

DPP- 2016: STRATEGIC PARTNERSHIP, THE WAY FORWARD

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DPP 2016. The ninth version of Defence Procurement Procedure (DPP) i.e. DPP 2016 was released by the Ministry of Defence (MoD) on 28 March 2016 to coincide with the opening of Def Expo 2016 in Goa. As per Chapterisation a new chapter i.e. Chapter VII on Strategic Partners and Partnerships will be notified separately.

Ch VII. This Chapter VII would be flowing out of the Dhirendra Singh Committee Report, a 10-member Experts Committee that was set up in May 2015. The committee was tasked to evolve a policy framework for facilitating 'Make in India' within the purview of the Defence Procurement Procedure (DPP) as well as streamline the procurement process.

Dhirendra Singh Committee. The specific recommendations of the Experts Committee also pertained to various models for the private sector. After taking into account the unique nature of defence equipment and the configuration of the global defence industry, the Committee has arrived at three models for the Indian set up – Strategic Partnership (SP), Developmental Partnership and Competitive Partnership. According to the Committee, the choice of the model should be based on “strategic needs, quality criticality and cost competitiveness.”

While suggesting the strategic partnership model, the Experts Committee has also identified the following six segments in which Strategic Partners (SP) from the private sector would be identified:

Aircraft: fighter, transport and helicopter and their major systems.

Warships of stated displacements, and submarines and their major systems.

Armoured fighting vehicles and their major systems.

Complex weapons which rely on guidance systems to achieve precision hits, which may include anti-ship, air defence, air-to-air, air-to-surface, anti-submarine, land attack.

Command, control, communication and computers, intelligence, surveillance, target acquisition and reconnaissance.

Critical materials (titanium alloys, aluminium alloys, carbon composites, nickel/cobalt alloys etc.).

Comments on Para 7.4 (ix). It may be noted that while identifying the different segments, the committee has categorically suggested that just one or two private players would be identified in each segment, limiting the number of players to almost the same number of players identified through the RUR selection process. In order to prevent 'conglomerate monopoly', the Committee has further suggested that only one SP should be permitted in one segment, and once it is chosen in a particular segment it should not be considered directly or indirectly (through cross holdings in another company) in the other segments. This has apparently not gone down well in the industry, especially the bigger ones which aspire to play a larger role in different segments of defence production. Some industry objections are:-

The task force also proposes to ban strategic partners from cross holdings in another strategic partner company and to seek government permission for any material change in their shareholding structure, which the private companies are opposed to.

Smaller firms feel that the selection criteria mean that only big companies will get selected as strategic partners. The defence ministry has, however, promised that interests of small and medium enterprises will be taken care of.

Sacrificing the benefits of competitive bidding for a cost-plus model, where the company will be reimbursed its expenses plus a fixed profit, they say, will breed inefficiency and make private firms just another version of public sector units. The govt is likely to have a mechanism to review non performing 'Strategic Partners' also.

There is also a fear among defence companies that such a model will bring charges of return of "crony capitalism".

Foreign defence suppliers feel that this restricts their options as the Indian government will be deciding their Indian partner for them. The foreign vendors definitely will get restricted as Indian SPs will be able to absorb ToT better and therefore negotiate with strength.

In a first, Mr Anil Ambani has at the Defexpo Goa, on 29 Mar 16 raised concerns on a likely clause that would restrict one company each to the ten broad areas of manufacturing like warships, land systems and submarines. He also represented against the division of ship building into above the water and below the water categories. He felt that govt must consider competition without any intra or inter segment restrictions between Air, Land and Navy in the 10 programs that have been identified for strategic partnerships.

Aatre Recommendations. The idea of strategic partnership is relevant since India cannot afford to have a very large and frequently changing number of players in every segment of major defence platforms. Even in the United States, the biggest defence market in the world, the production of major platforms and weapon systems is consolidated among a few major companies. Having said this, the major challenge for the government now is to select the SP in each segment. Given the general experience of accusations and counter accusations in the vendor selection of any project, the govt would be very careful in drafting the QRs for short listing the vendors and would want to make it totally transparent. For these very reasons govt formed a task force headed by former DRDO chief V K Aatre to recommend the modalities of the strategic partnership model.

The task force recommended that in the initial phase, only aircraft, helicopters, submarines, armoured vehicles and ammunition be considered for strategic partnerships. It has also recommended a series of criteria for the ranking of the companies, whereby the highest-ranked applicant company shall be selected by the defence ministry as a strategic partner. For the three areas of metallic material's and alloys, non-metallic material and ammunition, up to two partners from the private sector will be chosen by the ministry. The Aatre committee has suggested a minimum lock in period of 20 years for a strategic partner and has recommended that the process should be completed within nine months after a thorough verification of the financial records of companies applying for the partnership.

Forward Strategy: Make In India.

SPs will help create an eco-system where design, R & D, manufacturing, maintenance, upgrade and export capabilities thrive.

Reduction of Defence Imports. We need to aim to reverse the current position of largest defence importer without adversely affecting the requirements, capability and preparedness of the services. Since all the indigenous capacity cannot be built overnight, a graduated approach needs to be taken starting with a conscious shift in favour of the Make, Buy (Indian) and Buy and Make

(Indian) category and significant increase in the indigenous content. At the same time to ensure that 'Make in India' concept does not become just 'assemble in India', it is necessary to develop the capability for design and development and capacities for manufacturing, as well as the ability to service, maintain and upgrade a given system. Increased coverage of Make schemes will strengthen this further.

Threshold in Offsets. Once a higher portion of the defence procurement starts coming from the Indian vendors, a shift in the offset policy towards direct and directed offsets, leveraging the same towards acquiring critical technologies, should be made in future. This should be particularly so in the cases of various G to G purchases.

Indigenisation of Tier 2 Vendors. The culture of increasing the share of Indian vendors and indigenous content in our capital procurements needs to spread to other entities like the DRDO, the DPSUs, the OFB or any integrator for that matter, in their own sourcing. They must also follow the floor level for indigenous content stipulated in DPP 2013, if not better it.

Make Pgmes. The up-gradation plan of in-service weapon systems at the categorization stage, must keep in mind the Make in India initiatives. Most AoN cases must be executed under 'Make' procedure so as to increase the floor level for the Indigenous content.

Private Sector Participation. A vibrant Defence Industrial Base must necessarily include the private industry, both large, medium and small scale. This would enable utilisation as well as consolidation of the national manufacturing base in areas such as shipbuilding, engineering and metallurgy, automotive, electronics, avionics, telecommunication etc. Considering the available synergies between civil and defence technology applications, and the existing capability of Indian private industry, fostering a constructive, long term partnership is a strategic imperative to minimise dependence on foreign vendors. Larger and sustained production volume of any system leads to optimisation of cost as well as improved production efficiency.

SP. In Strategic Partnership model, a private sector partner is chosen for the development of a specific, identified, strategic platform / system or material, on a long term basis taking into consideration existing capacities in the Public Sector. The selection process is required to be transparent and based on clear criterion stated upfront. To guard against any conglomerate formation or cartelisation one private industry can become a strategic partner for only one platform / system and cannot have cross holdings in a company that is a strategic partner for another platform. Their books of account will be open to the Government. This will help curb any

monopolistic tendencies, particularly when capacity for the strategic system also exists in the public sector units.

Role of MSMEs. Realising the idea of 'Make in India' in the Defence sector will require that indigenous design, development and maintenance capacities are significantly enhanced. Additional required capacities would have to come from Indian private sector, who will need to be engaged with and facilitated through regular interaction and communicating specific requirements of the Services, making test and trial infrastructure available etc. The role of MSME cannot be underestimated, they should be equal partners in the increased out sourcing by DPSUs / OFB and other system integrators.

Target acquisitions of 6th Year. Given that the 'Make' cycle requires considerable lead time, there is a strong need to pre-position ourselves for 'Make' activities based on the projections under the LTIPP particularly items required from the 6th year onwards particularly so for large projects.

Aerospace. Development of indigenous capability in the Aerospace sector is inadequate. Considering that this is a technology-intensive sector, and any enhancement of indigenous capability in this sector would result in phenomenal downstream effect. A more effective partnership model, with "Industry lead—DRDO supported model" could bring higher dividends. The participation by foreign industry can also be included, where necessary.

Way Forward. The cross holding of shares of other SPs should not be allowed in any case. To begin with, instead of one SP per sub sector the govt could pick two SPs. This, although may be make the venture financially unviable, will push both the SPs towards more competition amongst themselves. The firm could be a co-SP in another sub sector so as to keep the orders moving.