

A New Dawn for Defence Production in India

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Summary

Defence acquisitions are always much debated and scrutinised. The criticism ranges from a lack of direction in procurements to needless procedural complexities and from corruption in defence deals to bureaucratic apathy. The Defence Acquisition Council, chaired by the Defence Minister, has taken some bold and much needed decisions on April 20, 2013 in an attempt to address some of these issues. This is not to suggest that all problems will suddenly vanish with the implementation of these decisions but the stage has been set for a significant re-orientation of the defence procurements, which is the real good news underlying the DAC decisions. The Issue Brief examines the decisions taken by the DAC and also reflects on some of the policy decisions.

Defence acquisitions always remain in the limelight in India, often for the wrong reasons. The criticism ranges from a lack of direction in procurements to needless procedural complexities and from corruption in defence deals to bureaucratic apathy. The Defence Acquisition Council, chaired by the Defence Minister, has taken some bold and much needed decisions on April 20, 2013 in an attempt to address some of these issues. Though one will have to wait for the details to emerge to form a more informed opinion about the impact of the decisions taken by the DAC and further steps may need to be taken to walk the talk, the press release of the Ministry of Defence¹ does provide enough reason to shed the usual scepticism with which such developments are generally received by the strategic community.

The decisions taken by the DAC broadly fall in three categories: decisions that would have an immediate impact on the existing procurement policy, decisions that aim at simplifying the existing procedures and the decisions that will show results in the long run. Proper implementation has long been the bane of all decision-making in India and unless the decisions taken by the DAC fall prey to the same syndrome, of which there is a real danger, the services and the defence industry have much to feel good about. This is not to suggest that all problems will suddenly vanish with the implementation of these decisions but the stage has been set for a significant re-orientation of the defence procurements, which is the real good news underlying the DAC decisions.

The policy decisions include (a) the decision to issue the public version of the Long-term Integrated Perspective Plan (LTIPP) 2012-27; (b) the stipulation that the 'Buy (Global)' decision can be taken only after the other options for procurement, *viz.*, 'Buy (Indian)', 'Buy & Make (Indian)', 'Make', 'Buy & Make with ToT', are ruled out in that order; (c) stopping the practice of nomination of the Ordnance Factory Board (OFB) and the Defence Public Sector Undertakings (DPSUs) by the Department of Defence Production as the recipients of the transfer of technology for maintenance (M ToT); and, (d) the decision to enhance the financial powers delegated to the Services and the Coast Guard from the existing limit of INR 50 crore to INR 150 crore in respect of each proposal for capital acquisition.

Considering that the LTIPP was approved by the DAC on April 2, 2012, the decision to issue a public version of the LTIPP by way of a 'Technology Perspective and Capability Roadmap' (TPCR) was long overdue. This should give a fairly good idea to the industry of the future needs of the service and help it draw up business plans for meeting those requirements, which, in turn, would inevitably give a fillip to the much needed research and development activity in the defence sector.

The Defence Production Policy of January 2011 says that, as far as possible, upgrades will be carried out by the Indian industry. The policy also requires the Defence Research and Development (DRDO), Headquarter Integrated Defence Staff (HQ IDS), Services Headquarters (SHQs), the Ordnance Factory Board (OFB), Defence Public Sector

Undertakings (DPSUs) and the private sector to work in close coordination for continuous upgradation of the systems. No coordination mechanism seems to be in place but it will be of immense help if information about the systems that would need upgradation in the coming years is also given out through the TPCR. If this information is not contained in the TPCR which is ready for release, a supplement can be issued as soon as possible.

Needless to say, the TPCR will be useful for the industry only if it contains the information in a format in which the industry requires it for chalking out its business plans. The purpose of releasing a public version will be defeated if it is not so. The MoD should be open to the idea of reformatting the TPCR if the version approved for release does not meet the industry's requirement. On its part, the industry should convey to the MoD what all it needs to know through the TPCR.

The decision that every proposal will be categorized as 'Buy (Indian)', unless there are valid reasons for not doing so, is a well-meaning but a slightly intriguing decision. What it apparently implies is that all preceding categories in the order of priority fixed by the DAC will have to be ruled out for reasons to be recorded in writing before moving on to the next category. At a time when seventy per cent of the defence requirement is met through imports it is not clear how the MoD could suddenly start buying everything from the indigenous sources under the 'Buy (Indian)' category, unless the Indian vendors are permitted to buy the equipment from abroad and sell it to the MoD with a mark up in the price. Surely, this could not have been the intention of the fiat.

Another difficulty in following this policy could arise from the lack of clarity as to what would constitute acceptable grounds for ruling out the 'Buy (Indian)', or for that matter any other, category of procurement in the hierarchy of categories now fixed by the DAC. The differing perceptions about what would constitute acceptable grounds could stymie the procurement proposals in the various committees through which these must pass before the Acceptance of Necessity (AoN) is accorded for commencing the process of tendering. Hopefully, such issues were kept in view while arranging the procurement categories in the order of their priority. The fine print of the DAC decision will provide answers to this question.

Since all the existing categories have been retained, the MoD clearly recognizes the fact that it will not be possible to procure everything under the 'Buy (Indian)' category. That being the case, it would have been more appropriate to lay down guidelines to be followed for proposing a particular categorization while initiating a procurement proposal. It would have minimized discretion and brought about greater transparency in the procurement process. It would also have made decision-making faster as there would have been little room for difference of opinion on whether the proposed category was justified or not. This would also have served the objective of promoting procurement from indigenous sources.

The decision to stop the practice of the OFs and the DPSUs being nominated for absorption of M ToT is a momentous decision not because this will bring in the private sector in the field of maintenance, repair and overhaul (MRO) but, more importantly, because it will enable the OFB and the DPSUs to focus on manufacturing, which is their core function, and improve the quality of production. This might also facilitate deeper involvement in research and development on their part.

Low serviceability levels have been an endemic problem for decades. Delinking of manufacturing and maintenance should also help in improving the serviceability levels of the equipment, weapon systems and other platforms held by the services. Considering that maintenance is presently carried out by the workshops, depots and shipyards run by the Services, it might be worth the while to consider if these entities could also directly participate in the process as prospective Indian partners for absorbing the maintenance technology, if necessary by converting them into government-controlled-company-operated companies (GOCOs).

According to the press release, this step would facilitate selection of the M ToT partner by the Indian bidders. The question of selecting an Indian partner for absorption of technology would come up when it is to be transferred by a foreign bidder and not by an Indian bidder, unless the Indian bidder is a DPSU and the intention is to permit them also to offload maintenance work to the private sector for the equipment they manufacture. Surely, it could not have been the intention that if the technology is to be transferred by a foreign bidder, MoD will continue to nominate the Indian entity to which it is to be transferred. There is a need for some clarity on this issue. Unless, of course, there is some nuance to it which is not apparent from the press release.

The decision to enhance the financial powers delegated to the Services and the Coast Guard for capital acquisition from INR 50 crore to INR 150 crore had been on the hold for close to a year because of various concerns, including the question regarding the capacity of the SHQs to handle the increased workload. One of the SHQs was lukewarm to the idea because it felt that the processing of the cases was taking longer under the delegated powers for a variety of reasons. There was a suggestion that a dedicated organization, replicating the Capital Acquisition Wing of the MoD, should be set up in the SHQs to process the proposals under the delegated powers. Unless these issues have been resolved, enhancement in delegated powers might only add to the pressure on the SHQs.

Enhancement in the delegated financial powers would also warrant an upward revision of the powers presently exercised by the Services Capital Acquisition Categorization Higher Committee (SCAPCHC) and the Defence Procurement Board (DPB) to accord Acceptance of Necessity (AoN) and the financial powers presently exercised by the Defence Secretary and the Defence Minister. It would be reasonable to assume that this issue has been resolved or will be resolved before the proposal is referred to the Cabinet Committee

on Security for approval. The enhancement of the delegated financial powers will possibly be welcomed by the SHQs despite the earlier reservations by one of the SHQs

The second set of decisions taken by the DAC concerns the procedural aspects of the procurement process. There are five decisions that fall in this category. The first one relates to simplification of the procedure for 'Buy and Make (Indian)' category. The press release says that the procedure has been brought at par with other categories, which will result in faster processing of the cases under this category. This does not give any idea of what changes have been made in the procedure but simplification of the procedure is never a bad idea.

One of the issues concerning 'Buy and Make (Indian)' cases is the absence of the guidelines for selection of the Indian companies to which the RFPs could be issued, if there are no companies with the requisite experience of manufacturing the product which is to be procured. This was the major hurdle in classifying the Avro-replacement programme of the Indian Air Force under the 'Buy and Make (Indian)' category. There are other issues also, such as sharing of the cost of technology between the government and the entity selected for absorbing the technology, ownership of the Intellectual Property Rights and sharing of future profits. Hopefully, the amendments approved by the DAC would provide answers to all these issues.

The second procedure-related decision concerns the definition of the term 'indigenization'. This assumes significance in the context of 'Buy (Indian)' and 'Buy and Make (Indian)' categories as the products offered for sale under these categories are required to have 30 per cent and 50 per cent indigenous content respectively. This decision will also be relevant in the context of the offsets. Any clarity in this regard would make the process of assessment of the indigenous content in a product smoother.

The third decision in this category relates to the instructions issued for speedier conclusion of the cases under the 'Make' and the 'Buy and Make (Indian)' categories. Unless the instructions clarify how the process is to be expedited, it might not make much of an impact.

The fourth decision relates to the contentious issue of the Services Qualitative Requirements (SQRs). The DAC has made it mandatory for the SQRs to be frozen before the AoN is accorded. Incidentally, the RFP can be issued only after the AoN has been accorded. By and large, this practice has already been in vogue. In any case, no RFP can be issued unless the SQRs are frozen, unless it is a design and development project under the 'Make' procedure, which has to be processed on the basis of the Preliminary SQRs. Therefore, the new fiat might not make much of a difference.

The real problem is the formulation of defective SQRs and not non-freezing of the SQRs before obtaining the AoN. Between September 2010 and March 2012, as many as 41 RFPs

of Army were rejected because of faulty/stringent GSQRs or faulty vendor analysis. This is the real issue warranting immediate attention. Various committees have gone into it in the past but the suggestions made by them for resolving the problem have remained unimplemented. Freezing of SQRs before the AoN stage might not make much of a difference.

The validity of the AoN has also been reduced from two years to one year, implying that a revised AoN will have to be sought if the RFP is not issued within a year of obtaining the initial AoN. This is likely to have some impact in expediting post-AoN processing of the cases as there will now be greater pressure to issue the FPs within a year of the AoN but this decision needs to be supplemented by identifying the reasons that account for this delay and taking appropriate action to address them.

The fifth procedure-related decision is to empower the DAC to approve the deviations from the procedure laid down in the DPP rather than such deviations being approved by the Defence Minister. The practice of seeking approval for deviations from the DAC has also been in vogue for quite some time, which has now been formalized. This will bring about greater transparency in the process.

The last category comprises the decisions that will show results in future. These are: (a) setting up of a high-level committee for simplification of the 'Make' procedure; (b) finalization of the list of defence items and its being sent to the Department of Industrial Policy and Promotion (DIPP) for notification; (c) clarifying to the DIPP that dual-use items will not require licensing; (d) circulation of the draft Security Guidelines for the Indian industry to various stakeholders for consultation; and, (e) reference to the Ministry of Finance (MoF) of the issues related to rationalization of the direct and the indirect tax structure for the defence industry; and (f) granting deemed export status to certain defence projects.

These measures are intended to bring about much-needed clarity in the area of licensing, provide incentives to the industry, and energize the 'Make' procedure which, in turn, could be a game-changer. Hopefully, the MoD has obtained inputs from all the possible stakeholders before referring the matter to the MoF and the DIPP and that MoD would continue to do so till the issues are resolved. These are complex issues and their resolution will take a long time. The MoD will do well to set up a task force for continuous coordination with the MoF, DIPP, other ministries/ departments and, most importantly, with the industry.

It has also been reported in the press release that the Small Industries Development Bank of India (SIDBI) has set up a fund with a corpus of INR 500 crore for providing loans to the MSMEs. Another fund with a corpus of INR 50 crore has been set up by SIDBI Venture Capital Ltd out of the 'India Opportunities Fund' for providing equity support to the MSMEs. This will enable the MSMEs to become partners in the endeavour to indigenize

defence production. In the Demand for Grant for capital outlay on defence services also there is a budget head for providing 'assistance to small and medium enterprises for technology development'. Though there is no allocation under this budget head for the current financial year there will be some overlap between this budget head and the corpus to be created by the SIDBI and SIDBI Venture Capital Ltd. There is a need to bring about synergy between the MoD and the SIDBI and also to formulate a scheme for the guidance of the MSMEs keen to participate in defence production.

It is good that the MoD has decided to streamline the procurement procedure to whatever extent it is possible under the circumstances. However, the real significance of the decisions taken by the DAC on April 20, 2013 lies in the fact that it has taken the first steps to assume the leadership role and to playing a pioneering role for strengthening the defence industrial base in India. The challenge would be to follow up these initiatives as there is a real danger of their slipping into inertia and also to start looking beyond these measures at other important issues, such as increase in the Foreign Direct Investment (FDI) cap; policy on actual export of defence goods, energizing the Defence Offset Management Wing (DoMW); setting up of a dynamic response mechanism in the MoD to respond quickly to the queries of all the stakeholders as soon as these are raised; and, above all, setting up of a forum for regular interaction between the MoD/SHQ officials on the one hand and the stakeholders on the other. This forum could provide a unique opportunity to the MoD to keep a firm hand on the pulse of the distraught defence industry in India which the MoD wants to nurture into a mighty industrial complex. A Think Tank like the Institute for Defence Studies and Analysis, which is fully funded by the MoD, could play an important role in this regard.