

MAKE IN INDIA: DEFENCE PRODUCTION

CREATING A LEVEL PLAYING FIELD FOR PRIVATE SECTOR

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India, as on date, is the fifth largest military spender after the US, China, Russia and Saudi Arab accounting for 12% of global sales of military hardware. We have spent \$ 75 billion in arms deal over last 15 to 16 years. India is followed by Saudi Arab, Egypt, UAE, China, Australia, Algeria, Iraq, Pakistan and Indonesia as regards to import of military hardware. The largest arms suppliers to India from 2013-2017 were Russia (62%), US (15%), Israel (11%). France, UK and Ukraine are other suppliers.

70 capital acquisition contracts worth Rs 1.3 lakh crore have been inked with foreign vendors since 2014. On other hand 120 contracts worth 1.7 lakh crores have been finalized with the Indian sources out of which **90% acquisitions would be from 5 DPSUs, 4 shipyards and 41 ordinance factories leaving only 5% share of the private companies.** This differential needs to change as it is not the job of government to do business for which they are neither mandated nor have time from their high priority governance issues. It, obviously, cannot be done in a jiffy as it requires altogether a new structural frame, policies, procedures and processes.

In order to make privatization of defence production a success story, **there is a need to create a level playing field** to beat the **competition** from well entrenched public sector as well as foreign OEMs. It is a **function of financial viability** of the private enterprise through **cutting edge technology, assured long term demand, optimal purchase commitments, industry friendly procurement procedure and flexibility to operate in open national as well as international markets .**

While world over it is the private sector which is the main stay of the defence production, it is not so in India due to deep set security

concerns, a manifestation of our defensive mindset. Moreover, lack of strategic culture and concomitant politico-military synergies, have not taken national security with the kind of seriousness it deserves. In consequence, **Persisting failures to come up with cutting edge technologies and high quality products has resulted in strategic vulnerabilities in absence of accountability of institutions and individuals entrusted with providing with structural strength to the armed forces.**

Given our dependence on imports of almost 65 % of our military hardware, it is essential to build up own military industrial base so as to minimize dependence on outsiders. The **'Make in India' initiative** by the present political dispensation has brought in some hope to inject much needed dynamism in the defence production sector. Looking at the sensitivity of the matter, the government is trying to bring in a paradigm shift by way of **pragmatic approach to achieve a long term vision** to enhance national power in all its manifestations. The team leaders have **reset and reposition the national priorities to exploit the in-house leverages to boost the defence production and affiliated industries.**

The scope of the policy has a **focus on encouraging private enterprise** who have tremendous talent amply proved in non military domain making Indian economy to graduate from regional to international standards. In this industrial matrix, the **public sector would continue to provide core industrial inputs alongside selected private industries as competitors**, thereby enhance the quantity as well as the quality content of the product and services.

Unlike government financed and protected public sector, the **edifice of private sector is profit maximization for which they invest, innovate and struggle to create a niche for their product so as to survive in the dynamics of open market.** Unless there is a reasonably assured market and optimal profit generation, they are unlikely to venture out in a maiden business line. **It is therefore, essential for government to facilitate fair market conditions**

by creating level playing field for private players to enter the defence production.

The government, in order to attract foreign investment and technology has already announced increase of **FDI upto 49% for automatic route and upto 100% in case of selected high sensitive technology equipment.** The policy also has increased the offset clause from 30% to 40% of the project value so as to provide incentives to the Indian industry seeking joint ventures with foreign OEMs. Besides this government plans to provide financial support for research and development to private sector depending on merit of each proposal. The current DPP encourages the Indian companies to tie up with multiple foreign OEMs to field their equipment in response to RFPs, albeit with provision of transfer of technology once contract is signed. There are **indications of inclusiveness of private sector in selected strategic weapon areas** also which was the exclusive domain of the public sector due to its security sensitivities.

There is a new policy on **strategic partnership** with the foreign OEMs and selected big Indian business houses to facilitate joint ventures related to big ticket weapon and equipment. Reliance, Mahindra & Mahindra, Tata, L&T, Bharat Forge etc have been considered for entering into strategic partnership with foreign manufacturing giants in the fields of air crafts, ships, sub marines, missiles, artillery guns and the like. They do not have requisite experience and infrastructure for these product lines. These companies, in initial stages, are likely to assemble the equipment in India and as the foreign OEMs are unlikely to transfer full contents of core technology except for what is needed for offset obligations.

Since public sector companies have adequate experience in manufacturing military hardware, they can act as firm base for private sector to absorb the new technologies and manufacturing processes. In consequence, it may be worth **trying clubbing selected public sector companies along with the nominated private companies as strategic** partners for joint ventures with the foreign OEMs. It would optimize capabilities of public as well as

private sectors as regards to infrastructure, engineering support, skilled manpower, finances, market dynamics, managerial interface and operational viability of the enterprise.

Manufacturing of high technology, high secrecy big ticket strategic equipment certainly needs government interface in Indian context, wherein public sector companies along with private partners would be better bet than leaving it purely to the private enterprise. Such an arrangement may **also take care of security concerns of foreign countries as regards to transfer of their cutting edge technology as Government of India would be one of the stake holders.**

The biggest fear of the private sector is the competition with the DPSUs who enjoy advantages of **assured capital at zero borrowing rates, well established manufacturing chain, experienced skilled manpower & management and above all a assured purchase of their product.** Whereas the private sector has none of it, hence expecting them to compete with the public sector is an impractical proposition. Government may consider foregoing suggestions to create a level playing field with attractive incentives so as to encourage the private sector.

Products available in the open market at competitive rates may be purchased exclusively from the private enterprises wherein it is found that it is not cost effective to produce them through ordinance factories due to high overhead costs. In order to facilitate this, the quantities beyond production capacities of the public sector may be earmarked for private sector initially **through separate RFPs so as to provide fair market competition.** Ordinance factories producing such products may then be **gradually repositioned to produce different products of importance** to utilize their structural capabilities and skilled manpower. Clothing and routine general stores may be considered under this scheme. There is already some movement in this regard.

Setting aside part of OFB quotas in case of selected products for private sector may be another way to encourage establishing in-house alternate sources of supplies. The **surplus production of**

the public sector units in such cases may be earmarked for **export to friendly foreign countries** through Govt to Govt routes. Once the private sector is well established and ready to face the market challenges, there would be a case to remove the protective policies favouring the private enterprises. Subsequently, **Permitting private companies also to export the surplus production** after fulfilling laid down internal obligations would be a big incentive to the private sector in this model. Low cost and low technology weapon & equipment and ammunition may fit into this category.

India enjoys reasonably high economic buoyancy as on date and it is time to relieve the government from the responsibility of running the businesses which is best avoided. Therefore, **privatizing selected DPSUs and ordinance factories would be an appropriate step to infuse better management practices to draw economies of scale.** British have done a similar exercise which has been largely successful. The government should gradually switch its role as a facilitator even in defence production like it has done for other industrial sectors. However, **control of strategic weapons and export of sensitive products should continue to be under the government domain.**

The above can be **done through out right sale of the public sector units to the private business houses with their existing infrastructure and man power in fully operational state.** Since it has national security connotations, government needs to carryout capability analysis of the companies willing to buy the public sector units prior to such a decision.

Another option is to go in for **GOCO (Government owned and corporate operated) concept** which is a hybrid business management model to involve private sector with minimal financial liabilities , which is the biggest dissuading factor for private players in venturing out in defence production field. This is planned to be introduced as a test case in running the **Army Base Work Shops** dealing with repair and recovery of sensitive defence equipment.

While it sounds good to lay down **transfer of technology as a precondition for joint ventures** with the foreign OEMs, but it is

unlikely to be given by them easily as it would impact on their own future businesses. So why should they forego their own interests .Even if it is agreed to , they may not give us the latest cutting edge technology, an essential battle winning factor, that we are looking for. Based on our experience, Russia had been found to be somewhat liberal earlier in this regards, whereas everyone, as of now, seem to be reluctant with exploitative tendencies to do business on their terms. It is also a fact that **that there are shades of grey in the business of arms production and sales.** Hence, need of utmost caution in proceeding ahead with schemes.

Going by the statistics so far, there has been **insignificant inflow of FDI in the defence sector despite all kind of incentives to foreign countries so far.** Therefore, it may be more sensible to have a relook on our policy in this regards. The terms of references to include, **higher off set obligations, commitment to meet our requirements and employment of Indian work force may be more acceptable to them instead of parting with their core competencies.** Incentives of higher FDI may be linked to above parameters and willingness of transfer of technology, based on merit of each case

With our experience so far, **it may be pragmatic not to insist on preconditions of technology transfer in all the cases initially.** It may be better to permit foreign OEMs to establish turn key projects as being suggested by a foreign visiting dignitary with an idea of **"Make For India"**. While it has its own negatives, but **it would provide much needed structural strength to our defence production** with foreign capital. A **network of ancillary units will also develop to support the production line benefitting small and medium enterprises,** generating direct as well as indirect employment. China draws her economic and military strength primarily from the foreign OEMs operating from Chinese geographical spread. China, from a weapon importer has become fifth largest weapon exporter as on date. It is worth looking at this model suitably modified in Indian context.

India in such an arrangement would be benefitted by cutting down expenditure on weapons due to competition and also reduction in logistics and after sale services costs. Moreover, eventually the technology and techniques would be known to Indian workforce over period of time. To be fair to foreign OEMs, even they need to have a reasonable degree of confidence in Indian systems and their own profitability prior to transferring the technologies.

There is also a need to bring about bold and path breaking provisions to facilitate user friendly **government interface with the industry.** The present **procurement procedure is too complex and complicated** and does not infuse confidence amongst private sector and foreign vendors who are used to fast track liberal ways of seeking and conducting business. It needs to be simplified for **'ease of doing business'** by aligning it with corporate sector practices. The concept similar to **"Single Window Clearance"** already in vogue in other sectors may be looked at with appropriate changes as regards to special requirements of the defence sector.

There are **hardly any secrets which are not known world over as regards to weapon sales** and their operational connotations in the global digital environment. Therefore, **present day information transparency when hyphenated with our obsession with security concerns prompts a reality check of our restrictive policies.** There exists a scope of simplifying the entire procurement mechanism thereby facilitating a level playing field in sync with international practices so as to motivate private sector as well as foreign vendors to join our national efforts.

The 'Make in India' campaign needs a fresh look and a mid course correction based on our experience of last four years. It needs to simplify the present industrial policies and DPP with their undue emphasis on centralized control and labyrinth of procedural spirals. **An open sky policy with reasonable checks and balances permitting fair market competition is right recipe** for encouraging the private enterprise to venture into field of defence production. Gradual **privatization of public sector to the**

extent possible would be the right policy in the longer run in Indian context.

Since the weapon technology lies with the foreign sources, we have little choice than to accommodate their interests as of now. Joint ventures with the foreign OEMs is the key to the structural buoyancy of the private sector in present day Indian context. Accordingly, government should support and encourage such alliances through creating a conducive business environment and facilities. Its time for India to be more pragmatic and take bold initiatives if we want to **reduce our military vulnerabilities, thereby enhancing our military deterrence and concomitant “strategic pull”** in the contemporary world community . It’s time to open up India.

(Views expressed are personal)

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