

DEFENCE INDUSTRY

In our last two issues, we have looked at the defence industrial capabilities of Russia and China. In this issue, Guy Anderson completes his survey of the defence industries of major non-Western industrial countries with a look at the defence industry of India.

India's Defence Industry

by *Guy Anderson*

Guy Anderson is editor and lead analyst of Jane's Industry Quarterly and Jane's Defence Industry, London. He looks at the slow pace of reform within India's defence industrial sector and suggests that India's emergence as a significant exporter in the global defence market is likely to be some way off.

India's emergence as a significant participant in global commercial markets contrasts with the sluggish development of the country's defence industrial sectors.

In 2000, India's IT industries achieved combined revenues of US\$5.7Bn (of which US\$4Bn was attributable to exports). The automotive industries, meanwhile, achieved revenues of US\$4Bn, of which US\$500M was attributable to foreign sales. Growth throughout this decade has been dramatic for both sectors. By 2007 the IT sector had grown into a US\$50Bn industry (US\$36.7Bn came from exports) while the automotive sector had reached US\$35Bn (with US\$4Bn from exports).

The status of India's defence industrial base in the global market is arguably reflected in its export performance. The country's nine state-owned military firms exported products worth just INR4.28Bn (US\$99.04M) in 2007 and US\$100M in 2009, an increase from US\$26M in 2001 (although it is notable that there has been no substantial growth since foreign sales climbed to US\$93M in 2004).

To put this in perspective, India was ranked 11th worldwide in terms of overall defence expenditure in 2007 (according to Jane's figures) but 41st globally between 2002 and 2006 in terms of defence exports (SIPRI¹ figures).

Furthermore, India's progress towards its long-standing goal of self-reliance indicates the extent to which the industrial base has fallen short of expectations. Throughout this decade, the country has aimed to achieve 70% self-reliance: as of 2009, just 30% of India's materiel requirements were met by domestic enterprises.

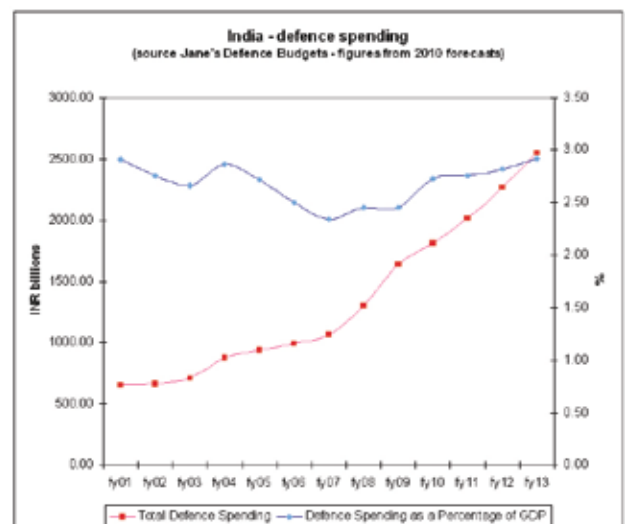
The ability of India's defence industrial base to meet domestic requirements in a timely and cost-effective manner has been questionable. While the output of items such as light vehicles and ammunition has been satisfactory, major platforms have

faced significant delays. Both the Light Combat Aircraft and the Arjun main battle tank fell more than a decade behind schedule, while the Kaveria aircraft engine (designed for LCA) and the Advanced Technology Vessel submarine both fell behind by around 20 years.

The reasons for the contrast between India's rapid rise in global commercial markets and the performance of its defence materiel producers are complicated. The article 'Eastern Promise: China, India and Russia in the Global Defence Market' in the July 2008 edition of *Jane's Industry Quarterly* argued that archaic state-dominated industrial structures, limited access (in previous years) to higher technologies, and the poor implementation of reforms have gone some way to providing an explanation.

Industrial Base – State Domination and Stagnation

India's defence industrial base remains centred on nine state-owned enterprises: a total of eight companies and a board comprising 39 factories (with two more factories scheduled to be completed by 2012). The enterprises are supported by the Defence Research and Development Organisation (DRDO) in addition to bodies such as the Defence Acquisitions Council; the Defence Procurement Board; the Defence Production Board; and the Acquisition Wing.





Model of the Arjun main battle tank [P.Allen/I.H.S.Jane's]

There has been an acceptance on the part of India's Government that private sector involvement in the defence industrial sector is desirable, given that it would be reasonable to expect competition to encourage innovation and efficiencies. In 2001, New Delhi began encouraging the private sector to plan a role on a basis similar to that of a subcontractor (although notably without the opportunity to compete with the state-owned champions on an equal footing).

Encouragement came in 2007. The Raksha Ufyog Ratnas (RUR) – or 'Champions of Industry' – initiative was announced, under which 12 or 13 private companies were to be granted a number of benefits that previously had only been granted to public sector undertakings. These were – it was proposed – to have included eligibility to design, develop and produce equipment, and to manufacture defence items that have been developed under the aegis of the DRDO.

Furthermore, favoured private enterprises would have been able to apply for the duty-free import of equipment for defence research; to apply for up to 80% funding from the Indian Ministry of Defence for research and development projects; and to enter into transfer of technology agreements and subsequent licensed production of defence equipment originating from overseas companies.

It is noted that the proposed policy was opposed by the left wing of Indian politics, and that by 2009 the policy had still not been introduced. Indian defence procurement officials conceded to Jane's early last year that it is likely RUR will be sidelined indefinitely.

The result, of course, is that a two-tier defence sector continues to exist. Rahul Chaudry, chief executive of Tata Power – an arm of the private Tata conglomerate that has expanding interests in defence manufacturing – told Jane's that he believes the Government needs to achieve fairness if targets (specifically 70% self-reliance) are to be

met. "The big question is actually a very simple one," he said in mid-2009. "Is the Indian government willing to put a stop to its protectionist policies that continue to favour the Government's own companies?"

Offset Obligations

The Defence Procurement Procedure (DPP) of 2006 contained India's current offset policy, which stipulates that defence contracts valued at INR3Bn or greater must have offset clauses attached amounting to at least 30% of the total contract value. Joint ventures (JV) between domestic organisations and foreign contractors have been encouraged (leading to a raft of such accords in recent years as Western firms look to take advantage of India's forecast procurement requirements – see the procurement spending chart). The Defence Offset Facilitation Agency has stated that it expects JVs to improve standards within the domestic sectors as they learn from their global peers. It is notable, however, that the policy initially excluded the transfer of technology, leading to reasonable questions concerning the value of such accords to India itself.

Furthermore, the offset policy was introduced with a target of generating work worth US\$10Bn for domestic industries by 2011. By mid-2009, Jane's noted that it was highly unlikely that this target would be achieved. Between 2006 and 2009, the offset policy resulted in work valued at around INR75Bn (US\$1.5Bn).

Reasons have been attributed to a number of stalled procurement programmes (which have led the MoD to return unused funds to the finance ministry at the end of the financial year); a relatively inflexible approach to offsets; a system under which suitable private-sector partners for foreign firms have to be vetted in the first instance by state-owned industries; and – arguably – the relative inexperience of Indian firms in positioning themselves to benefit from offset obligations.

Foreign Direct Investment – Sluggish Progress

India has permitted foreign-owned companies to invest up to 26% of a local defence enterprise since 2001. It is notable, however, that take-up has been minimal. In June 2009, the Ministry of Commerce and Industry's Department of Industrial Policy and Promotion published figures that showed that foreign direct investment (FDI) in domestic defence companies totalled just US\$142,000. The Indian service sector topped the national league with a total of US\$19Bn attracted through FDI. Defence, in contrast, was the lowest ranked sector of the 62 areas listed.

There have been calls – notably from Indian Chambers of Commerce – to increase the FDI cap to 49%. The Government said in September 2008 that it was prepared to consider proposals for JVs in which foreign firms held up to 49% on a case-by-case basis.

The first significant proposal to go before regulators was that of BAE Systems and Mahindra and Mahindra, a private Indian



The Tejas light combat aircraft [P.Allen/I.H.S.Jane's]

company that submitted a recommendation in June 2008 to form a JV to develop land systems in India. In October 2008 the Indian Foreign Investment Promotion Board (FIPB) rejected the proposal on “technical grounds”. The JV was subsequently approved at the start of 2009 (albeit on the foundation of a revised proposal based on a BAE Systems stake of 26%).

It is also notable that Indian authorities have taken a sluggish approach to the establishment of such JVs. The FIPB said in September 2009 that it had decided to defer separate bids submitted by Vyoneech Technologies in New Delhi and the Tata Group to create such ventures. Vyoneech was seeking to create a JV with an unnamed foreign company to design and manufacture unspecified defence electrical equipment. Tata, meanwhile, looked to create a JV with Israel Aerospace Industries (to be named Nova Integrated Systems) to produce unmanned aerial vehicles, radars, and electronic warfare and security systems. Earlier in the same month, the FIPB deferred for a second time its decision on whether to approve a defence-related JV between EADS Deutschland GmbH and private Indian company Larsen & Toubro, in addition to deferring a decision on a JV proposal submitted by Taneja Aerospace and the Tamil Nadu Industrial Development Corporation to establish defence maintenance, repair and overhaul facilities.

A proposal by the Indian Rizing Fund – the aim was to create a defence industry venture capital fund – was withdrawn in late 2009, having been deferred on three separate occasions.

The Indian Ministry of Defence was – at the time of writing – expected to publish an updated defence procurement procedures (DPP) document before the start of 2010. The MoD declined to comment on the likely content, although

industry sources suggested that the focus would be on an increase in the FDI cap and a simplified offset policy.

Outlook

It is evident that reforms have progressed at a glacial pace, and it remains questionable whether currently pending measures will be sufficiently far-reaching to achieve the desired aims.

However, the success of India’s private sector in high-technology commercial spheres points to the country’s potential in the defence domain. The Indian Government has called for greater collaboration between high-technology civilian domains and military industries. Should such advice be heeded (and, more importantly, encouraged and facilitated through reforms), the potential for India to carve a future in areas such as command, control, communications, computing and intelligence and network-centric warfare sectors is plausible.

Tata’s Rahul Chaudry concurred. He told Jane’s that he believes Indian defence companies have “tremendous potential for defence exports over the next 20 years”, adding that “IT and communications are critical technologies that drive the development of today’s defence equipment and of course there are also the strong points of Indian capabilities”.

India’s emergence as a significant exporter in the global defence market, however, is likely to be some way off. It seems probable that the initial focus will be on achieving existing self-reliance goals. ■

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¹ Stockholm International Peace Research Institute