

Indian Defence Industry

Deciphering a Multifaceted Growth for Private Participation





CONTENTS

1. Introduction	2
2. Structure of Defence in India	4
3. Defence Budget	7
4. Heavy Reliance on Imports in the Defence Industry	9
5. Defence Production in India	11
6. Changes in Line	13
7. Taxes	24
8. Virtues of Self Reliance	26
9. Outlook of India's Defence Industry	27
10. Conclusion	29

INTRODUCTION



Defence, as an industry, has always stood at the forefront of cutting edge technology and innovation, due to its strong association with national security and sovereignty. This has become of paramount importance, especially with the recent surge of global terror attacks. Around the world, as many as 464 terror attacks, with over 3,033 fatalities have been recorded in the first 5 months of 2017. The 2017 concert fiasco of Manchester (claiming the lives of 22 bystanders), the 2016 Bastille Day slaughter in Nice (with a 86 death toll), and the Paris attacks (leaving 130 dead) are just a few of the numerous terror activities that have alarmed the government for strengthening national defence. This in turn has prompted the rising demand for procurement and innovation in this sector.

India, with its diverse population and history, is also subject to cross border terrorism. The ongoing disputes with neighboring countries such as Pakistan (in relation to Kashmir) and China (in the state of Arunachal Pradesh and the South China Sea), present potential threats, making the country extra vigilant. Alongside that, China's "One Belt One Road" project, involving the China-Pakistan Economic Corridor that passes through the PoK territory, has also threatened India's national sovereignty. There was already a lot of tension surrounding PoK, with extremist measures being used in relation to Kashmir. These new developments can aggravate the friction among these sovereign states and therefore increase the weightage put on maintaining an effective defence mechanism.

Many Indian soldiers have given up their lives in order to protect the country's borders and fight terrorism. Concurrently the GoI has spent a large portion of its national wealth in the import of defence procurement. However, the quest

for providing its forces with the state-of-the-art equipment needs a newer outlook, as heavily relying on imports is not sustainable. Not only does it add towards a current account deficit but also makes the nation dependent on others. In view of this, India needs to generate indigenous skills that are spread out all over the value chain - ranging from R&D, production, integration, support, repair etc. In other words, opt for a defence industry that is built upon self-reliance.

In order to further this model, the government has till date initiated multiple ways to build further capacity in terms of infrastructure and technology, and support the manufacturing of defence goods within the nation. This thought first surfaced when the upper house of the Indian Parliament (Rajya Sabha) expressed concerns over the increased dependence on imports. It therefore created a Self-Reliance Review Committee (SRRV) in 1992, raising the level of indigenous content required. However, this did not attain the level of self-reliance



sought by 2011. Hence this concern was brought forward again in 2012, and sprung the National Democratic Alliance (NDA) government to pioneer the campaign of "Make in India", in order to drive domestic manufacturing to a new level.

The motive behind the "Make in India" campaign is to build upon the notion of indigenization and manufacture products through private participation, which in turn will create increased employment opportunities and lead to a growth in GDP. The government has put in several reforms since 2014, to simplify the regulatory framework and create ease in doing business locally in the defence space. Policies related to obtaining industrial licenses have been liberalized to enable a higher number of private firms to enter this sector. FDI caps have been increased, allowing 49% inflows by foreign investors through automatic routes in the defence-manufacturing zone. The Foreign Investment Promotion Board (FIPB), which was an added layer of institutional scrutiny over foreign investments, has also been removed in 2017, as a measure to reduce bureaucracy in this space. The policy necessitating Indian firms to hold a majority equity stake of 51% in joint ventures with foreign counterparts, in the production of defence goods, has also been dropped. Defence procurement procedures have been restructured, including categories such as the Buy (Indian) and Buy and Make (Indian), which ensure multiple means to procure from the native market. This increased preference for products

with higher indigenous content (Procurement categories such as "Buy Indian" and "Buy and Buy and Make Indian") for the procurement of various arms and armaments, has incentivized indigenous manufacturing in this sector.

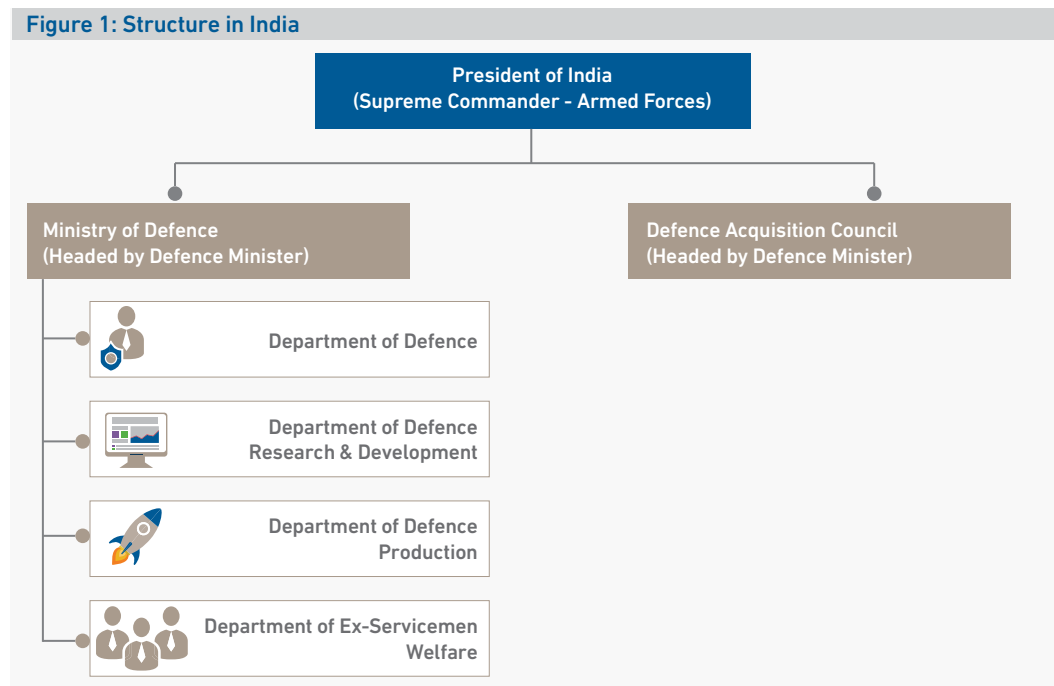
However, the bigger concern for India is to develop the required level of technological viability and innovation for manufacturing advanced equipment in time. In the beginning of this year, the Navy had rejected the home grown Light Combat Aircrafts - "Tejas"- on account of them being technologically backward. Its requirement was more towards obtaining twin-engine fighter planes, which integrated the latest technology and know-how available; something that was manufactured more by foreign vendors. Similarly, the Army rejected the assault rifles manufactured by the Ordnance Factory Board (OFB), due to its poor quality and ineffective fire power. The government has attempted to address this crisis by setting up a Defence Innovation Fund. This fund can be leveraged by both Indian and foreign entities, including startups operating in the defence innovation space.

Nevertheless it is yet to be determined on whether the "Make in India" initiative, along with other reforms, would eventually be able to successfully address the core issue the country has in mind; that is, whether it can enhance India's defence manufacturing capabilities and eventually reduce its foreign dependence in this industry.

STRUCTURE OF DEFENCE IN INDIA

To start, India has a composite defence industry, comprising of various regulatory bodies for the different functions. The Government of India (GoI) and the Cabinet are responsible for managing the security and territorial integrity of the country. This is carried through a multilayer governance structure of the defence industry, as represented below.

Figure 1: Structure in India



Principal Regulators

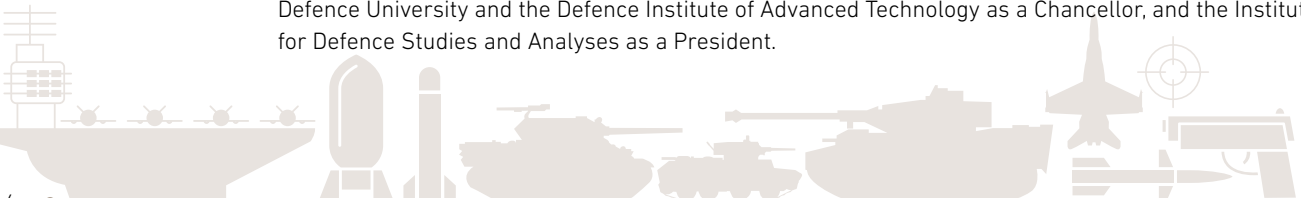
The President of India

The President of India is designated as the Supreme Commander of the Armed Forces, who also appoints the chiefs of the service branches. All important treaties and contracts are made under the President's name.

The Ministry of Defence and the Defence Minister

The defence function of the government is carried out by the Ministry of Defence (MoD). Its core functions include managing all Indian Armed Forces, viz. the Army, Navy, Air Force, and defence agencies. It is also charged with managing and coordinating all agencies and functions of the government that directly relate to the Indian Armed Forces and national security.

The MoD is headed by the Defence Minister, who works together with the Minister of State for Defence, and the Deputy Minister of Defence. The Defence Minister also serves on the board of the National Defence University and the Defence Institute of Advanced Technology as a Chancellor, and the Institute for Defence Studies and Analyses as a President.



Defence Acquisition Council (DAC)

The DAC, headed by the Defence Minister, is the principle authority for decision-making in relation to the defence planning process. This involves looking at capital acquisitions in the long-term perspective, and approving each Capital Acquisition program.

The decisions from the DAC are implemented by its three boards: (i) Defence Procurement Board; (ii) Defence Production Board; and (iii) Defence Research & Development Board. The DAC also accords Acceptance of Necessity (AoN), which is a category-based approval mechanism 'in principle' that paves the way for acquisitions.

Department of Defence

This is one of the most important departments that form part of India's defence structure. Its main function includes formulating, executing and reviewing policies for the topics/ business as allocated by the Government/ Defence Ministry. Apart from this, it is responsible for matters related to the Parliament, defence budget, establishment matters, defence related co-operation with other countries and coordination regarding the same.

Department of Defence Research & Development Organization (DRDO)

The DRDO is a part of the MoD. It works towards increasing India's self-reliance in the defence system. Thereby, it engages in design & development that eventually would lead to the manufacturing of world-class equipment – arms and ammunitions and weapon systems. The organization works in various segments of military technology, which range from armaments, missiles, electronics, instrumentation engineering systems, combat vehicles, materials, simulation, naval systems, aeronautics, advanced computing, and life sciences.

Department of Defence Production (DDP)

The DPP was set up in 1962, with the intention of developing an exhaustive infrastructure for the production of all equipment and arms required for defence: i.e. weapons, platforms, systems etc. It also deals with the indigenization of imported equipment. In this regard, the department has set up production units in the form of Defence Public Sector Undertakings (DPSUs) and Defence Ordnance Factories (OFs). The function of the DPSUs and OFs lies in supplying arms and ammunitions to the armed forces and making India self-sufficient in defence production.

Department of Ex- Servicemen Welfare

This department operates as an independent resettlement division. It was set up with a view to take care of the welfare, rehabilitation and resettlement of ex-servicemen, war widows and other dependents. It is headed by a secretary and consists of 2 divisions: (a) resettlement division and (b) pension division. It also has 3 attached offices: (a) Directorate General of Resettlement; (b) Kendriya Sainik Board Secretariat (KSB Sect.); and (c) Central Organization, Ex-servicemen Contributory Health Scheme (CO, ECHS).



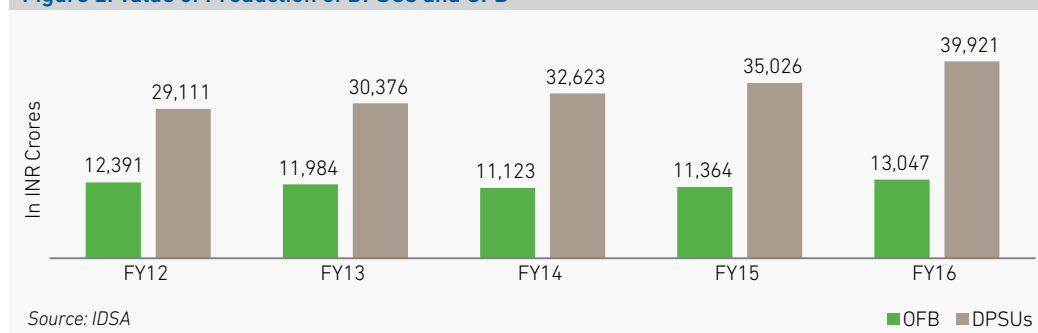
Key Players

A variety of players operate in the Indian defence industry. These include the following:

Defence Public Sector Undertakings (DPSUs)

There are currently 9 DPSUs in India. While both DPSUs and OFs deal in the production of equipment, DPSUs generally serve the "strategic requirements" of the armed forces. Production wise, they account for 65% of the output (in terms of value) of all defence public sector undertakings, including OFs. They deal in the production of warships, aircrafts, helicopters, submarines, missiles, heavy vehicles & earthmovers, alloys & special purpose steel, electronic devices and components etc. The DPSUs account for 40% of the capital budget.

Figure 2: Value of Production of DPSUs and OFB



Defence Ordnance Factories Board (OFBs)

The Ordnance Factories Board - also called the Ayudh Nrimani Board - functions under the Ministry of Defence as an industrial organization. It comprises of 41 ordnance factories, 3 regional centres, and 9 training institutes, along with 4 regional Controllerates of Safety, which are spread across the country. This department engages in the research, development, testing, production, marketing and logistics of an extensive product range for land, air and sea systems.

Private companies

India inherently has been extremely conservative in allowing private sector participation in defence manufacturing. However, this sector is now gradually opening up and many private companies are keen to start operation. In anticipation of the opportunities ahead, they have been investing to build up their capacities in electronics, land systems, aerospace products and short-range missiles. Historically this sector has been daunting for many companies, due to the stringent costs, huge implications, and regulatory barriers involved in conducting business. However, with the introduction of favorable policies, private participation has begun to gradually improve.

Foreign Companies

Foreign participation is high in this sector, producing around 50% of India's defence goods. Among it, players from Russia, US, France and the UK dominate the market. For example, Russia supplied over 71.6% of India's total arms imports from 2010 to 2015. Alongside, imports from the US have drastically increased from USD 54 mn in 2010 to USD 302 mn in 2015.

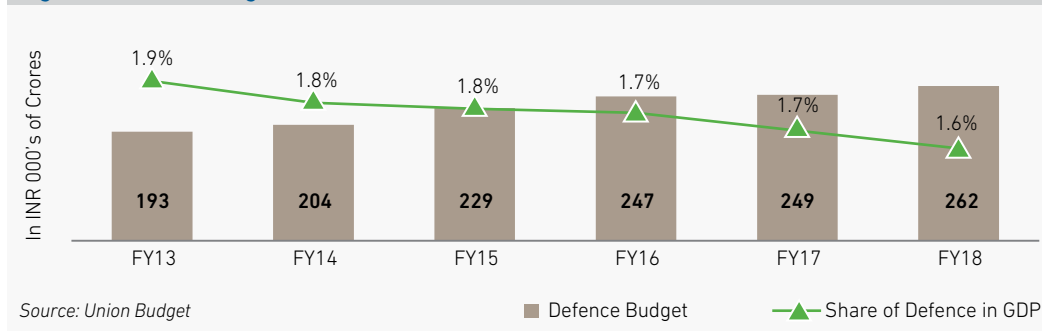
Russia had the first mover's advantage in India, due to the diplomatic ties between the two countries. Nevertheless, the huge market opportunity here has prompted other nations to also actively participate. In-fact, many foreign companies have lately been entering the country via JVs (joint ventures) – probably in response to the government's increased efforts in joint participation, such as the revision of the offset clause.



DEFENCE BUDGET

The Indian economy has continued to grow over the last 3 consecutive financial years, achieving around a 7% rise in GDP, inspite of the suppressed global economic outlook. Since FY15, the Union Budget has laid a thrust on the NDA government's investment approach, ensuring greater priority towards building infrastructure, rural development, public health & sanitation, alleviation of poverty, national security etc.

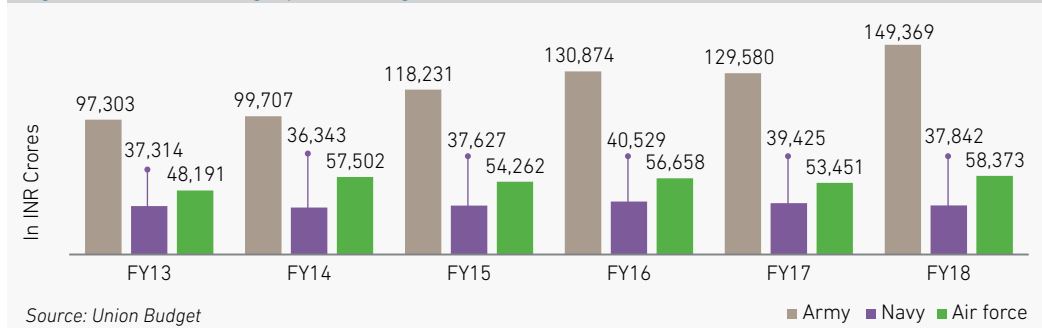
Figure 3: Defence Budget



As per SIPRI, India is the 5th largest spender in defence goods. From FY13 to FY18, its budget has grown from INR 1,93,000 cr to INR 2,62,000 cr (at a CAGR of 6.30%). Finance Minister, Arun Jaitley, has allocated INR 3,59,854 cr (including pensions) to the defence sector in the Union Budget for FY18; this is a meagre rise of 5% from the previous budget. With that, nearly a third of the budget is allotted for Capital Expenditure, which includes modernization related acquisitions as well. With nearly 50% of arms and equipment in the hands of the Indian Armed Forces (IAF) currently being obsolete, the modernization drive is presumed to require a solid investment.

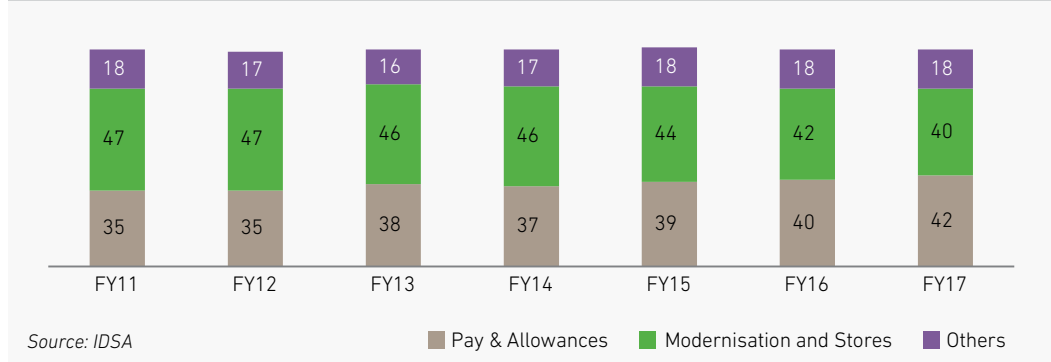
Going by services, the army has received a substantial proportion of the defence budget for FY18, amounting to nearly 57% of the total allocation. This is followed by the Airforce, which claims a share of 22%, while another 14% has been set for the Navy. A small portion of the funds is allocated to DPSUs and OFBs, amounting to around 7% of the overall budget. The size of the Indian army tops the other two services of the Indian Armed Forces, and is constantly battling with inflation in human capital costs.

Figure 4: Defence Category-wise Budget



The defence budget has been rising by a single digit on annual basis, which is insufficient to accommodate all the planned expenses.

Figure 5: Distribution of Defence Expenditure Among Major Elements (%)



With that, the departments have been utilizing majority of the marginal increase in their annual budgets to cater the day-to-day operational expenses, pension payments, and rising employee costs. In FY17, around 12% of the total INR 70,000 cr modernization budget was made available for signing new schemes; the remaining portion was set aside to discharge liabilities pertaining to existing contracts. Needless to mention, the ratio between Revenue and Capital Outlay needs to substantially change in order to step up the modernization drive. However, the numbers reveal that a whopping 10.5% of this modernization funding, amounting to INR 7,393 cr, was not utilized by the Indian Armed Forces in FY17. The Air Force is the only line of service under all the 3 verticals, which has experienced a hike in budget allotment for modernization programs in FY18. This is because many big ticket contracts were signed in the last 5 years, such as procurement of Rafale fighters, Apache attack, and Chinook heavy lift helicopters. On the contrary, there is underutilization by the army for over 50% of the modernization funds. Thus, there is a growing concern related to the inefficient procurement process and poor management of funds by the Armed forces.

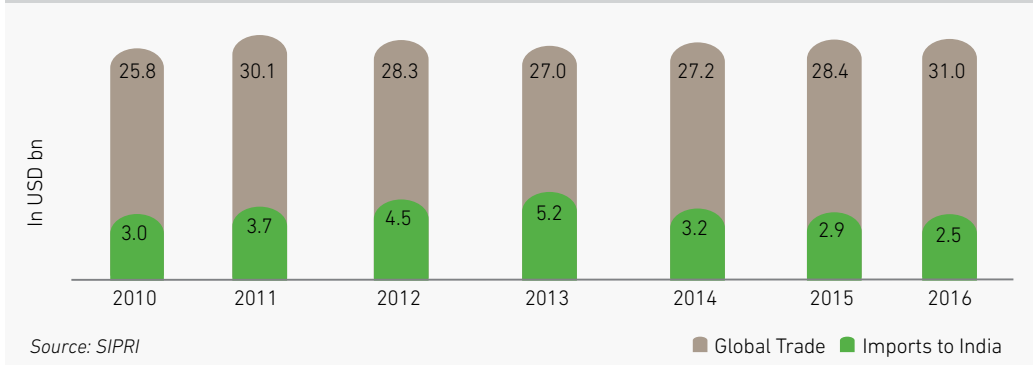


HEAVY RELIANCE ON IMPORTS IN THE INDIAN DEFENCE INDUSTRY

India has been majorly dependent on imports as a means for defence procurement and is the world's largest importer for arms and ammunition (as per the data by SIPRI). Cumulatively, India has imported arms estimated at USD 24.9 bn between 2010 and 2016, which accounts for around 12.5% of the global arms transfer during this period. The nation has spent tremendously on its defence imports, comprising of parts, components and raw materials in 2012 and 2013 (with an aggregate value of USD 9.6 bn).

As aforementioned, a Self-Reliance Review Committee (SRRV) was constituted under the supervision of Dr A.P.J. Abdul Kalam in 1992, which had formulated a 10 year programme aimed at gaining self-reliance in the defence space. The committee worked towards raising the indigenous content in total procurement expenditure from 30% to 70% by 2005, and a Self-Reliance Index was created to measure this change on a yearly basis. However, a study by the Institute for Defence Studies and Analyses (IDSA) in 2014, cites that a Self-Reliance Index of only 48% of the targeted 70%, was achieved by 2011.

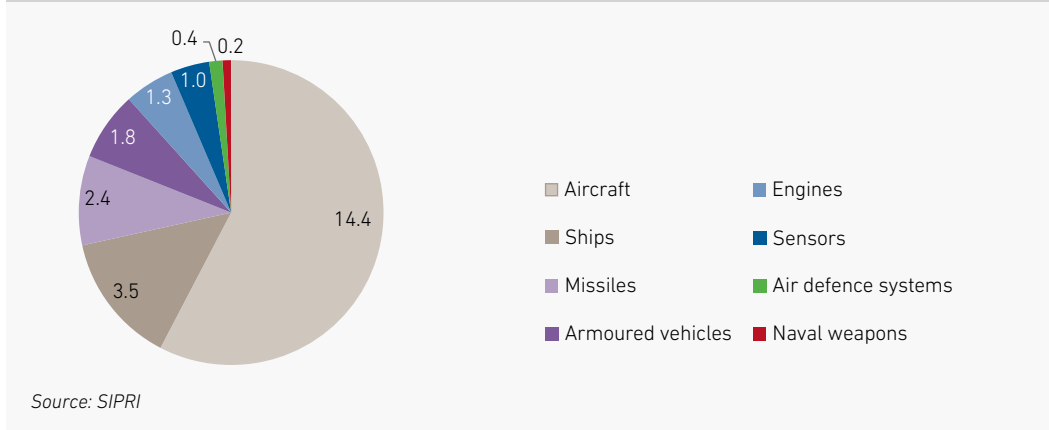
Figure 6: Global Arms Transfer



The import bill for defence has leaped by 43% between 2007-2011 and 2012-2016. Aircrafts constituted nearly 57% of the import expense over this period. This is closely followed by ships and Armoured vehicles. Though China's overall defence expenditure between 2010-2016 was more than thrice of India's defence expenditure, the fact still remains that India's imports are far above its neighbors. While China has been mainly resorting to indigenous manufacturing of defence equipment, India is largely dependent on acquisitions of technologically viable military equipment from other nations.

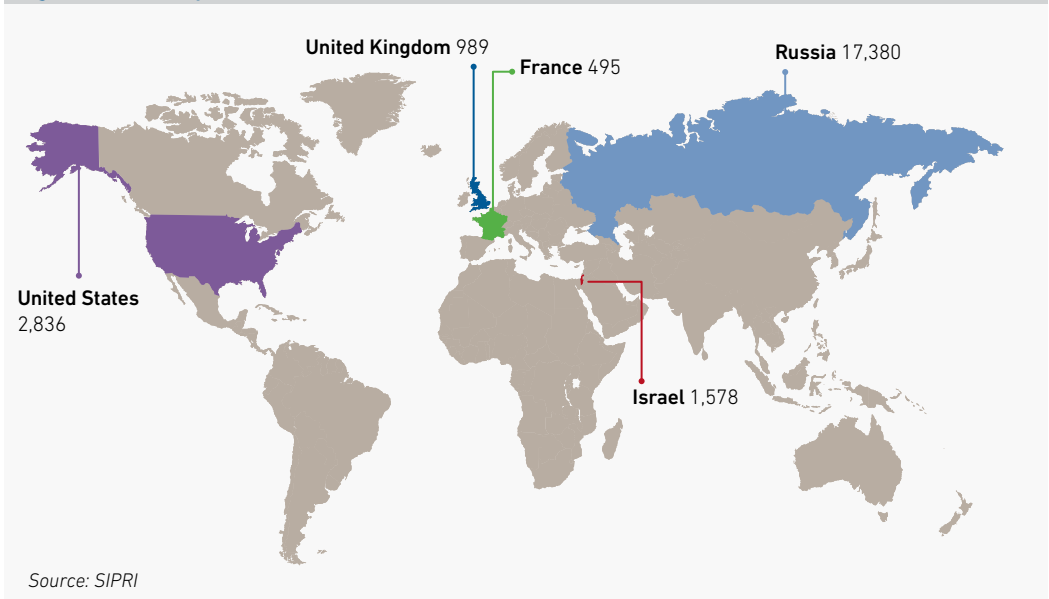


Figure 7: Total Import Value 2010-2016 (bn USD)



Over the last few years (2010-2016), Russia/USSR has been the main supplier of arms and ammunition to India, followed by other nations such as the US, UK, Israel and France. Russian counterparts constituted nearly 80% of the import bill in 2010, which has reduced by 20% in 2016. The US has marched its way up the supplier list between 2012 and 2013, by sealing Indian deals estimated to be around USD 10 bn. These deals are a part of the Foreign Military Sales Agreement between the two nations. Countries such as Canada and Ukraine have also entered the Indian exporter list, whereas Uzbekistan has lost its space in the market.

Figure 8: Total Import to India 2010-2016 (mn USD)



DEFENCE PRODUCTION IN INDIA

Undoubtedly, defence as an industry is important for any nation, and therefore it is not surprising that India has established numerous programs and policies. As this is one of the most sensitive areas governing territorial security.

As India's economy grows further ahead, so will its threats from other sovereign powers. After all, there is a positive correlation between power and war. Hence, it is of utmost importance that the country has innate defence capabilities in place to protect itself and its interests.

With this in mind, India has sought to attain self-sufficiency in arms production through several of its initiatives. It has also installed large set-ups; however, as seen by the Self Reliance Index and the recent defence expenditure, the production output has largely been insufficient to meet the growing needs. Hence, several committees have been established in the past to review and analyze the reason for deficient production and make alternative recommendations. Clearly, the nature of defence production has not been fully in line with long-term objectives.

After much deliberation, there were a variety of causes identified that are associated with the restricted domestic production, as addressed below.

Reasons for Deficient Domestic Production in Defence

Low Labor Productivity

An analysis of the average productivity of an employee in the Indian defence-manufacturing sector suggests that India is far behind when it comes to profit per worker. A Comptroller and Auditor General (CAG) report of 2014 states that the average productivity in 8 of India's DPSUs is around USD 67,000. Contrast this with the average labor productivity of the top 5 arms producing companies worldwide, which is USD 370,000.

Non-Implementation of Reforms

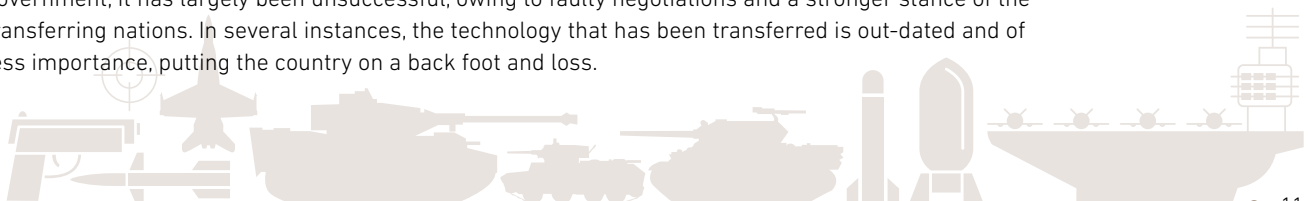
While the recommendations of several committees have largely been accepted at an ideological level, they have always fallen short of implementation. The political scenario and bureaucracy have been in stasis, as far as changes in the defence policy and production mechanism are concerned. However, the current government's stance on this has changed with decisions taken at a faster pace.

Relations with other Nations

In many instances, India's defence related buying has been a result of its diplomatic agreements with different countries. This has created inefficient negotiations, excessive costs and time over-runs, leading to escalation in expenses. In a few cases, the arms supplied have not been at par, leading to a loss of millions of dollars. However, the country has not been able to counter this in order to satisfy its diplomatic obligations.

Inadequate Local Research and IP Development

India's heavy dependence on imports from developed countries has led to a lack of focus on indigenous development. While negotiations for transfer of technology have always been a focus of the government, it has largely been unsuccessful, owing to faulty negotiations and a stronger stance of the transferring nations. In several instances, the technology that has been transferred is out-dated and of less importance, putting the country on a back foot and loss.



Lack of Private Participation

Previously, domestic private participants were kept at an arms-length by the government. This inherently low trust on private players resulted in a lack of level playing field, which created an oligopolistic situation for the foreign players, while the domestic players - though may be capable of developing and manufacturing at par - lost out on opportunities.

Make in India – An Acute Necessity

In view of the above, one of the most extensive goals of the government in power now is to improve the manufacturing sector in the country. For this purpose it has identified 25 sectors, one of them being defence. The government has set a target to achieve 70% of India's total defence requirements internally. For several decades, imports have been used to bridge the gap between the country's capacity and the requirement; particularly as the local DPSUs and OFBs could not meet the demand.

This slow shift from being a major importer to manufacturing the output has propelled the NDA government to stress on the "Make in India" program even more, and attach associated operational benefits in taxation and funding. However, there is still a need to further build on the infrastructure and technology, in order to equip the country with complete capabilities to design and manufacture equipment in-house.

This manufacturing drive has also instilled India to establish its name in the exporter list of other nations. The ministry is working rigorously in shaping up the necessary base to realise an export target of USD 2 bn by 2019. Countries such as Vietnam, Mauritius, Bangladesh, Philippines, Afghanistan, Oman etc. form potential buyers for indigenously manufactured goods such as:

- Personal Protective Items
- Offshore Patrol Vessels
- Spares for Radars
- Cheetal Helicopters
- Turbo Chargers and Batteries
- EOPOD ALH System
- Light Engineering Mechanical Parts
- Missiles
- Self-Propelled Artillery Guns
- Fencing Material
- Bridging Equipment etc.

Until the last decade, DPSUs and OFBs have been shouldering the production volume required for exports, with negligible support from private companies. However, with the onset of "Make in India" easing out of the tendering process, and introduction of the Strategic Partnership Model, Indian private companies have started eyeing this industry as well.



CHANGES IN LINE

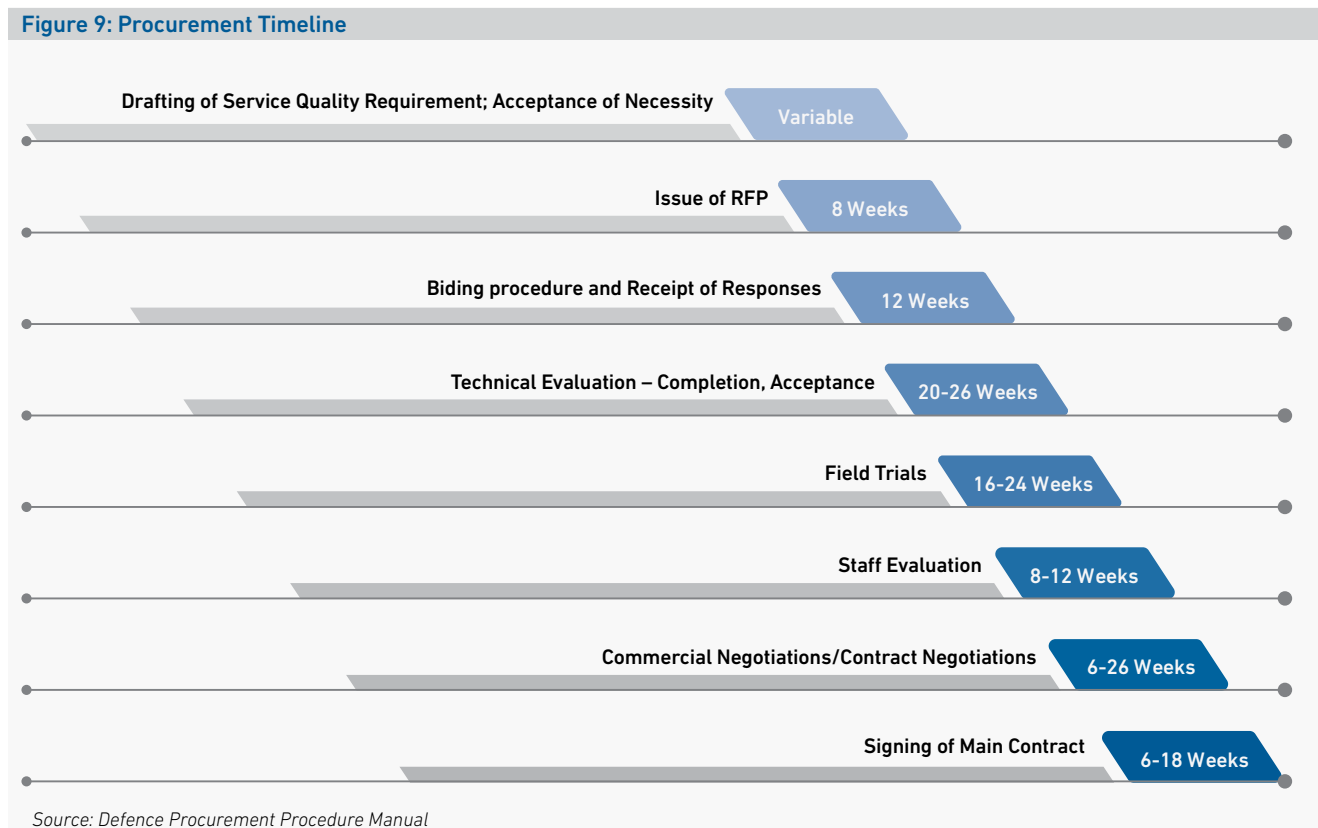
One of the first steps in pursuit of the "Make in India" target involves revamping policies in place to make them in favor of domestic production. In relation to this, the GoI has followed through the below mentioned developments.

New Perspective of the DPP

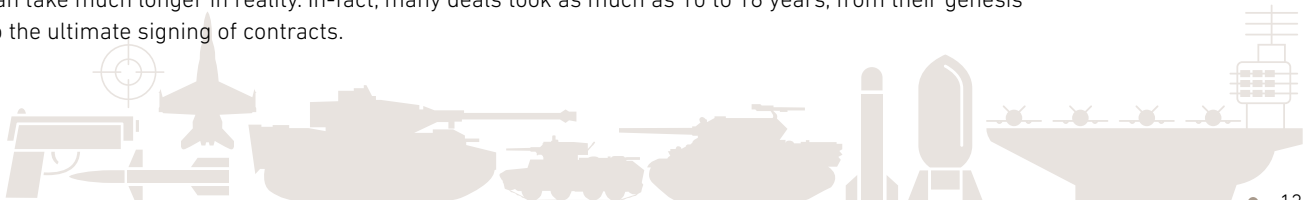
The Defence Procurement Procedure is the "Master Manual" for all capital defence procurements in India. The DPP 2016 defines the aim of the procedure is to "ensure timely procurement of military equipment, systems and platforms as required by the Armed Forces in terms of performance capabilities and quality standards, through optimum utilization of allocated budgetary resources; while enabling the same, DPP will provide for the highest degree of probity, public accountability, transparency, fair competition and level-playing field. In addition, self-reliance in defence equipment production and acquisition will be steadfastly pursued as a key aim of the DPP".

Procurement Timeline

A standard procedure, outlining the series of events of procurement in the defence industry of India, is pictured as below:

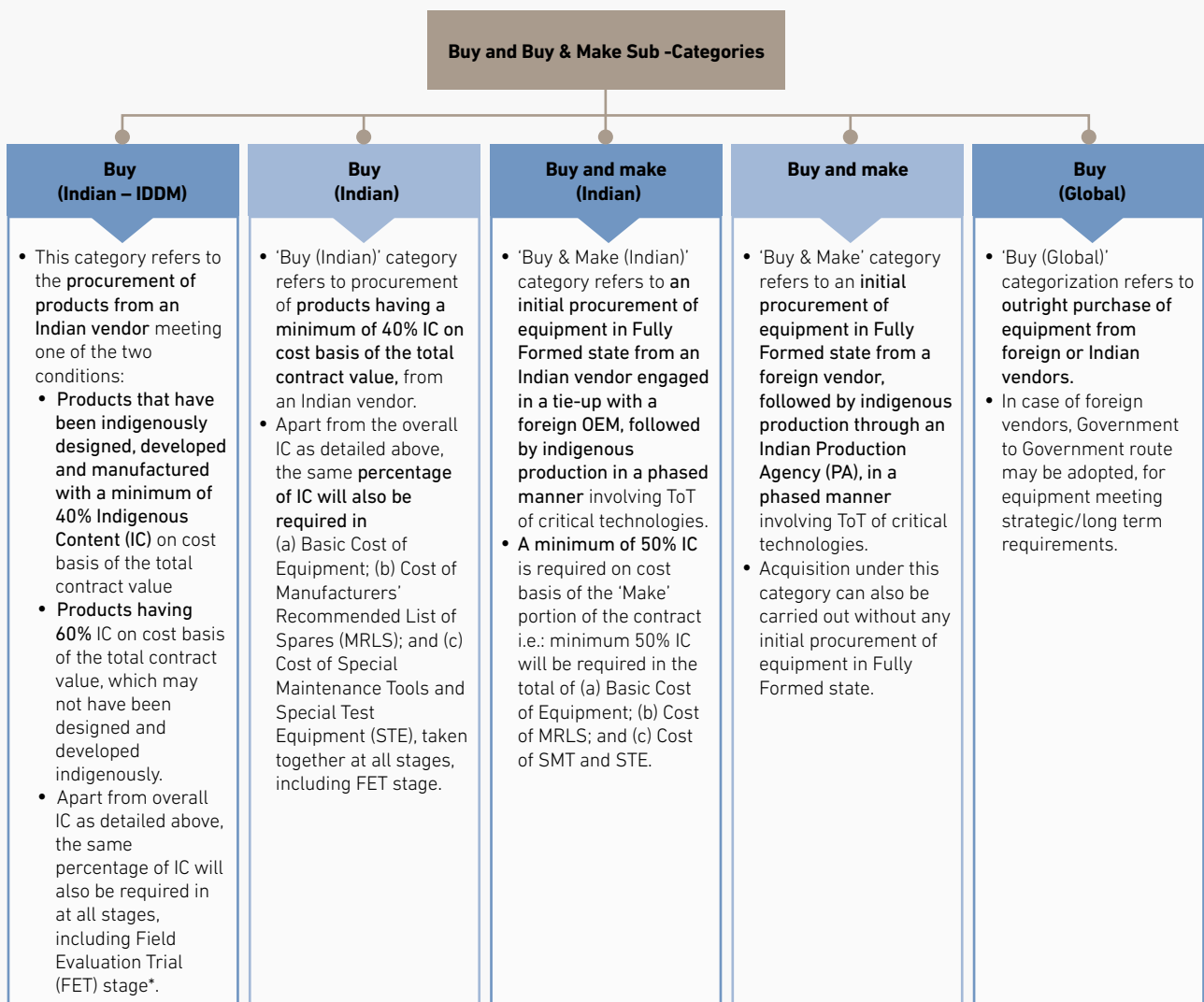


Though the entire chain of events is to be completed roughly between 76 to 126 weeks, the process can take much longer in reality. In-fact, many deals took as much as 10 to 16 years, from their genesis to the ultimate signing of contracts.



However, these set of policies are not static. The DPP has greatly evolved over the years, in line with current requirements. The 2013 version of the DPP was aimed at relaxing the bottlenecks and ambiguity associated with the various modes of acquisition in this sector. It has also provided a higher level of transparency through simplification of norms. However, the NDA government further revised the DPP in 2016, making changes in the procurement procedures, which lays a greater emphasis on indigenization and capability building in the field of defence manufacturing. This can be seen from the following infographic, which lists the various categories in place for obtaining AoNs (Acceptance of Necessity):

Figure 10: DPP

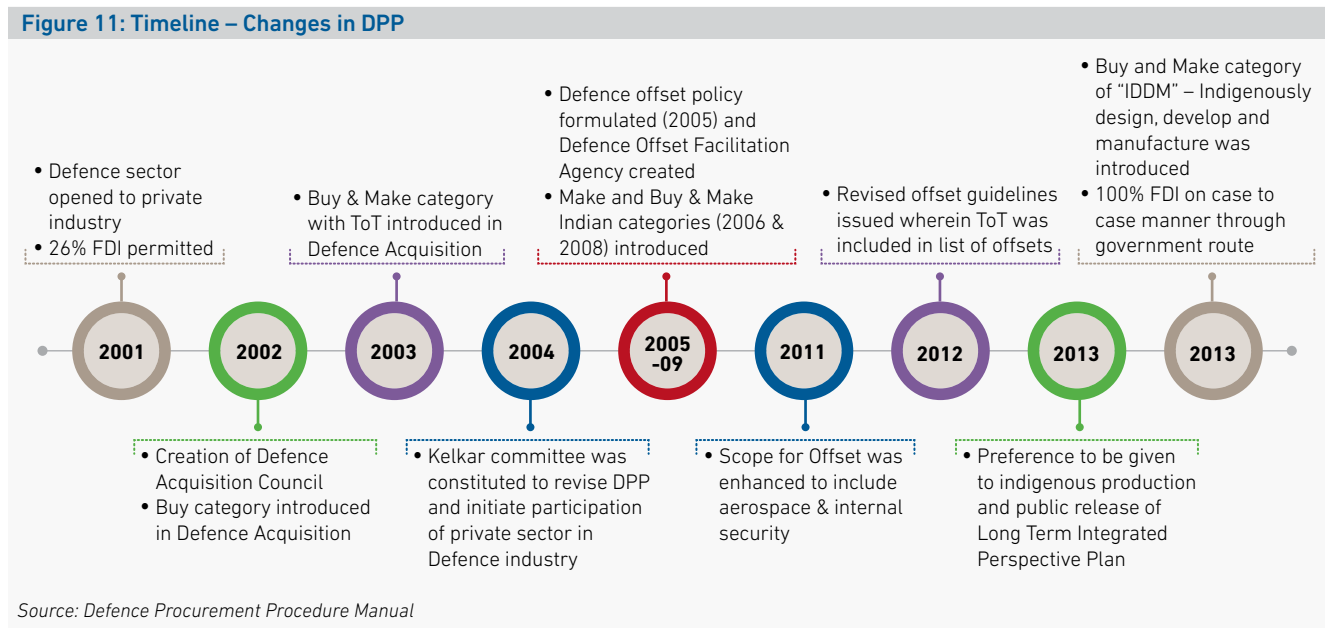


*Stages: (a) Basic Cost of Equipment; (b) Cost of Manufacturers' Recommended List of Spares (MRLS); and (c) Cost of Special Maintenance Tools (SMT) and Special Test Equipment (STE).

Source: Defence Procurement Procedure Manual



With that, the below Infographic highlights the entire evolution process of the DPP up till now:



All the above changes, which may not have been present in the DPP 2013, have been added in the newly revised DPP 2016. Comparisons of this can be made by looking at the highlights of both the DPP 2013 and DPP 2016 as below:

- DPP 2013**
- Hierarchy in Procurement Procedures:** Introduction of categories by the government, listed in order of preference: "Buy (Indian), Buy & Make (Indian), Make (Indian), Buy & Make, Buy (Global)". This implies that justification will be required if opting to obtain an Acceptance of Necessity (AON) under the Buy (Global) category. The idea is to focus on manufacturing in India and reduce dependence on imports.
 - Indigenous Content Evaluation:** The 30% IC requirement in the Buy (Indian) category needs to be achieved on the overall cost, as well as the core components (Basic equipment cost, Spares, Special tools and Test equipment).
 - Fast Procurement Scenarios:** Procurement cases, from INR 50 cr to INR 150 cr, may be expedited (if required) through special powers vested with the Services Capital Acquisition Plan Categorization Higher Committee; meanwhile, those from INR 150 cr to INR 300 cr may be expedited by the Defence Procurement Board.
 - Higher Impetus on the Buy and Make (Indian) Category:** Simplification and unambiguous definition of the "Buy and Make (Indian)" and "Make" categories of procurement, through shortlisting of vendors by the Project Appraisal Committee.
 - Validity Time-period for AONs:** The validity of AON has been reduced from 2 years to 1 year, which is intended to cut the time-period involved between obtaining the Service Qualitative Requirements (SQR) and the AoN for a project.
 - Maintenance of ToT Norms:** Indian vendors are allowed to provide maintenance services for transfer of technology (ToT) to any other Indian vendor of choice, under the "Buy (Global)" scheme of procurement.

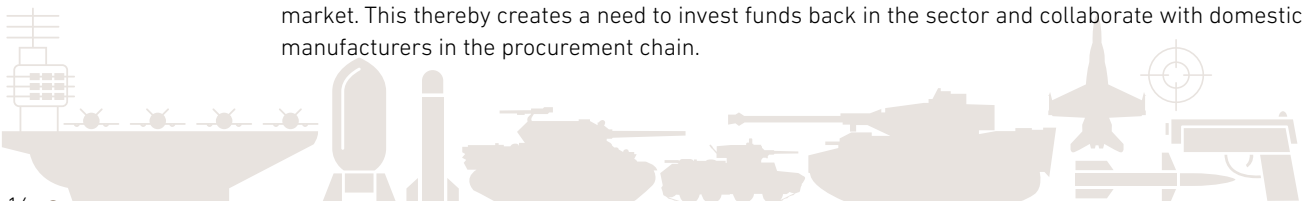


DPP 2016

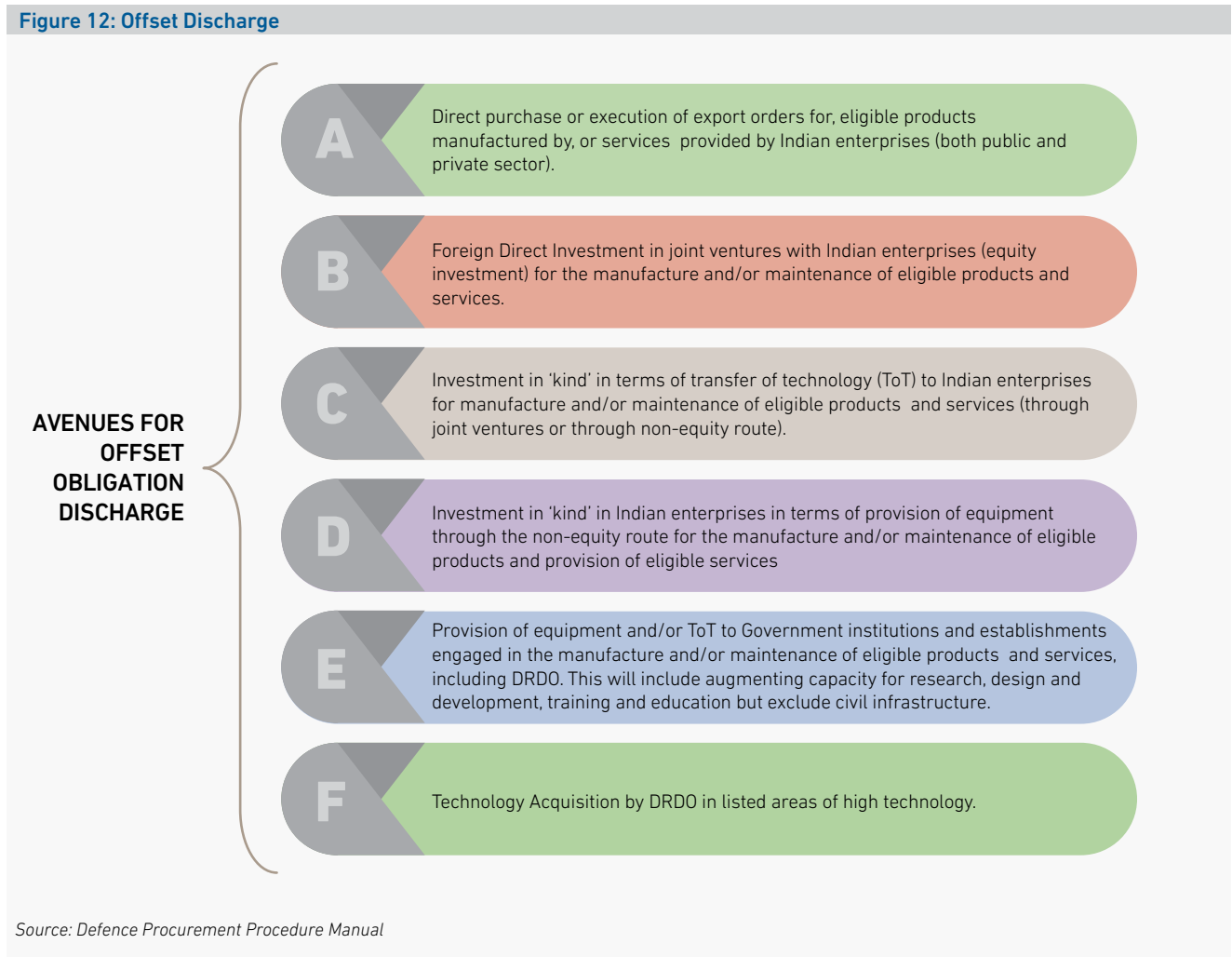
- **Introduction of Buy (IDDM – Indigenous Development designing and manufacturing):** A new sub-category has been introduced under the “Buy” category of procurement, which would provide an opportunity for R&D in this sector. Here, an indigenous content (IC) requirement of 60% has been set for products that are not indigenously designed and developed and 40% for those that have. This pre-requisite of having a significant component of indigenous content would also reduce the sole reliance on foreign players.
- **Indian Vendor (Elaborate Definition):** The DPP 2016 provides further clarity on deciding who is eligible to be an Indian vendor. Previously, any company established in India according to the regulatory requirements was considered as an “eligible” Indian vendor. However, this led to the inclusion of wholly owned foreign subsidiaries as well. It therefore created a channel for foreign companies to circumvent their IC obligations.
- **Indigenous Content (IC):** The IC has been increased by 10% (30% to 40%) on cost basis under the “Buy (Indian)” category. Meanwhile, the IC on the “make” portion of the “Buy & Make (Indian)” category has been increased to 50% from the previous 30%. Additionally, Indian companies will have to undertake R&D of technology to increase the IC level in the product(s) of their foreign partners.
- **Staff Qualitative Requirement (SQRs):** The requirement of listing SQRs under the Essential Parameter-A, Essential Parameter-B and Enhanced Performance Parameters in the RFP, will have a greater effect in the selection of the Proposal. The SQRs under Essential Parameters-B will not be tested at the trial and evaluation stage. Additionally, the technical superiority of equipment would get recognition through the EPP.
- **Offsets (Limits Modified):** Offset is now made applicable to contracts where the indicative cost of procurement is INR 2,000 cr or more (increased from the previous threshold of INR 300 cr). This will act as a relief to foreign OEMs and would keep them interested in the Indian defence sector.
- **Single Vendor Situation at Bid Submission Stage:** A single vendor situation arising at the bid submission stage is now permitted with due approvals.
- **‘MAKE’ Category of Acquisition:** The “Make” category has been completely delinked from other categories of Acquisition. It will be handled by a new organization, namely the Project Management Unit. It has been sub-divided into categories called Make-I and Make-II, based on the source of funding and type of work involved in the project.
- The Make-I category is funded by the GoI, which will undertake projects focusing on long-term procurement and creation of self-reliance. Funding in this case has been hiked by 10% (80% to 90% as in the DPP 2016).
- The Make-II category is funded by industry players and would incorporate projects focusing on the maintenance of existing capabilities and import substitution.
- A sub categorization has been formed for MSMEs, which will include projects ranging within a certain value reserved for them. MSMEs under the Make I category should involve a developmental cost ranging between INR 3 cr to INR 10 cr and MSMEs under the Make II category would involve a developmental cost of less than INR 3 cr.

Introduction of the Offset Policy

The Offset Policy was introduced in 2005 as a part of the DPP, with the prime motive of protecting the interests of domestic manufacturers, by promoting indigenous manufacturing of defence products. This protectionist move by the GoI has surfaced a pool of opportunities for niche firms operating in the local space. It requires foreign manufacturers participating in defence contracts with the GoI, beyond a certain threshold, to plow back a minimum of 30% of the total contract value into the Indian defence market. This thereby creates a need to invest funds back in the sector and collaborate with domestic manufacturers in the procurement chain.



The various ways in which an offset liability can be discharged are as follows:



The implementation of the offset policy has resulted in creating a huge market opportunity for Indian companies, which is estimated to be over USD 10 bn. This market is currently made up of domestic private sector firms, foreign companies in joint venture with Indian firms and DPSUs. The size of the offset market is expected to double by the end of another decade. The offset obligation pertaining to FY15 was valued at USD 2.23 bn and nearly 80% of the same has been claimed by foreign manufacturers in the same year. These offset market players are either involved in the manufacturing of sub-parts of defence equipment, or its supply chain.

Originally, foreign players that dealt with a contract value above INR 300 cr and procured through the Buy or Buy & Make categories of the DPP were eligible for offset liabilities. This threshold was raised to INR 2,000 cr in 2008, liberating foreign entities from the burden of offset liabilities on smaller value deals. The GoI has meticulously set a varied means to discharge offset liabilities, focusing on ToT and increased domestic manufacturing in the defence sector. Foreign entities are required to discharge a minimum of 70% of the applicable offset obligation through activities pertaining to the first 4 categories of the offset discharge avenues mentioned above. Additionally, there is scope to bank any excess offset credits earned through permissible operations in India, for a maximum period of 7 years. Foreign manufacturers can then utilize the accrued offset credits generated against future offset obligation(s) associated with future procurement deals.

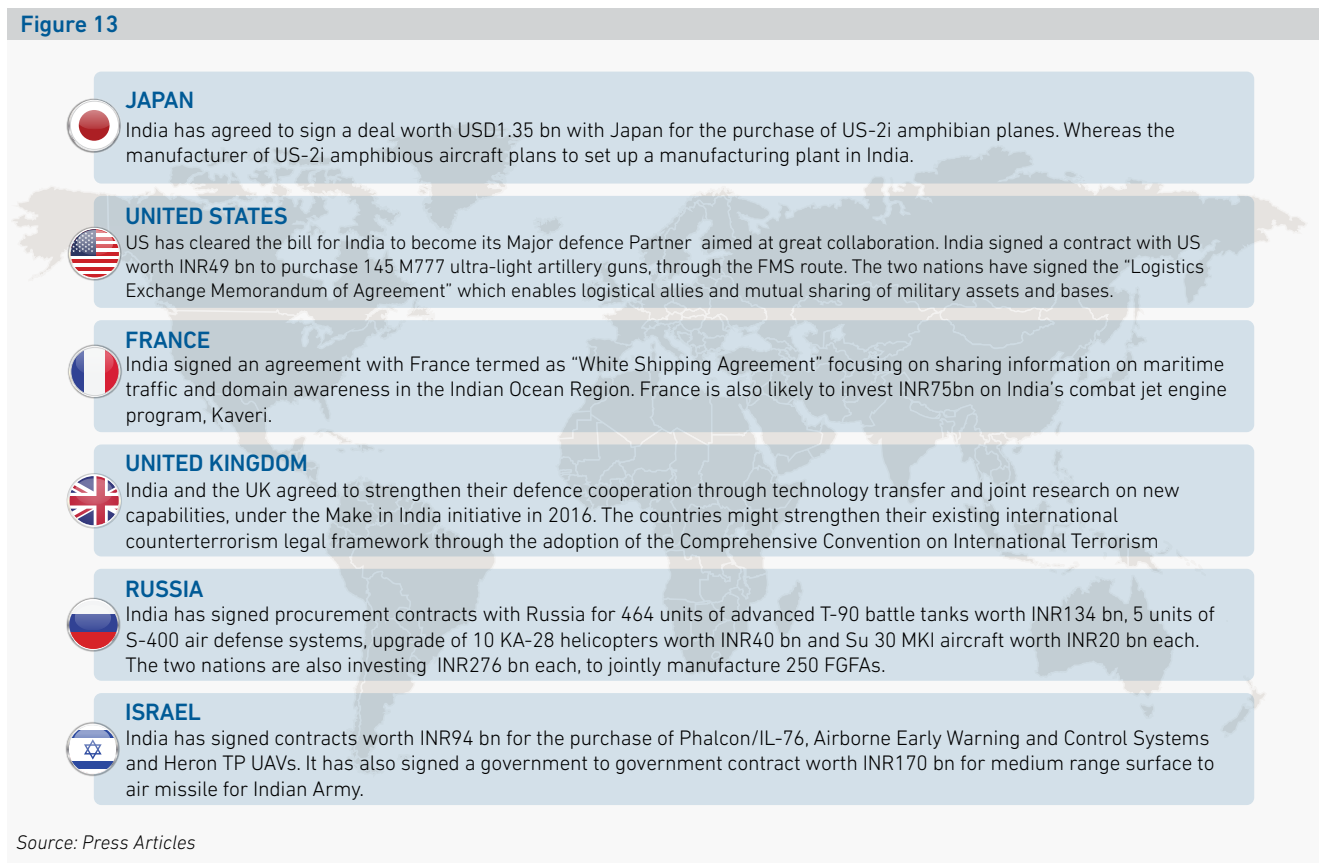


The GoI has sanctioned a pack of deals with other nations in the last 10 years, which has led to the pooling in offset obligations for the Indian defence sector. Currently, countries such as Israel, the US, Russia, UK, Switzerland, and France have offset obligations in India. The US, among all the other nations, owns the highest quantum in offset obligation, which has been generated through its twin deals signed with Boeing. These contracts, signed in 2009 and 2011, involve procurement of P-8(I) long range reconnaissance aircrafts and 10 C-17 Globemaster aircrafts; they have generated offset obligations worth USD 641.3 mn and USD 1.09 bn respectively.

Other deals that have generated major offset opportunities in the Indian defence space include those made with the following:

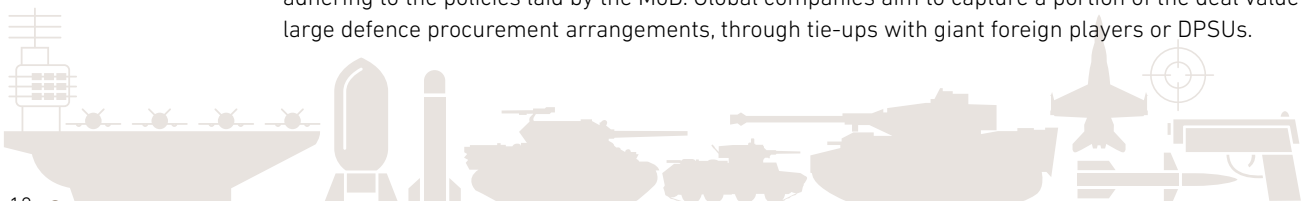
- Lockheed Martin (of USD 219 mn) - US
- Rosoboronexport (of USD 405 mn) and MiG Corporation (of USD 308 mn) - Russia
- Thales & Dassault (of USD 592.8 mn) and MBDA (of USD 386 mn) - France

Many other such country wide deals (signed or expected) are as follows:



Major defence players worldwide have expressed their interest in exploring this growing defence offset market. This includes SAAB, which is a defence company based in Stockholm, Sweden. It has planned to establish a manufacturing setup in India and thereby invest in this sector. On similar lines, Lockheed Martin and Tata Group have agreed to establish a plant in India to manufacture F-16 fighter jets indigenously. With that, Reliance has formed a JV with Dassault Aviation to manufacture combat aircrafts.

These foreign players form joint ventures with Indian firms to tap the increased rate of activity here. They deploy an Indian enterprise for face value and participate in Indian defence business deals, adhering to the policies laid by the MoD. Global companies aim to capture a portion of the deal value in large defence procurement arrangements, through tie-ups with giant foreign players or DPSUs.

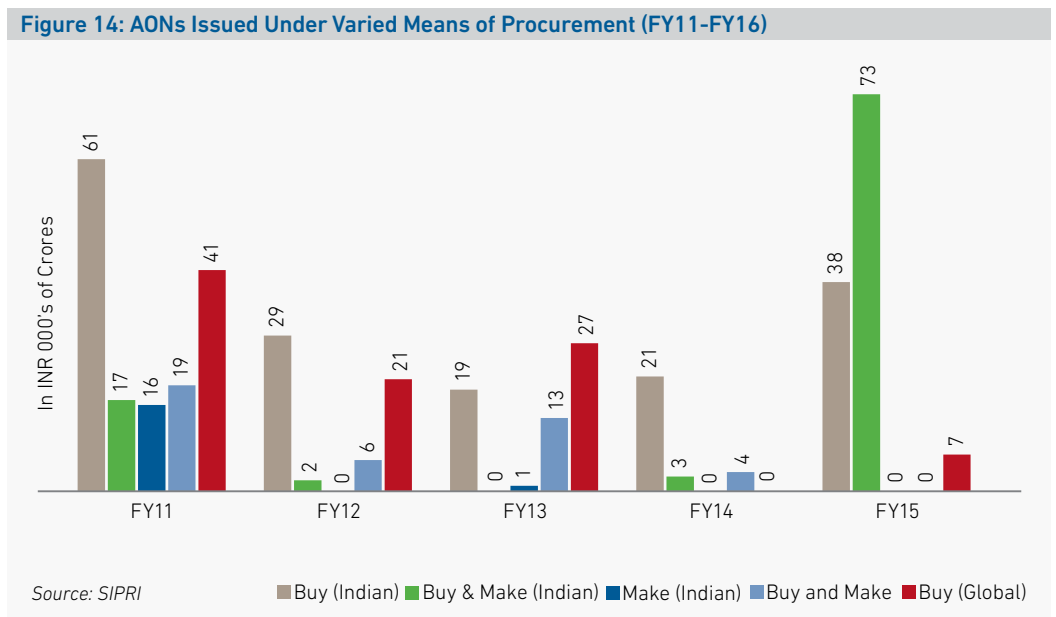


Subsequently, foreign counterparts disburse their offset liabilities through investment in the defence infrastructural setup in the Indian economy, ToT to DPSUs or the DRDO, and/or by providing assistance in the export of defence goods manufactured in India.

Acceptance of Necessity (AoN) for Procurement

The Acceptance of Necessity (AoN) approval mechanism in defence procurement proposals was a wise step taken by the DAC to streamline projects. Through this method, the DAC (which is essentially the decision-making body for defence procurement proposals channeled in by the Indian Defence Forces), clears the various procurement projects, granting them AoNs for a variety of acquisitions. It thereby paves the way for the tendering procedure to start.

Since the release of the revised version of the DPP in 2013, the Buy (Indian) and Buy & Make (Indian) categories have gained significant traction. These two categories accounted for 94.3% of the total AoNs approved in FY15, as compared to 31.4% in FY13. This proves the ministry's calculated efforts towards manufacturing in the domestic market. Between 2014 and 2016, the DAC has approved 66 schemes, amounting to INR 200,000 cr.



However, it is to be noted that not all AoNs are translated into contracts. Many AoNs are lapsed if a Request for Proposal (RFP) is not issued within a year of according an AoN. A whopping 314 AoNs have lost out on "contemporary relevance" due to the fast-moving advancement of technology or other reasons, which they could not catch up with. In these cases, the DAC generally asks the services to analyze and cancel any pending proposals.

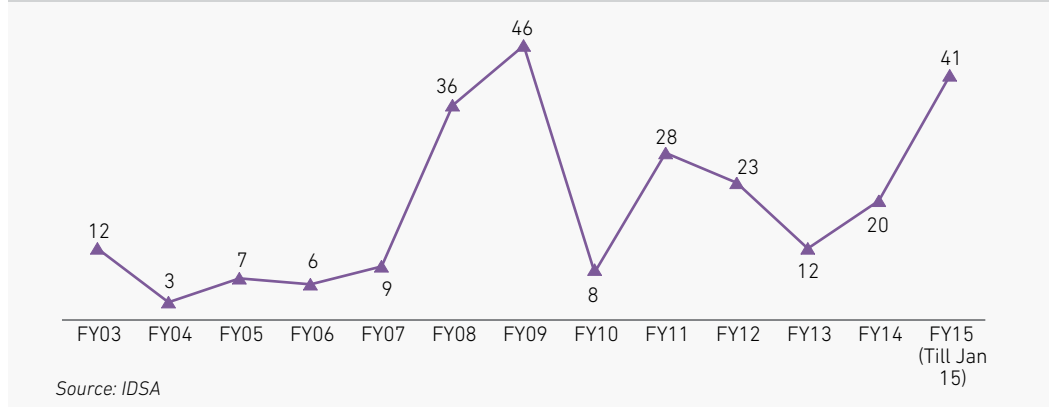
A new sub-category – Buy (Indian – IDDM) – has also recently been put in place under the Buy category of the procurement process, acting as a catalyst for more innovation under this sector in India. Alongside that, the Make category has been put on a standalone basis, which will be looked after by the Project Management Unit. It is sub-divided into the Make-I and Make-II schemes, where the funding will be provided by the GoI and industry players respectively. This categorization also caters towards MSMEs, having a certain value reserved for them so that they can also enjoy a level playing field.



Industrial Licensing

In order to manufacture defence equipment in India, companies need to acquire the relevant license(s). The Gol has taken measures to boost domestic manufacturing, by easing out the licensing procedure for manufacturers in the last 5 years. This has resulted in the cumulative issuance of 132 licenses by the Department of Industrial Policy and Promotion (DIPP) from 2010, in the field of Defence production.

Figure 15: Industrial Licenses



This increase in the number of Letter of Intent (LOIs) issued indicates a higher amount of activity in this sector. New players have entered in the manufacturing space, aiming to benefit from the companies currently prevailing here, which ultimately adds to GDP growth.

Furthermore, the licensing procedure has also been modified to reduce the hassle associated with its procurement. Few of these notable alterations made in the Industrial licensing process in India are listed as follows:

- The application process for an Industrial License has been made completely online.
- The initial validity period of an Industrial License has been increased from 3 years to 15 years, with the provision to grant an extension for a period of 3 years.
- The license allows for the sale of defence items to government entities under the control of the Ministry of Home Affairs (MHA) and state governments.
- The Gol has also revised the Standard Operating Procedure for the issue of 'No Objection Certificate' for export of military stores.

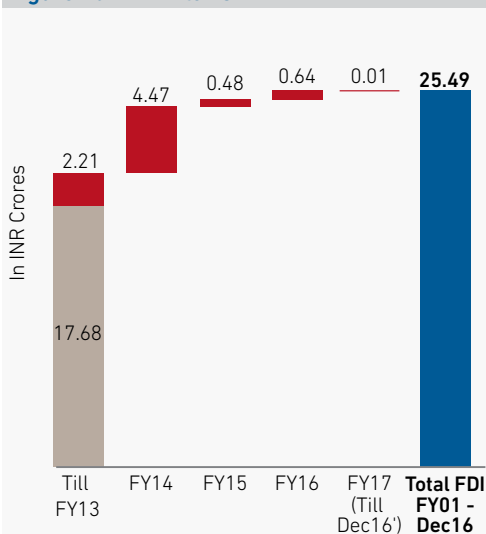
Foreign Direct Investment (FDI)

FDI has been a major source of inflow in some sectors, ever since liberalization was attempted in India in the last decade of the 20th century. On the contrary, the Indian Defence sector had been reserved by the government and public sector undertakings till the 2000s. Thus, the inflow of investment through FDI in this industry has been remarkably low in the past. Foreign investors have been quite apprehensive about the foreseeable future of their investments, as this sector is known for its long gestation periods and restrictive laws governing rights of foreign/private players.

With the unfurling of the 21st century, the Gol has gathered momentum towards achieving global access in this sector. It aims to attract foreign investment to facilitate indigenous manufacturing in the defence industry. Thus, the NDA government identified certain sectorial confinements; it has then attempted to make relevant modifications in the policy pertaining to FDI in the recent years (2014-2017). A marginal increase in foreign investment has been witnessed post the implementation of the modified FDI policy; that is, increasing the cap of having 49% investment through the automatic route.



Figure 16: FDI Inflows



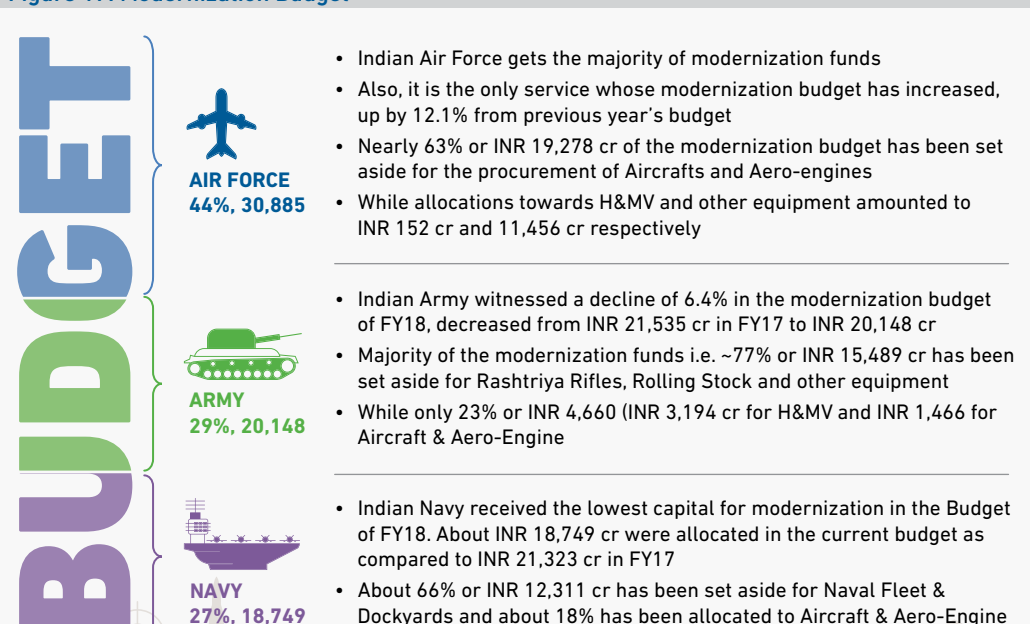
Source: Department of Industrial Policy & Promotion

However, the momentum of increase in the inflow of foreign capital in this sector is comparatively lower than that in other popular spaces such as telecom and insurance. In view of this, the GoI has recently removed the extra institutional scrutiny layer of the FIPB (Foreign Investment Promotion Board), easing out the FDI process. Alongside, the government's decision to allow private firms to participate in strategic alliances in this sector will encourage new entries; this will subsequently attract more foreign inflow into defence.

Modernization Drive Adopted by the Indian Armed Forces

The drive towards modernization, adopted by the Indian Armed Forces, has also necessitated procurement of technologically viable arms and armaments. The Indian Armed Forces have acknowledged that nearly 50% of the defence equipment currently employed by the Army, Navy and Air Force personnel, are obsolete and need replacement. The Air Force currently has merely 32 squadrons of fighters, which is an all time low in a decade. This not only poses operational difficulties but also compromises on safety as the Air Force requires 42 squadrons of fighters to guard the northern and western skies with China and Pakistan. Similar situations have surfaced in the other 2 service lines. All the 3 verticals are therefore simultaneously pursuing procurement projects to replace their equipment, on very different timelines. A snapshot of this, for FY17 and FY18, can be seen as below:

Figure 17: Modernization Budget



Source: IDSA, Mazars Analysis

It is fair to say that upgradation of technology/equipment and the funding allocated in this area is expected to be significant in the near future. As of now, the Capital Outlay for modernization was estimated to be INR 140,200 cr in the last 2 years. The Union Budget for FY18 has earmarked INR 69,783 cr (out of the Capex allocation of INR 86528 cr) for modernization of related procurements. This trend is expected to hold in the next decade as well, keeping the domestic consumption demand level relatively high.

Strategic Partnership Model

The DAC has finalized a policy reform in May 2017, which would allow private participation in high tech defence manufacturing. This model, popularly termed as the “Strategic Partnership Model”, is set to provide a broader scope towards achieving “Make in India” in this sector. The private firms are expected to set long-term strategic alliances with OEMs and jointly manufacture equipment in India. Such alliances provide a greater opportunity for ToT and investment in the civil infrastructure of defence manufacturing.

In this model, the government will be shortlisting local companies to join hands with foreign counterparts to make specific orders such as helicopters, fighter jets, submarines and more.

Many Indian firms such as the Tata Group, Mahindra and Mahindra Ltd., Reliance Infrastructure Ltd., Larsen and Toubro Ltd. etc. are expected to greatly benefit from this new development.

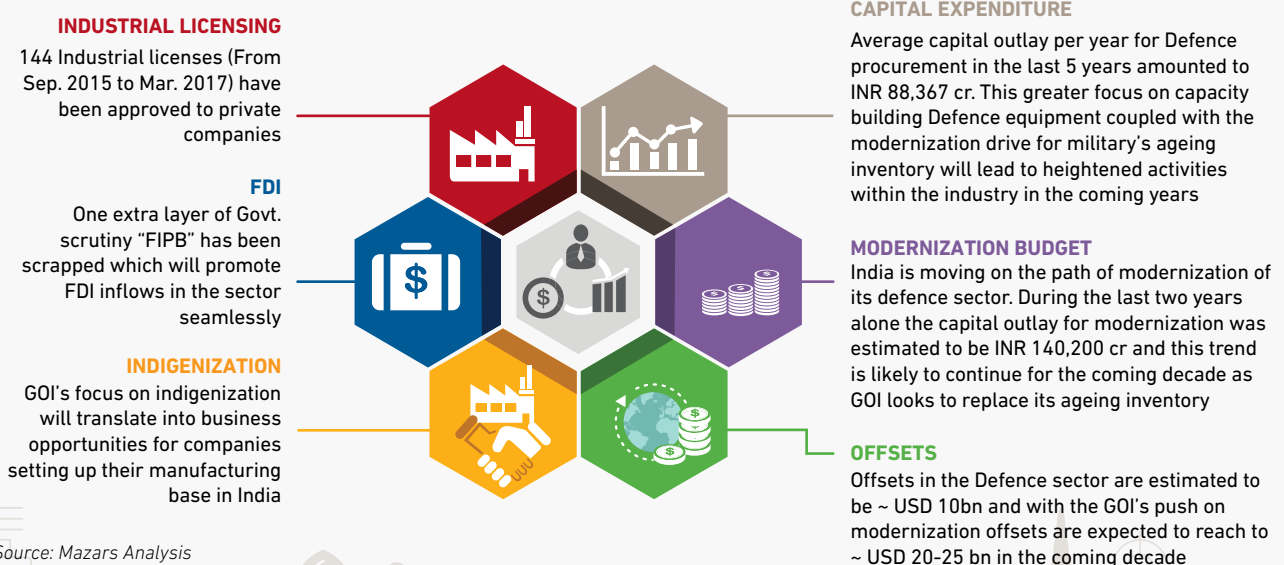
The MoD has also taken steps towards the creation of strategic partnerships in 6 major segments: i.e. airborne, warships/submarine, armored vehicle, missiles, command and control system, and critical materials.

The annual opportunity for Indian companies in this sector (public and private), as estimated by FICCI and Centrum, is expected to reach over USD 41 bn by 2022. This can hike up even further, due to the increase in partnerships through this model.

6.8 Road to Indigenization

All these changes have greatly encouraged indigenization in the defence industry, stimulating growth and increasing the rate of activity in the country. The inline Infographic highlights each of the market levers and its relative impact within the sector:

Figure 18: Market levers



In a nutshell, efforts taken towards indigenization of defence goods, necessitated through the “Make in India” strategy of the Government, have resulted in a notable amount of activity in the industry. With that, the liberalization of policies associated with foreign investment, licensing and private sector participation, has set the floor for new entrants to step foot. Simultaneously, the multitude of deals sanctioned with other nations have increased the scope for production in this space, gearing employment opportunities, industrial profits, export income etc. All these positive macro level movements have helped uplift sentiments and create opportunities for collaboration with players worldwide.

Some prominent global deals signed in all the 3 services of the defence sector are detailed below:

Figure 19: Major deals by service line



GOI signed a contract worth ~ €7.9 bn with France in Sep 2016 for the procurement of 36 Rafale jets from Dassault Aviation comprising of 28 single-seater jets and 8 dual-seater jets.

- Rafale jets' cost is estimated to be ~ €3.3 bn; €91.1 mn per unit for the single-seater jet and €94mn per unit for the double seater
- The Remaining €4.6bn is estimated for spares, logistics and weaponry in this deal.
- The deal undertakes a 50% offset liability clause. Thus in order to execute the offset obligations, Dassault Aviation has formed a 49:51 JV with Reliance Aerostructure. The new venture is termed as “Dassault Reliance Aerospace Limited”.
- The JV is meant to focus on the production of aero structures, electronics and components for the Rafale’s Snecma M88 engines
- Also, the JV will invest in time on developing major Indian programs with higher levels of technology transfer and promoting programs under the new procurement policy “Buy Indian - IDDM”



GOI signed a contract worth ~ \$2 bn with Israel in Feb 2017 for the procurement of Medium-Range Surface-to-Air Missiles and firing units from Israel Aerospace Industries. It is meant to replace the obsolete air Defence systems required in navy vessels.

- The first delivery in this deal comprised of 16 firing units, fire control systems and surveillance systems in the regiment. The deal includes delivery of 200 missiles through five regiments and other related equipment.
- Each MRSAM weapon system comprises of one command and control system, one tracking radar, missiles and mobile launcher systems. The weapon is 4.5m-long and is equipped with canards and fins for control and manoeuvrability.
- The deal involves Indian companies such as Tata Advanced Systems, Bharat Dynamics, Bharat Electronics, L&T, Elta, Rafael along with DRDO. The manufacturing required 80% Indigenous Content in the product.
- Tata Advanced Systems has designed and manufactured the combat management systems and Bharat Dynamics has been the lead integrator for the missile systems.



GOI signed a contract worth ~ \$ 3 bn with France in Oct 2005 for the procurement of 6 units of Scorpene-class submarines. India’s French counterpart DCNS, was involved in transfer of technology in this deal and public sector undertaking ‘Mazagon Dock Ltd was responsible for the manufacturing of the submarines.

- This project was termed as “Project-75” comprising of 66 metres long diesel-electric submarines; which could travel to a depth of 300 metres in the water.
- The first unit named “Kalvari” has been manufactured and is under trial until next year, whereas the remaining are expected to be delivered by 2020.
- This is the most expensive project undertaken by the Indian Navy, involving \$ 9.9 bn which has attracted many foreign players to approach future submarine deals in India

India is exploring its capability to further collaborate with foreign vendors to procure 6 next generation submarines. DCNS has also offered to provide an advanced version of the Scorpene submarine technology for future procurement needs in Indian Navy.

Source: Industry Discussions, Press Articles



TAXES

Apart from the change in policies, India's move towards self-reliance (including in the defence sector) is also illustrated from the evolution of its tax system. Presently, the GoI has been continuously focusing on improving the ease of doing business in India and hence creating a tax environment that boosts the confidence of foreign companies.

Direct Tax

Although there are no specific direct tax benefits pertaining to the Defence sector, some of the existing provisions do indicate there to be a vision to promote manufacturing in India. These include the following:

1. At present, the effective corporate tax rate for domestic companies (with Turnover greater than INR 50 cr and Net Income greater than INR 10 cr) is 34.608%. For foreign companies, the effective corporate tax rate is 43.26%.
2. The Indian Finance Ministry has provided various tax incentives in relation to new assets acquired by manufacturing units set up in the notified backward areas of Andhra Pradesh, Telangana, Bihar and West Bengal, between 01 April, 2015 and 31 March, 2020. Such an assessee is allowed an additional investment allowance of 15%, along with an additional depreciation of 35% on the cost of the new Plant and Machinery.
3. The requirement of PAN, in the case of foreign companies to avoid withholding tax at the rate of 20% has been diluted, subject to the fulfilment of prescribed conditions. This encourages foreign companies in developed countries to transact with Indian manufacturers, increasing their quality and efficiency.
4. To encourage local manufacturing, each assessee (subject to tax audit) will be provided a further deduction of 30% on additional employee cost, where the total employee emoluments are up to INR 25,000 per month.
5. The tax rate applicable to foreign companies on Royalty and Fees for Technical Services has been reduced from 25% to 10% (plus applicable surcharge and cess), which has brought down the cost of technology. This will encourage foreign companies in developed countries to share technology and intangibles with Indian manufacturers, helping them establish their market quickly.
6. In order to promote India in becoming a global R&D hub, the Royalty income of a resident - in relation to a patent developed and registered in India - is taxed at lower rate of 10% (plus applicable surcharge and cess) on the gross amount. This is applicable only to the "true and first registered inventor of the invention."
7. MAT is not applicable on income earned by foreign companies, which do not have a permanent establishment in India.

Further, Royalty under section 115BBF (as per point 6 above), being income of a resident patentee of indigenous R&D activities, would not be subject to MAT.

8. Certain profit linked deductions are also provided in the Income Tax Act viz. setting up newly established units in Special Economic Zones (Section 10AA).
9. Several other direct tax changes such as clarifications on rules relating to the indirect transfer of assets, dispute resolution schemes, and rationalization of litigation and penal provisions also indicate the intention of the government to promote domestic manufacturing.



Indirect Tax

Customs Duty

1. A majority of defence sector goods were earlier exempted from customs duty. However, in order to provide a level playing field and encourage the "Make in India" initiative, this exemption has been withdrawn on the import of specified goods for defence purposes by the GoI, the state government, or its contractors/ sub-contractors.
2. With the introduction of the Goods and Services Tax (GST), the duty structure under the Customs law has been modified. Earlier, the Basic Customs Duty (BCD), Countervailing Duty (in lieu of Excise), Education Cess (EC) and Special Additional Duty (in lieu of Sales Tax) were levied. However, the GST has summed up Excise and Sales Tax. Hence, the duty structure consisting of BCD, EC & Integrated GST (IGST) is now levied.
3. To further provide impetus to indigenous manufacturing, the government has amended the Customs law to provide for the exemption of customs duty, including IGST, on the import of "tools and toolkits" for aircraft, subject to the fulfilment of certain conditions. The time limit on the stay of foreign aircraft undertaking maintenance, repair or overhauling has been increased from 60 days to 6 months, or such extended period as approved by the DGCA.
4. Earlier, under the Standard Exchange Scheme, the import of aircraft parts for repair/overhaul in India was subject to customs duty. However, these imports have now been granted exemption.
5. In order to increase the ease of doing business in India, the procedure for availing duty exemptions on aircraft parts, testing equipment, and tools and toolkits has been simplified; alongside, the restriction of the one-year utilization of duty-free parts for Maintenance, Repair and Operations (MRO) on aircraft has been removed, subject to the fulfilment of specified conditions.

Goods and Services Tax

The GST has revolutionized the Indian taxation system. The new law has come into effect from 1st July, 2017. GST is a comprehensive, multi-stage, destination-based tax that is levied

upon every value addition. It has a four-tier tax structure, consisting of 5%, 12%, 18% and 28%.

GST is a significant step for indirect tax reforms in India. By amalgamating a large number of Central and State taxes into a single tax, it would mitigate cascading or double taxation, simplifying the procedure. GST is largely technology driven, with all compliance and disclosure done through the common GST Network. There are simplified and automated mechanics for registration, returns, refunds, tax payments, etc.

This will help to create a unified common national market for India, giving a boost to foreign investment and the "Make in India" campaign. However, in order to avoid breaking the value chain, exempted transactions before the GST have generally been brought in the bracket of 5%. Further, some additional changes, pertaining specifically to Defence, are as follows:

1. Prior to the implementation of the GST, the Standard Excise duty rate was 12.5% and exemption from this duty was available for aircraft, if it was sold to the government or to commercial airlines engaged in specified activities. However, this rate has been brought down to 5% and the exemption has been removed.
2. Duty on indigenous procurements of tools and toolkits for aircraft, which was exempted under the Excise law, is now taxable under the GST.

From the consumer's point of view, the greatest advantage would be in terms of a reduction in the overall tax burden on goods. GST would also make Indian products competitive in domestic and international markets. Such a tax environment would increase the ease of doing business locally, boosting the confidence of foreign companies.

In a nutshell, while there may be less of a concentrated focus towards defence, the change in taxes over the last three years do indicate the government's aim to promote the industry, with greater manufacturing done in India. It will be interesting to see how the GST (with its focus on Equality), alongside the current indirect tax regime, embraces the tax provisions to fulfil this vision.



VIRTUES OF SELF RELIANCE

Surely, the GoI has taken a potpourri of measures in the Defence Industry, which directly correlate with its "Make in India" objective. The goal behind this is to build a sector that runs on self-reliance, as opposed to foreign dependence. This framework brings in a range of benefits, given the nature of the defence industry as it stands in the country. Some of these core value additions are outlined below:

Increase in Job Opportunities

The defence industry, despite being in existence for a very long time, is still at a very nascent stage. Currently it employs about 200,000 people. The Prime Minister enumerated in his speech that at this potential, even a 20-25% decrease in defence imports would directly create additional highly skilled jobs of up to 100,000-120,000. This increased employment opportunity will also spill over to other allied sectors such as manufacturing and service.

Technology Transfer and Building Local Capability

Transfer of technology will expose the Indian companies to the new age technology that may have been inaccessible until now. This in turn will help increase the competitiveness of products on a global stage, improving the country's tactical capabilities. It would help India tap the high export potential. This will also create multiplier opportunities in allied sectors such as IT, Electronics, Hardware etc.

Improved product quality will help the industry reach its targeted export of USD 2 bn by 2019, reaching out to countries such as Vietnam, Mauritius, Bangladesh, Philippines, Afghanistan and Oman.

Cost Effectiveness of Indian Made Arms

India has an abundance of highly educated and skilled labor that will immensely aid in defence production, lowering many of the associated costs. Indian companies claim that their products are more affordable than those made by their US counterparts. For example, ultra-light weight howitzers, which are currently developed by the Kalyani group, are priced at just half the price than that offered by the US companies.

Increased Private Participation

The defence industry of India is heavily regulated by the government and therefore of a complex nature. The producers of this industry are also greatly dependent for technology inputs, production permits, raw material imports and sales (both within the country and outside). The entry requirements here are very high and intricate. Thus, for any private company to enter or sustain in this sector it would require substantial government support. The GoI has therefore taken the aforementioned steps to boost the defence sector under the "Make in India" campaign, changing its policies in play to upturn defence manufacturing locally.

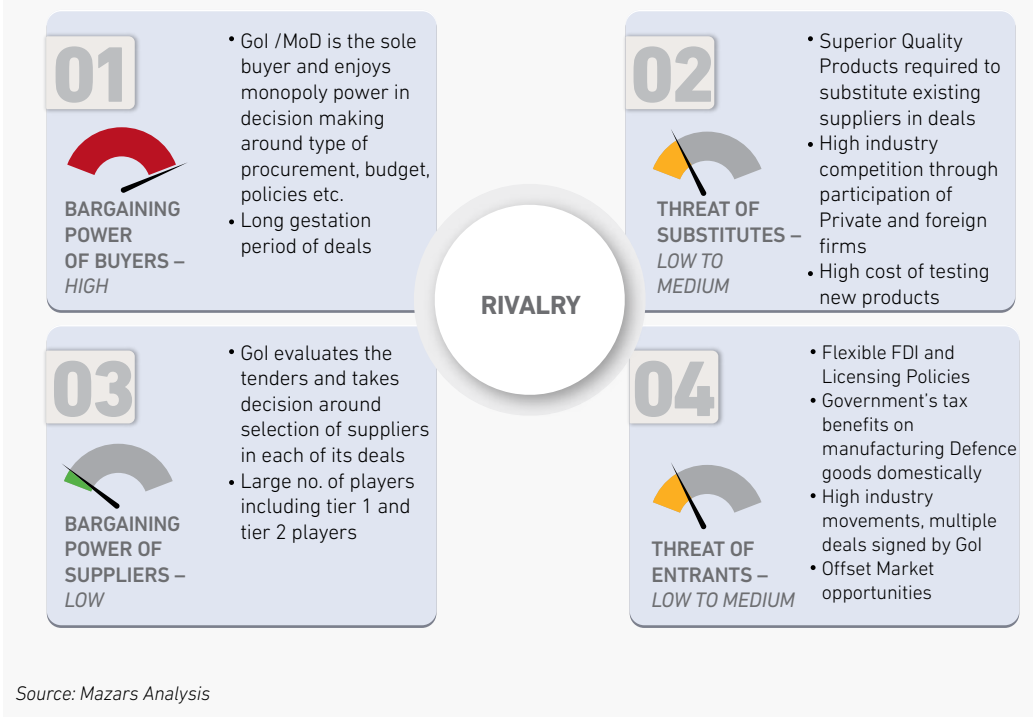
With that, the introduction of several new policies has been carried out to increase the participation of private players in this field as well. After all, healthy competition drives up quality, which is something that cannot be compromised in defence.



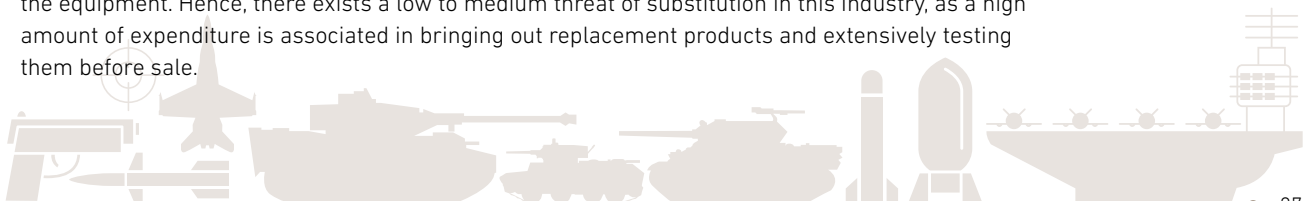
OUTLOOK OF INDIA'S DEFENCE INDUSTRY

The developments made in the Indian defence industry uptill now will have long-lasting impacts on the various forces that come into play. These in turn will then determine how this sector pans out in the time ahead, in terms of competition and sustainability. This can be seen by touching upon Porter's 5 Forces of an Industry, as represented below:

Figure 20: Porter's Five Forces Analysis



- High Bargaining Power of Buyers:** The bargaining power of buyers is high here as the GoI is the sole buyer of defence goods; it is entrusted with the responsibility of managing national security. This thereby gives it monopoly power in decision making on what products are to be procured for national security services. This is performed through the issuance of AoNs by the Ministry of Defence, which declares the procurement requirement of the country. Hence, the ministry is vested with much of the power. For example, it is authorized to carry out monetary disbursements of the manufacturers, and look over how the major proportion of the annual Capital Outlay is spent. This trend does not seem to change much over time, even with the "Make in India" initiative; the suppliers will be increased, but the government will largely drive purchases, given the nature of this industry.
- Low-Medium Threat of Substitutes:** Defence products are meant for national security and thus vouch on their quality and technology. It is difficult for any firm to market its product in this industry without ending advanced technology and know-how on a similar level. With that, large organizations have association with niche firms for the manufacturing and supply of sub-parts of the equipment. Hence, there exists a low to medium threat of substitution in this industry, as a high amount of expenditure is associated in bringing out replacement products and extensively testing them before sale.



However, with the increased demand in this sector, there are a considerable number of entrants stepping foot in this space. This may create possible avenues for substitution in the coming time.

- **Low Bargaining Power of Suppliers:** The supplier network in this space includes government owned bodies (DPSUs & OFBs), private sector organizations such as L&T, Reliance, Mahindra, TATA etc., and large foreign entities such as Thales, Lockheed Martin, Dassault etc. Apart from these entities, which are characterized by their large capital base and strong goodwill, there is a long list of MSMEs operating in this industry.

Generally, public sector organizations and large organizations (such as conglomerates and MNCs) win the large government contracts. These contracts also outsource manufacturing of certain sub-parts of the equipment to smaller firms operating in this industry. The bargaining power of suppliers here is therefore low to medium, as the Gol rolls out the majority of deals. Companies need to submit tenders and compete mutually to win the contracts from the government. Certainly, some networking and corruption also exists in the midst of all the process. Hence, on this current trend, the supplier power in this sector stays at a minimal level.

- **Low-Medium Threat of New Entrants:** The defence sector has gathered a huge potential for companies operating in the manufacturing of defence goods. This is backed by recent deals signed by the Gol, the modernization venture adopted by the Indian Armed Forces and a bullish defence market outlook. However, that is not to say that the threat of new entrants is potentially high in this sector. Unlike some other industries, defence is a highly capital and know-how intensive area, and not anyone can enter the market that easily. This in some way creates barriers for new entrants. Nevertheless, this is not to say that the situation may never change. If the Gol continues on its current trend of liberalizing FDI and licensing policies, basically increasing the ease of doing business from a regulatory nature, then this can lure many new entrants in this sector in the upcoming time.

- **Increasing Rivalry in the Industry:** On the whole, with high buyer power and significantly lower supplier power, high rivalry is to be expected amongst the players. Couple that with the government's recent move to sell stake in the DPSUs, which would increase private participation. The Gol's sensitivity towards price and quality of the products is also expected to rise with the increase in the number of tenders. This is a natural response to the rising competition that will manifest amongst the suppliers.

This high competition may also create room for malpractice as participants scour all possible means to win projects. This will only end up intensifying the rivalry in this industry even more.

Times Ahead

If looking at the big picture, it is fair to infer that over time this industry will be engulfed with a high level of competition, as the entry barriers are liberalized and new players enter in line. This can be positive, as it will create an atmosphere where the quality and technological advancement of goods determine their competitiveness in the industry. New job opportunities will also be created in this area. Couple this with the modernization plan across all 3 verticals of the Indian Armed forces, which portrays a bullish defence market in the upcoming period.



CONCLUSION

A strong domestic manufacturing will have a multidimensional impact on India's well-being. Firstly, on a financial level, it would save millions of dollars spent on imports every year (which contributes to the national current account deficit), improving its balance of payments and also providing export opportunities worldwide. Secondly, on the economic front, manufacturing defence equipment in-house would help create numerous job opportunities for the local population, in not only the defence sector but other allied sectors as well. It will therefore have a spill over effect over many parts of the country, making the economic pie bigger for all. Last, but not the least, possessing capabilities in defence equipment manufacturing inside national borders will also help establish a strong sense of security among all, where India may need not depend upon others in times of peril for its protection. This is by far one of the most important functions of the defence industry for any country.

Historically, India had relied on importing arms and armaments from other countries. By doing so, it had in effect deprived its own nation of developing this expertise and skill set in-house. Private participation grew slowly and employment opportunities within this sector were stunted, preventing healthy competition from setting foot. This framework was certainly not sustainable in the long run and needed to change.

In view of this, the Indian government has taken a host of measures to change policies that favour self-reliance. It has also set numerous export targets so that the country can work up to its potential and extend its reach to other global players. However, just changing the regulatory landscape is not enough. If India is to reach its desired goal of indigenization, it has to incentivize the participation of private players as well. This will keep its industry running well in the long term. Given the host of initiatives taken in the "Make in India" program, it is certain that the country will see the entry of many new private players in the time ahead.

This will work towards a steady development of India's manufacturing base for defence equipment, which will benefit the nation in a variety of fronts - monetary aspects as well as invaluable facets relating to national sovereignty and protection.

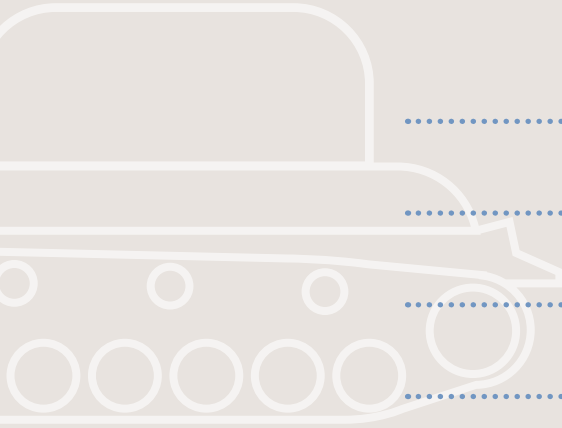


NOTES

NOTE: This page contains a large white outline of a military tank in the upper right corner. The rest of the page is filled with horizontal blue dotted lines for writing notes.



NOTES



NOTES

Handwriting practice area with blue dotted lines and faint background illustrations of military equipment including a tank, a control panel, a gun, and bombs.



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