

**STRATEGIC  
PARTNERSHIPS –  
STRENGTHENING  
INDIA’S DEFENCE  
MANUFACTURING  
BASE**



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*By*

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# STRATEGIC PARTNERSHIPS – STRENGTHENING INDIA’S DEFENCE MANUFACTURING BASE

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India’s Defence Industrial base has for long been the preserve of the State. Purportedly for security concerns, India’s defence procurement has largely been driven by the various defence public sector undertakings (DPSUs) and the Ordnance Factory Board (OFB). While defence manufacturing was opened up participation to not just private players but also to foreign entities (26% foreign direct investment in defence), private sector companies have been hesitant to join the defence manufacturing sector - for various reasons ranging from restrictions on products, lack of assured orders and apprehensions of tectonic changes in policy that could jeopardise their investments.

The same goes for FDI, which, despite limits having since being increased to 49% on automatic route and 100% on a case-to-case basis, have remained a mere trickle. It remains a harsh fact that India’s defence manufacturing capabilities fall far short of its requirements resulting in a very high dependence on imports to meet the requirements of its Armed Forces to the extent that India reckons amongst the topmost importers of military hardware.

From the time of his assuming office in 2013, , Prime Minister Modi has emphasised a target of 70% indigenous weapons procurement with the Private Sector making a significant contribution in the field of defence manufacture. Chapter VII

to the DPP-2016, released in May this year aims to move towards attaining that goal.

The new Policy expects that “from a strategic perspective, this will help reduce current dependence on imports and gradually ensure greater self-reliance and dependability of supplies essential to meet national security objectives”. As enunciated, ‘Strategic Partnerships (SPs) would be contracted with eligible private firms so as to “harness the entrepreneurial and manufacturing capacities of the Private Sector” and see, their “active involvement” in the manufacturing of major defence equipment to “enhance competition, increase efficiencies, facilitate faster and more significant absorption of technology, create a tiered industrial ecosystem, ensure development of a wider skill base, trigger innovation, promote participation in global value chains as well as exports”.

### **Dhirendra Singh Committee and VK Aatre Task Force**

The concept of strategic partnership had been mooted in 2013 by the Dhirendra Singh Committee set up by the Government to evolve a policy framework for facilitating ‘Make in India’ within the purview of the Defence Procurement Procedure (DPP) and streamline the procurement process. This Committee took into consideration the best practices in the global defence industry and concluded that private industry can be involved in defence procurement only through “well-defined models depending upon ... strategic needs, quality criticality and cost competitiveness.” It emphasised that the ‘strategic partner model’ is to be established in addition to the existing infrastructure and capacity of public sector units.

The Government thereafter appointed the VK Aatre Task Force to recommend detailed criteria, both generic and specific, and prescribe the methodology and parameters for the selection of Strategic Partners. On its part, this Task Force suggested that the focus should be on selecting strategic partners for Aircraft, Helicopters, Submarines and Armoured vehicles (under Group I) and on Ammunition (under Group II). **The**

**current strategic partnership model ratified by the MoD has focused only on the Group I products and does not include ammunition (which is a Group II product).**

### **Government's Motives and Expectations<sup>1</sup>**

Recent statements of Defence Minister Arun Jetley elucidate on the Government's intent and expectations from the new policy. He stressed on the government is laying "big emphasis" on expanding defence manufacturing within the country. He said the government is looking at a 'balance' between the defence public sector units and bringing private sector in defence manufacturing 'so that all national resources' are committed to it and 'its potential can be unleashed'. The *"strategic partnership policy has been brought in, because it is going to supplement the FDI policy, whether the SP partner comes through the FDI route or just a tech tie-up, they would be free (to choose),"* and that *"FDI change merely opens the door. They are enabling... They themselves do not ensure that immediately entry of participants will take place"* clarifying that *"there is only one purchaser (of defence equipment) within India that is the government of India. Unless opening of FDI is accompanied by some reasonable possibility of a possible investor getting orders, he is not going to set up an establishment"*.

### **Salient Features of the SP Model**

**Weapons platforms and groupings:** In the initial phase, strategic partners will be selected in the following segments: (a) Fighter Aircraft, (b) Helicopters, (c) Submarines, (d) Armoured fighting vehicles (AFV)/Main Battle Tanks (MBT). Only one SP will generally be selected per segment. Addition of more segments or further subdivision of the identified segments may be considered by the MOD as deemed necessary.

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<sup>1</sup>Strategic partnership to help attract FDI in defence: Arun Jaitley Indian Express 01 June 2017 @ <http://indianexpress.com/article/india/strategic-partnership-to-help-attract-fdi-in-defence-arun-jaitley-4684286/>

**SP's Role:** Role of the Strategic Partner would be of a system integrator, which is expected to build an extensive eco-system comprising of development partners, specialized vendors and suppliers, in particular those from the MSME sector.

**Tie-up with Foreign OEM:** The tie-ups between the Strategic Partner and foreign Original Equipment Manufacturer ("OEM") can be in the form of a joint venture, equity partnership, technology-sharing, royalty or any other mutually accepted arrangement between the companies. The OEM will be jointly responsible along with the Strategic Partner for certification and quality assurance of the platforms supplied to the MoD.

**Government Safeguards and Support:** In order to introduce needed competition among potential private sector participants and to ensure that the best interests of the government are fully safeguarded, final selection of the Strategic Partners will be guided by the price quoted by the potential Strategic Partners. Government to government support for licensing and transfer of technology as well as provisions for intellectual property issues shall be worked out. Any subsequent change in shareholding pattern/ownership of the Strategic Partner shall require prior approval of the MoD.

**SP to be an Indian Owned Company:** The applicant company participating in the selection process for Strategic Partner should be an Indian company, owned and controlled by resident Indian citizens.

The management of the applicant company should be in Indian hands with majority representation on the board of directors. The chief executive(s) of the applicant company shall be resident Indians who are part of the Indian group owning and controlling the applicant company or the Strategic Partner.

**Implications:** As a company is considered as 'Owned' by resident Indian citizens if more than fifty percent (50%) of the capital in it is directly or beneficially owned by resident Indian citizens and/or Indian companies, which are ultimately

owned and controlled by resident Indian citizens. This implies that the maximum permitted foreign direct investment (“FDI”) shall be forty-nine percent (49%).

**Selection of SP:** Selection of SPs would be based upon the broad parameters of financial strength, technical capability and capacity/infrastructure. Potential SPs will be identified primarily based on their experience and competence in integration of multi-disciplinary functional system of systems, engineering and manufacturing. The procedure to be followed for identifying SPs for each section would follow the following sequential steps:

- EOI to be issued to Indian private companies for selection of Strategic Partner in identified segments seeking details of Minimum Qualification Criteria
- Submission of response to EOI by applicant companies, indicating inter alia choice for segments in which they wish to participate;
- Evaluation of companies based on prescribed Minimum Qualification Criteria;
- Segment-wise verification of segment specific criteria;
- Shortlisting of companies who meet the Minimum Qualification Criteria, for issue of segment-wise request for proposal;
- Issue of segment-wise request for proposal with Defence Acquisition Council (“DAC”) approval to short-listed companies based on the segment option submitted by them in EOI response;
- Submission of techno-commercial offer in response to request for proposal by companies, in collaboration with one of the shortlisted OEMs, or in exceptional cases, with two OEMs in segments with diverse platforms;

- Opening and evaluation of technical offer of companies;
- Conduct of field evaluation trials and staff evaluation;
- Opening of commercial offers of companies that are technically compliant with the request for proposal, segment wise;
- Selection of Strategic Partner having the lowest bid, segment wise, with DAC approval;
- Commencement of contractual negotiations;
- Finalisation and signing of contract.

**Selection of OEMs:** The SP will need to enter into relevant tie-ups with foreign Original Equipment Manufacturers (OEM), a potential list of which will be shortlisted by the MOD through an open process based on Staff Qualitative Requirements (SQRs), Technology Transfer needs and indigenisation roadmap. The process of shortlisting of OEMs will involve the following processes, commencing with the issue of RFI to potential OEMs.

- Formulation of SQRs. The SQRs will cover aspects of the platform as well as weapons required, wherever feasible.
- Based on SQRs and information already available/collected, an EOI will be issued to OEMs in each segment. EOI shall define the technologies to be acquired including the details of the weapons and associated sensors along with the range and depth of transfer of technology (ToT) to achieve the stipulated level of indigenisation and development of industrial eco-system in India.
- OEMs shall provide response to the EOI within two months. Based on the responses TEC will be carried out. Besides compliance to SQRs, besides compliance to other criteria specified in the Model.

- OEMs that meet TEC requirements will be shortlisted for each segment, with the approval of DAC.

Significantly, the Model provides that even if only one OEM is shortlisted, the process will be taken forward.

**Tie-ups of SP with OEM:** The SP will require tie-ups with foreign OEM to cover manufacturing, ToT, assistance in training skilled human resources and other support. Such partnerships or tie-ups between SP and OEM may take the form of joint ventures (JV), equity partnerships, technology-sharing, royalty or any other mutually acceptable arrangement between the companies concerned, subject to the stipulated ownership conditions. The OEM will be jointly responsible along with the SP for certification and quality assurance of the platforms supplied to MOD.

**Primacy to ToT:** As ToT is one of the main factors in selection of OEM, the quantum and scope of Technology being offered for transfer by the OEM will be a primary consideration in the selection procedure. Shortlisting of OEM will take into consideration the following factors:-

- Range, depth and scope of technology transfer offered in identified areas.
- Extent of indigenous content proposed.
- Extent of eco-system of Indian vendors/manufacturers proposed.
- Measures to support SP in establishing system for integration of platforms.
- Plans to train skilled manpower.
- Extent of future R & D planned in India.

**Cooperative Arrangements with DPSUs:** Cooperative arrangements including transfer of technology and teaming arrangements between DRDO/OFs/DPSUs with the SP

could be envisaged to enable defence related capacities to be developed in the country or for other reasons as decided by MOD. MOD may consider the role of DPSUs/OFB at the appropriate stage(s) keeping in view the order book position, capacity and price competitiveness.

**Issue of RFP:** All companies compliant with minimum qualifying criteria shall be short-listed for issue of RFP in the relevant segment. Segment-wise RFPs shall be issued to the short-listed Indian companies which shall seek the following details:

- Technical details of the equipment.
- Commercial offer for the identified platform and 10-years Performance Based Logistics (PBL)/other maintenance arrangements specified.
- Mandatory requirements related to indigenisation roadmap, Transfer of Technology, creation of R&D capabilities and skilling provisions etc.

**Response to RFP:** The Response to RFP shall be in two parts, a technical offer and a commercial offer. The technical offer shall include details of the equipment, company's willingness to meet mandatory requirements related to indigenisation roadmap, transfer of technology, creation of R&D capabilities and skilling provisions etc. The commercial offer shall include the price of the platform along with maintenance related costs as required in RFP.

**Evaluation of Responses:** The process of evaluation of responses shall be as per the sequence below:

- Technical offers shall be opened first.
- Field Evaluation Trials (FET) are to be conducted, except where the equipment has been evaluated earlier or where FET is not applicable (such as submarines). (There is provision to carry out the FET at the vendor premises as necessary).

- Staff Evaluation will be carried out and platforms that meet minimum SQRs and ToT requirements will be shortlisted.
- The commercial offers of the companies shall be opened thereafter and the company having lowest bid shall be designated as SP in that segment.

**Indigenisation Roadmap:** The selected SP in each segment will be required to present a roadmap for future development including PBL, upgrades, etc. as indicated below:-

- **Indigenisation Content Requirements:** The SP shall commit to a plan to indigenise, in terms of value of production, manufacturing of the platform over a set period for each platform as defined in each RFP.
- **Eco-system of Domestic Manufacturers:** SP shall develop tiered industries in each segment by entering into teaming agreements and development partnerships with other industries, including micro, small and medium enterprises (MSMEs), DPSUs, OFs, other PSUs, DRDO and foreign companies that are part of the global supply chain in the relevant sector, so that an eco-system of domestic manufacturers in the Indian defence sector is developed, including for spares and capacities for repair and maintenance of the platform. (The SP is required to submit an action plan to MOD in this regard, the implementation of which will be monitored by MOD).
- **R & D Roadmap:** The Strategic Partner shall formulate a research and development roadmap to achieve self-reliance within the country in respect of the Segment. The road-map is to be mutually finalised along with the MOD. Test and Evaluation Facilities.

**MOD Actions:** The MOD would undertake the following actions:

- Constitute a Contract Negotiation Committee to conduct negotiations with the selected SP and sign a contract for deliverables. (The OEM may participate in these negotiations if needed).
- Sign a Contract for supply of the platform with the SP, and with OEM if necessary.
- In case a JV/SPV is formed by the OEM and SP, consider signing a tripartite contract between MOD, SP and the JV/SPV.
- Make available existing test and evaluation facilities to the SP.
- Periodically assess (either itself or through experts) level of technology absorption carried out by the SP and development of a domestic ecosystem for manufacturing.
- Conduct if and when necessary, special audits of all certifications and costs relevant to the Segment at all or any stages (tiers) of manufacturing/ production/ assembly.

### **Termination of Contract**

MOD shall have the right to terminate the Acquisition Contract in the following cases:

- Material breach of the Acquisition Contract or an integrity related provision by the SP or the JV/SPV.
- If SP or the JV/SPV loses 50% (fifty percent) of net worth as submitted in its application or is unable to pay its dues.
- If the SP or the JV/SPV is adjudged insolvent, commences a voluntary winding-up.
- Any other contractually relevant issue.

## **Qualifying Criteria**

**Technical Gate.** Demonstrated capability of integration of “System of Systems”, which refers to any system with multiple technologies of major systems like aircrafts, ships, chemical plants, power plants, automobiles etc as specified in the EOI.

**Financial Gate.** Following aspects inter-alia would be considered, as specified in the EOI/RFP and include Consolidated Turnover, Networth and Rating.

## **Segment Specific Criteria**

### **Submarines.**

- Availability of at least one suitable Dry dock or Building bay with ship lift/ floating dock for submarine of 3000T displacement and length of 90m.
- Availability of at least two slots forewater frontage/wet basin/outfitting berths/outfitting bays for submarine of 3000T displacement and length of 90m.
- Should have successfully delivered a Warship/Ship as lead or prime contractor in the past five years.

### **Fighter Aircraft/Helicopters.**

- Availability of hangar and land space exclusively for production, assembly and testing of Aircraft/Helicopters
- Experience in production of Aircraft/Helicopters/ systems and components thereof
- Availability of special machining/processing facilities for composites for Aircraft/Helicopters

### **Armoured Fighting Vehicles (AFV)/ Main Battle Tank (MBT).**

- Mobility track, Test driving track and adequate land bank available

- Simulation and Modelling capabilities for complex systems
- Integration of complex automotive and/or armament systems
- Processing facilities for metals and composites including forging, casting, machining and forming/moulding.

### **Limitations and Cautions**

The prospect of the SP Model being a ‘game changer’ has been in discussion from the time the Dhirendra Singh Committee made its suggestion until after its announcement. The major limitations that emerge from discussions and the assessment of Business Forums are as discussed below.

**Limited number of Private Industry Qualifiers:** There are presently a mere handful of private sector companies that have experience in the manufacture of defence products. The issue therefore arises as to whether an adequate number of applicants would respond to the RFI and if so, the eventual choice of SP would emerge from out of a genuine competition.

**FDI Limit – A defining Constraint:** The permissible FDI limit for SPs is 49%, as is the existing FDI limit and it is unrealistic to expect TOT of the latest cutting edge technology at that limit. The general experience is that defence manufacturing in India rarely incorporates cutting edge technology and neither has our manufacturing ecosystem developed adequately to absorb cutting edge technology. **The entire SP model assumes that SPs would facilitate Technology transfers and give impetus to technology innovation through R&D.** There is view, particularly amongst the Defence Scientists community that the assumption is misplaced and that for genuine and substantive technologies, an eventual return to developing these indigenously is inevitable.

**Need to speed up Procurement Procedures:** No major

changes in Government procurement procedures have been mentioned, either in this policy or effected separately. Unless the time taken for decisions in the defence procurement process, from the initial clearance to placing the final order, are sharply reduced, the SP Model would not bring the expected positive impetus.

**MOD Objectivity:** There is need to allay doubts on possible favouritism on the part of MOD in using the vast discretion allowed to it to favour /disfavour some or other firm.

**SPs to compete for future Orders:** In a significant departure to the recommendations of the Dhirendra Singh Committee, the policy as disseminated states that existing SPs would not be the automatic choice for future contracts, though they would be given some weightage in the tendering process for the core expertise developed during the execution of the initial contract under the Strategic Partnership model.

**Vagaries of changes in the Political dispensation:** A 'frank' opinion expressed by some within Industry forums was the lack of any guarantee that the SP model would survive in the (even if unlikely) event of a change in the political dispensation. Investments required to be made by the SP are very large and the 'culture' of contract awardees of one political regime being treated with antipathy and contempt by a rival successor dispensation would carry enormous financial risks and efforts. This would be a detrimental factor in the calculus of prospective applicants.

**Partnership Valid only for Initial Order:** The above risks also become accentuated by the fact that, contrary to the recommendation of the Dhirendra Singh Committee for the SP being for a specific long term period, the Policy as eventually enunciated does not provide for future orders being awarded automatically after the initial contract. The experience with DPSU's and OFs lacking spirit for product development and timely supplies being blunted due lack of competition was

perhaps the underlying reason for removal of the proposed clause. While this would ensure that the SP would strive to constantly improve the product and maintain competitiveness and core expertise, the question some in the Industry raised is whether it would make the entire process of bidding for a SP being viable at all. The costs of not being assured of future contracts for a fixed period carries the risk of jeopardising the entire investment.

**Ambiguity and non-specificity in Significant Clauses:**

*Although the revised DPP mentions “an appropriate institutional and administrative mechanism” and “adequate expertise in relevant fields like procurement, contract law and Transfer of Technology arrangements”, the Industry is not impressed. As emphasised by Laxman Behera, Research Fellow at the IDSA, it is “the lack of reforms in the structures and decision-making processes surrounding procurement and production that have inhibited the development of a strong defence industry”. The DPP does not indicate how existing decision making structures have, or being planned to be made more responsive to provide the SP with the appropriate administrative support ambience. A significant aspect stressed by Beherais that “in the past, several promising measures, especially those connected with the ‘Make’ and ‘Buy and Make (Indian)’ procedures, have failed to yield the desired results because of these shortcomings” and hence “much would depend on how they unfold”<sup>2</sup>.*

**Challenge of ensuring a ‘Substantive’ Level Playing**

**Field:** It is a harsh reality that critical platforms, hitherto the purview of the DPSUs and OFs being manufactured in direct competition to them directly impinge on ensuring a level playing field. There has undeniably, been a past ‘culture’ of comfort in such platforms as proposed to be manufactured

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<sup>2</sup>Laxman K Behera “An Assessment of the Strategic Partnership Model in Defence Industry” IDSA June 02, 2017@ [http://www.idsa.in/idsacomments/strategic-partnership-model-in-defence-industry\\_lkbehera\\_020617](http://www.idsa.in/idsacomments/strategic-partnership-model-in-defence-industry_lkbehera_020617)

by SPs being contracted with DPSUs or the OFs. **Erstwhile ToTs executed by DPSUs and OFs have in fact become available on ‘friendship’ G to G basis because the recipient of the ToT is a State controlled entity.** Further, **Laxman Behera** also stresses that *“time and again, the MoD has deviated from its own promise of fair play in award of contracts and handed over large orders to DPSUs and OFs on nomination” and that “It would be futile to expect SPs to make major investments if the government does not provide a level-playing field to the private sector”*.<sup>3</sup>

**Potential for Future Oligarchies:** The Dhirendra Singh Committee had put forth a significant recommendation against any cross-holding in two or more SPs by one parent company. This has not been specifically mentioned in the final Chapter in the DPP, leaving the issue open, leaving scope for subsidiary companies of from the same conglomerate as the SP in future being themselves designated as SPs in future leading to more than one platform being manufactured by entities belonging to a single conglomerate, resulting in an avoidable state of oligarchy.

**Ambiguity Regarding Export of Surplus Products:** There is need for clarity on some significant grey areas, particularly as to whether an SP would be eligible to export surplus stocks or those not lifted by the MOD.

### **Assessment**

The apprehensions on TOT, though concerning on the surface, may be misplaced as is the opinion of some in the Industry who view that on a practical plane, cutting edge technology really speaking has a short shelf life. Its real worth accrues only when it is encashed. Foreign players are well aware of the commercial opportunities they have in any India deal and would make practical and sensible choices.

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As in the case of any new venture, loose strings and rough edges would exist. Amongst these, the most mentioned is as to how the MOD would execute its functions of monitoring and oversight. A prior exposition of parameters and yardsticks to be followed in its decision-making would not only assuage such apprehensions but also ensure requisite transparency.

It however needs emphasis that a contract for manufacture of a major platform under the SP Model is no ordinary contract. The stakes for the Government as indeed for the nation in the successful execution of the contract has direct bearing on national security. The role set for the MOD at each relevant stage have been carefully stated and well calibrated to enable a 'real-time' check on the progress of execution of the contract. Industry must see and appreciate this role in its correct connotation and not consider these provisions as intrusive or overbearing.

One aspect that does emerge with requisite clarity from the wording of the model is of user involvement and participation through various stages of execution of the contract, both directly - on deputation to the SP - as also members of inspection and oversight teams. There is no gainsaying the all-round advantages of doing so.

Notwithstanding, the SP Model stands apart as a completely new and well-articulated scheme that has definite prospect to be the much needed 'game changer' to provide thrust to indigenous manufacture. Private Industry now has an opportunity to prove their enterprise and mettle while contributing to at the same time to nation building and to national security. Letting such an opportunity go by would be against the grain of commercial common sense.