

## Defence Procurement Procedure 2013 - A ringside view

*Amit Cowshish*

*Amit Cowshish is a former Financial Advisor (Acquisition) & Additional Secretary and Member Defence Procurement Board, Ministry of Defence. He is presently a partner with the Dua Associates, Advocates and Solicitors, New Delhi.*

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## Summary

The Ministry of Defence (MoD) came out with the much-awaited Defence Procurement Procedure (DPP) 2013 on June 1, 2013. The most talked about change introduced through the new DPP is in regard to arrangement of the procurement categories into a hierarchy with 'Buy (Indian)' as the most preferred category, followed by 'Buy and Make (Indian)', 'Make (Indian)', 'Buy and Make' and 'Buy (Global)'. Apparently, the idea is to reverse the trend of importing most of the equipment and weapons systems that the armed forces need by giving the first opportunity to the Indian industry to meet the requirement.

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Will it work? Well, it might, provided the MoD takes concomitant steps to make sure that the policy does not get stumped by unanswered questions about how it is to be implemented.

To begin with, while the DPP does describe with varying degrees of clarity what these categories are all about, it does not prescribe the guidelines for selection of a particular category in preference to another. Why 'Buy (Indian)' and not 'Buy and Make (Indian)'? Why 'Buy and Make (Indian)' and not 'Make (Indian)'? And, so on. These are the kind of questions on which everyone has a view as long as there is no danger of being held accountable for it.

The starting point of a procurement proposal is the Statement of Case (SoC) prepared by the Service Headquarter (SHQ) concerned. The SoC is then sent for comments to the officers concerned in the Administrative Branch of the Department of Defence (DoD), Department of Defence Production (DDP), Defence Research & Development Organization (DRDO) and the Finance Division of the MOD. Every one of them could possibly have a different view on the categorization proposed in the SoC.

This divergence of views on the proposed categorization could also appear in the Services Capital Acquisition Plan Categorization Committee (SCAPCC), Services Capital Acquisition Plan Higher Categorization Committee (SCAPCHC) and the Defence Procurement Board (DPB)/Defence Acquisition Council (DAC) through which every procurement proposal must travel before it is accorded Acceptance of Necessity (AoN), which is nothing but the approval-in-principle to commence the tendering process.

Considering that all these committees in the chain of decision making have members from the DoD, DDP, DRDO, Finance Division and, last but not the least, the Services, divergence of views on any issue, including the proposed categorization, could result in processing of the proposal taking longer than what it would take if every aspect of the proposal is in accordance with some laid down guideline.

Till now, categorization has generally not been a major factor contributing to protracted deliberations over a procurement proposal. But experience shows that this issue could be

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<sup>1</sup> Can be accessed at [www.mod.nic.in](http://www.mod.nic.in)

highly contentious. The Avro-replacement programme of the Indian Air Force (IAF) started with the suggestion that it be placed in the 'Buy (Global)' category. During a presentation by the Air Headquarters to the then Secretary (Defence Finance), it was suggested by this author that the programme had the potential of being placed in the 'Buy and Make (Indian)' category by roping in the private sector. The suggestion was received well by the IAF team, led by the then Deputy Chief of Air Staff.

The suggestion to categorize the proposal as 'Buy and Make (Indian)', however, ran into difficulty as there are no guidelines that could be followed to nominate the Indian companies from the private sector to whom the Request for Proposal (RFP) could be issued. After further rounds of discussions, it was decided that the proposal could be placed under the 'Buy and Make' category.

That gave rise to another problem. In 'Buy and Make' category, there is a requirement of nominating an Indian Production Partner (IPP) but there are no guidelines that could be invoked to nominate an Indian company from the private sector. It was then suggested by this author to let the foreign Original Equipment Manufacturer (OEM) select the IPP. Two specially constituted committees, the first headed by the Scientific Advisor to the Defence Minister and the other by the Additional Secretary in the Department of Defence Production, went into this issue before a *modus vivendi* could be worked out. The RFP has only now been issued recently in this case after more than a year of deliberations.

All such delays are avoidable if proper guidelines are evolved because then processing of a procurement proposal will be less likely to be stymied by varying perceptions about whether the grounds offered for selecting a particular category are valid. In fact, guidelines need to be laid down for handling various situations that frequently arise in the course of a procurement programme. Cost estimation is one such area. This would enable all those handling procurement to implement the policy decisions without having to fill the procedural gaps with their own, often very conservative, interpretation of various provisions of the DPP.

Let us take the most important policy decision introduced through DPP 2013, which is that 'Buy (Indian)' should be the first option or the most preferred category. The basic requirement under this category is that the equipment must be purchased from an Indian vendor and the equipment being bought must have a minimum of 30 per cent indigenous content. It gives rise to many questions.

Suppose there is no Indian vendor manufacturing the equipment proposed to be purchased but the Indian industry claims that it can offer the equipment that meets the basic requirement of 30 per cent indigenous content. How would the prospective vendors be identified in this situation? Will it be on the basis of the claim made by individual companies or on the recommendations made by the industry associations and, if so, which ones? What if there is only one vendor who is prepared to jump into the fray? How would the

claim of the vendor(s) that it would be possible to supply the equipment with 30 per cent indigenous content be verified? Will the Indian companies with nothing more than MoUs or Joint Venture Agreements (JVAs) with the foreign OEMs to back their claims be recognized as potential vendors to whom the RFP could be issued? Unless there are transparent guidelines, the selection process could get mired in controversy.

Consider a different scenario. Suppose there is only one Indian company which is already manufacturing the requisite equipment with a 30 per cent indigenous content. In a situation like this, will the RFP be issued only to that company on a single-vendor basis? It is an important question because single-vendor situations have been the bane of many a procurement programme in India. Or, will other Indian companies, not yet manufacturing the equipment but claiming to be able to do so, backed by the MoUs or JVAs with the foreign OEMs, be also allowed to participate in the tender? All these issues need to be addressed.

'Buy (Indian)' is a good idea but the basic requirement of 30 per cent indigenous content could be counter-productive as it provides no incentive for achieving a higher percentage of indigenization; an important implication being that the critical technology underlying the equipment may still remain out of reach for the Indian company manufacturing/assembling it in India in collaboration with the foreign OEM.

It is possible to argue that a higher percentage of indigenous content would reduce the cost and, therefore, make the vendor offering a product with a higher indigenous content more competitive. But the counter-argument would be that there is an initial cost associated with increasing the indigenous content in a product and, therefore, unless there is an assured long-term local market and prospects of export, it might not be viable to increase the indigenous content. There is also the question of the foreign collaborator's willingness to part with the technology required for increasing the indigenous content beyond the bare minimum limit of 30 per cent.

Some of these issues would also be relevant in relation to the 'Buy and Make (Indian)' and 'Make (Indian)' categories, which are the next two preferred categories after 'Buy (Indian)' in the new hierarchy ordained by the DPP. One of the important issues concerns identification of the Indian companies to whom the RFP could be issued. Identification of the prospective vendors by surfing the internet or through Request for Information (RFI) route may not be the best way of selecting the Indian companies who have the potential of being the prime vendors for manufacturing the requisite equipment.

Indian companies with limited or even no experience of participating in the manufacture of the requisite equipment may throw their hats in the ring on the basis of the MoUs with foreign manufacturers. How will their suitability as prospective vendors be assessed? How will the Indian partner be selected/nominated in 'Buy and Make' cases? If the Avro-model is to be followed in all 'Buy and Make' cases, what conditions must an Indian company

fulfil to be eligible for being considered as a prospective Indian Production Partner by the foreign OEM? Or, should it be left to the OEM to select the Indian Production Partner of his choice? If, on the other hand, MoD wants to retain the power to nominate an Indian Production Partner for absorbing the technology, what will be the basis on which it would be decided in a particular case whether the Indian partner is to be nominated by the MoD or selected by the OEM? There is a need for objective guidelines to be laid down in regard to all these issues for the sake of transparency, probity and quick decision-making.

The USP of DPP 2013 is the thrust it seeks to provide to indigenization. The new provisions define how the indigenous content would be measured. Apart from this, it would now be necessary to ensure the requisite percentage of the indigenous content (on cost basis) in 'Buy (Indian)' and 'Buy and Make (Indian)' cases not only in relation to the overall cost of the contract but also in relation to the cost of the basic equipment, Manufacturer's Recommended List of Spares (MRLS) and the Special Maintenance Tools and the Special Test Equipment (SMTs/STE). This would require the Indian companies to burn the proverbial midnight oil to draw up a more extensive indigenization plan but there is no doubt that it would result in more pervasive indigenization.

There had been lack of clarity as regards the stage at which it would be necessary to demonstrate that the offered product has the requisite extent of indigenous content in it. The general understanding was that it must be demonstrated at the stage when the product is offered for trials. DPP 2013 has attempted to clarify this issue.

In so far as 'Buy (Indian)' cases are concerned, a minimum of 30 per cent indigenous content is to be ensured 'at all stages of (the) contract, including the FET stage'. The 'Buy and Make (Indian)' cases require a minimum of 30 per cent indigenous content in the 'first basic equipment made/ assembled in India and in subsequent deliveries thereof'. In 'Make (Indian)' cases also a minimum of 30 per cent indigenous content (on cost basis) is required in the 'successful prototype'. The way these requirements are mentioned in the DPP is a bit convoluted. A simpler way of laying down the requirement would have been to say that a minimum of 30 per cent indigenous content will have to be demonstrated in the equipment/ prototype offered for trials and this percentage will be required to be progressively increased to achieve the prescribed extent, if applicable, as in the case of 'Buy and Make (Indian)', by the end of the delivery period.

Be that as it may, the basic question is whether it would be feasible for the vendors in 'Buy (Indian)' cases to demonstrate that the equipment being offered for trials has a minimum of 30 per cent indigenous content. It might not make business sense for the Indian companies to make investment for manufacturing a product for trials with 30 per cent indigenous content in the face of the uncertainty about the product qualifying in the trials and the company getting the order, especially if there are multiple vendors who qualify the field evaluation.

The new DPP seeks to achieve the objective of indigenization not just through manufacturing but also through maintenance of the equipment. The MoD's Press Release of June 1, 2013 said that in 'Buy (Global)' cases, it will now be possible for the Indian vendors to transfer the maintenance technology (MToT) to the Indian vendor of their choice and that the MToT partner would no longer be required to be nominated by the Department of Defence Production. This is a welcome step, as long as it implies that the foreign OEMs would also have the liberty to transfer the maintenance technology to an Indian company of their choice. But Paragraph 28 of DPP 2013<sup>2</sup>, which deals with 'Transfer of Technology for Maintenance Infrastructure', does not make this intention very clear. This issue needs to be addressed.

Regular interaction between the MoD and the industry (the Indian public/private sector, the foreign OEMs and the Micro, Small and Medium Enterprises) is a *sine qua non* for achieving the objective of indigenization. Presently, interaction between the MoD and the industry is infrequent, unstructured and fragmented. Securing an appointment with the higher officials is a task in itself. The situation is slightly better when it comes to interaction between the Services Headquarters and the industry but this is of limited help as the decisions are generally taken by the ministry and not the SHQs. The Indian industry also makes presentation to the SCAPCC in relation to specific procurement proposals but the higher committees have limited knowledge about it. There is also lack of coordination among the industry associations which, at times, possibly act at cross purposes.

There is a need to create a forum for free and frank interaction between the MoD, SHQs and the industry to resolve the issues as they arise lest they become roadblocks in the endeavour for indigenization. In fact, other departments, such as the Ministry of Finance,

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<sup>2</sup> Paragraph 28 of DPP 2013 reads as follows: "28. ToT For Maintenance Infrastructure. The provision of ToT to an Indian Public/Private entity, for providing Maintenance Infrastructure, would be applicable for 'BUY (Global)' category cases. The decision to apply this clause would be debated in the SCAPCHC meetings on a case to case basis and approved by DAC. In such cases, the vendor would have to transfer technology for maintenance to an Indian entity which would be responsible for providing base repairs (third line) and the requisite spares for the entire life cycle of the equipment and cost of MToT is to be borne by Private Indian Bidder. The Indian entity could be a company incorporated under The Companies Act 1956, including DPSUs or entities like OFB / Army Base Workshops / Naval dockyards / Naval Aircraft Yards/Base Repair Depots of Air Force. This entity would be identified at SCAPCHC stage and would be included in the recommendations of SCAPCHC as also in the SoC submitted to DAC for seeking approval of AoN. The RFP would spell out the specific requirements of ToT for Maintenance Infrastructure which could cover the production of certain spares, establishment of base repair facilities including testing facilities and the provision of spares for the entire life cycle of the equipment. Both the vendor and the nominated Indian entity would be jointly responsible for providing the maintenance facilities and support for that equipment."

Department of Industrial Policy and Promotion (DIPP), etc. must also participate in such interaction as the MoD, acting on its own, cannot resolve all the problems faced by the industry. This is necessary for infusing life into the policy initiatives taken by the MoD.

The success of the policy initiatives introduced through DPP 2013 would also depend to a large extent on how the Indian industry makes use of the expertise gained from technology acquired by it through various modes of procurement. The foreign OEMs are not likely to shift their operations *en masse* to India given the problems related to industrial licensing, FDI, taxation, formation of joint ventures and exports – to name a few. In some cases, this may even be a politically sensitive issue in the countries where the OEMs are presently based. It remains to be seen, but the Arms Trade Treaty approved by the UN General Assembly in April this year could also impact transfer of technology at some point of time in future.

This underlines the urgency to increase the level of self-reliance in defence production. The challenge, therefore, is to utilize the expertise gained by the industry through the limited transfer of technology to progressively reach a stage where the industry could, on its own and through its own research & development efforts, start manufacturing the defence equipment required by the armed forces without critical dependence on, and without infringing the intellectual property rights of, the foreign OEMs. This lends urgency to the task of simplifying the 'Make' procedure, for which steps have been taken by the ministry. More importantly, the Indian industry must aim at acquiring the capability to develop futuristic technologies. That will be the real coming of age for the Indian industry and a big relief to the defence establishment.