the government enterprises. Issuance of a large number of industrial licenses in the last 17 years is an indicator of the role that the private industry is expected to play in our quest to become self-reliant in defence weapons/equipment in the next two decades. The measures that have already been taken by the government to facilitate and encourage the private industry participation in defence sector, have not produced the desired results so far. Immediate affirmative action on the foregoing recommendations will provide much needed stimulus to the private sector companies to enter the field, invest and contribute to the indigenisation and self-reliance in the defence sector.

Galvanising Indian Defence Industrial Base ...

Notes

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