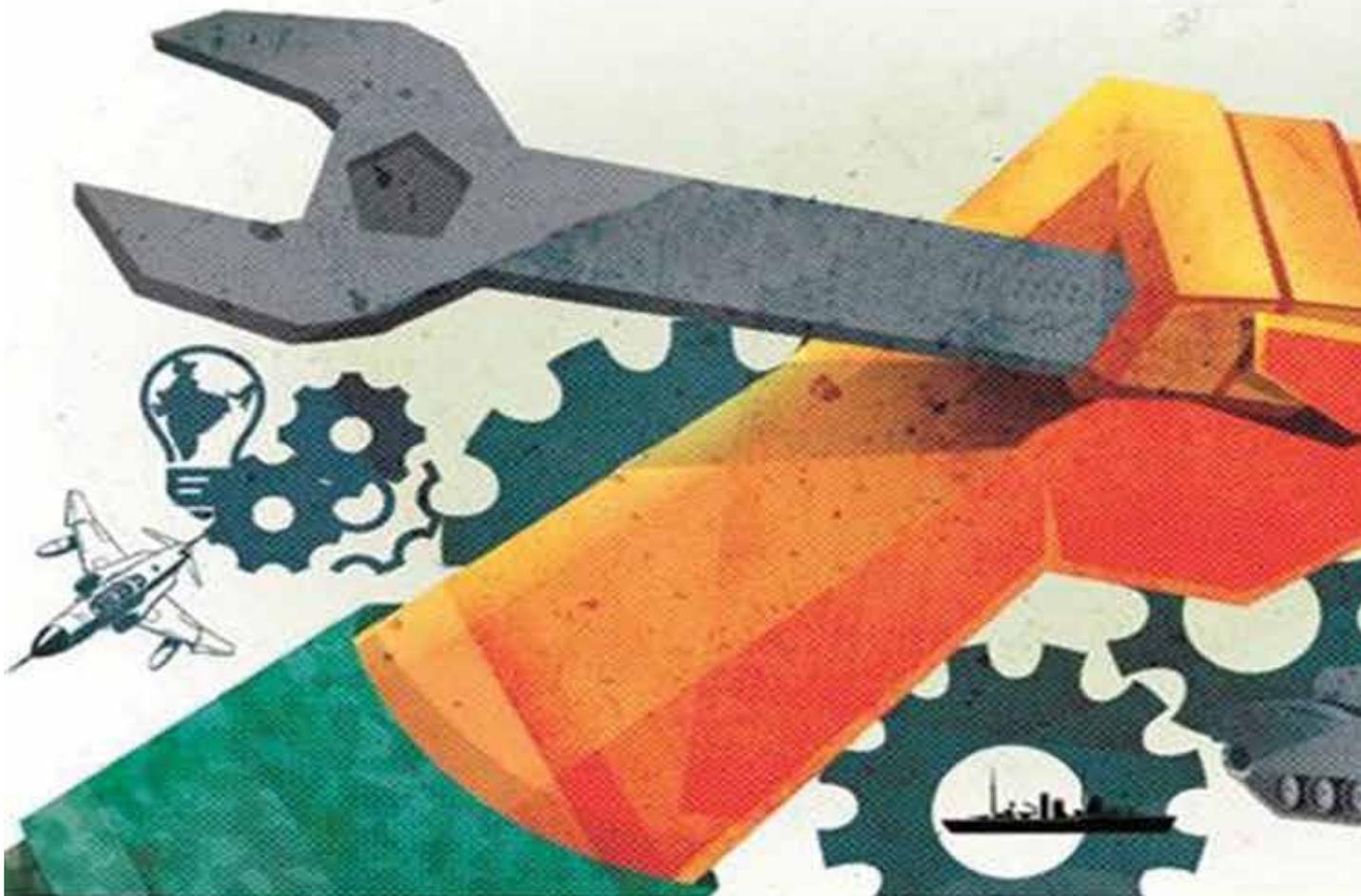


# OPPORTUNITIES IN DEFENSE MANUFACTURING AS GOVERNMENT UNVEILS STRATEGIC PARTNERSHIP MODEL

*Fostering constructive partnership with the Indian private defense industry is considered not just a sound economic option but a strategic imperative to minimize dependence on imports and infuse self-sufficiency in defense manufacturing; however, only time will tell if the strategic partnership model has the desired effect*



**T**he Indian Government's policies in the last few years have gradually moved in the direction of making the defense manufacturing sector more attractive for private entities. This sector has been traditionally dominated by public sector utilities. In an attempt to simplify the regulations involving defense sector and to project India as an attractive destination for defense manufacturing, a series of policy level changes have been notified:

- FDI policy for the defense sector has been reviewed and as per the revised policy, composite foreign investment up to 49% is allowed under the automatic route and beyond 49% with government approval.
- The Defense Products List for the purpose of issuing Industrial Licenses (ILs) under the IDR Act has been revised and most of the components, parts, sub-systems, testing equipments, and production equipments have been removed from the List, so as to reduce entry barriers for the industry, particularly the small & medium segment.



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- Validity of Industrial License granted under the IDR Act has been increased from 3 years to 15 years with a provision to further extend it by 3 years on a case-to-case basis.
- To establish a level-playing field between the Indian private sector and the public sector, anomalies in excise duty / custom duty (now GST) have been removed. As per the revised policy, all Indian industries (public and private) are subject to the same kind of excise and custom duty levies.
- The Exchange Rate Variation protection has been allowed on foreign exchange component to all Indian companies, including private companies in all categories of capital acquisitions, so as to create a level playing field between the Indian and foreign industry.
- In order to encourage indigenous design, development and manufacturing of defense equipment, the Defense Procurement Procedure 2016 ('DPP 2016') introduced a new category of capital procurement - Buy Indian-IDDM (Indigenously Designed, Developed and Manufactured). As per the DPP 2016, preference will be given to 'Buy (Indian-IDDM)', 'Buy (Indian)' and 'Buy and Make (Indian)' over the 'Buy (Global)' categories of capital acquisition.

As a further push for increasing private participation, promoting indigenous production and housing of critical technologies, the Government has recently released the 'Strategic Partnership' model by adding the seventh chapter under the DPP 2016, thereby allowing Indian private players to play the strategic partner role for critical Indian defense programs.

### Strategic Partnership: The Model

The strategic partnership model seeks to identify a few Indian private companies as Strategic Partners ('SPs') who would initially tie up with a few shortlisted foreign Original Equipment Manufacturers ('OEMs') to manufacture big-ticket military systems. In the initial phase, the selection of SPs would be confined to only four segments and only one SP will generally be selected per segment:

- a) Fighter Aircraft.
- b) Helicopters.
- c) Submarines.
- d) Armored Fighting Vehicles / Main Battle Tanks.

The SP is expected to play the role of a system integrator by building an extensive eco-system comprising development partners, specialized vendors and suppliers, in particular, those from the MSME sector.

The Strategic Partnership model enables an Indian private sector entity to partner with the Ministry of Defense (MoD), to make necessary long-term investments in manufacturing infrastructure, an eco-system of suppliers,

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skilled human resources, R&D for modernization and upgrades as well as and other capabilities, besides production of equipment. The overall aim is to progressively build indigenous capabilities in the private sector to design, develop and manufacture complex weapon systems for the future needs of the Indian Armed Forces. This will be an important step towards meeting broader national objectives, encouraging self-reliance and aligning the defense sector with the 'Make in India' initiative of the Government.

In order to ensure that the chosen platform for manufacturing meets all the operational requirements of the Armed Forces and to access advanced and appropriate technologies, the SP will need to enter into relevant tie-ups with foreign OEMs to cover manufacturing, transfer of technology, assistance in training skilled human resources and other support. Such partnerships or tie-ups between SP and OEM may take the form of joint ventures (JV), equity partnerships, technology-sharing, royalty or any other mutually acceptable arrangement between the companies concerned, subject to the ownership conditions indicated above.

As per the Policy, the applicant company has to be an Indian Company owned and controlled by resident Indian citizens. The management of the applicant company should be in Indian hands with majority representation on the board of directors. Further, a company shall be considered as 'Owned' by resident Indian citizens if more than fifty percent (50%) of the capital in it is directly or beneficially owned by resident Indian citizens and/or Indian companies, which are ultimately owned and controlled by resident Indian citizens. This implies that the maximum permitted FDI (both direct and indirect) shall be forty nine percent (49%). Any subsequent change in shareholding

pattern/ownership of the SP shall require prior approval of MOD.

In terms of ensuring quality, it is provided that the OEM will be jointly responsible along with the SP for certification and quality assurance of platforms supplied to MOD.

The Policy lays down a broad procedure for selection of SP:

- a) Issue of expression of interest (“EOI”) to Indian private companies for selection of SP in an identified segment seeking details of Minimum Qualification Criteria;
- b) Submission of response to EOI by applicant companies, indicating inter alia choice for segments in which they wish to participate;
- c) Evaluation of companies based on prescribed Minimum Qualification Criteria;
- d) Segment-wise verification of segment specific criteria;
- e) Shortlisting of companies that meet the Minimum Qualification Criteria, for issue of segment-wise request for proposal;
- f) Issue of segment-wise request for proposal with Defense Acquisition Council (‘DAC’) approval to short-listed companies based on the segment option submitted by them in EOI response;
- g) Submission of techno-commercial offer in response to request for proposal by companies, in collaboration with one of the shortlisted OEMs, or in exceptional cases, with two OEMs in segments with diverse platforms;
- h) Opening and evaluation of technical offer of companies;
- i) Conduct of field evaluation trials and staff evaluation;
- j) Opening of commercial offers of companies that are technically compliant with the request for proposal, segment-wise;
- k) Selection of Strategic Partner having the lowest bid, segment-wise, with DAC approval;
- l) Commencement of contractual negotiations;
- m) Finalization and signing of contract.

The Policy notes that - an appropriate institutional and administrative mechanism for effective implementation of Strategic Partnerships will be set up within MOD, the development of such institutional and administrative mechanism is yet to be undertaken.

## Industry Reaction

Recent initiatives provide India an opportunity to change the status quo and become a key player in the global defense industry and have been lauded by Industry. These initiatives present opportunities for foreign OEMs to enter India and local companies to collaborate and design, develop and showcase their engineering strength. This will also further India’s objective to create jobs, catalyze technology development, and transform India into a self-reliant nation with export capabilities in the defense sector.

Encouraged by initiatives taken by the Government, even big Indian conglomerates with no real defense experience have made an entry. For instance, the Adani Group, has tied up with Saab AB, which produces the Gripen fighter jets, to bid for a multibillion-dollar deal.

The significant interest manifested from companies such as Boeing, SAAB and Lockheed Martin in partnering with Indian private companies and otherwise having advanced discussions for establishing their manufacturing centers in India, is a positive sign for the Indian defense manufacturing industry and a step closer to India’s growing attractiveness as a defense sourcing hub.

The Strategic Partnership policy provides that, ‘only one Strategic partner will generally be selected per segment’ so that it ‘maintains focus on a core area of expertise’. Industry has voiced its concern with respect to the same, and has requested for appropriate changes in the Policy. As per news reports, the government is likely to bring a change in this, which will allow the applicant company to be selected in more than one segment identified for strategic partnership. The foreign OEMs have raised concerns with respect to protection over propriety technology since they will have minority shareholding in the JV as the FDI cap is 49% and have sought governmental protection.

## Conclusion

The Indian government recognizes that opening up of the defense sector to private sector participation will help Foreign OEMs to enter into strategic partnerships with Indian companies and leverage the domestic markets as well as aim at global markets. Besides helping in building domestic capabilities, this will also bolster exports in the long term. Fostering a constructive partnership with the Indian private defense industry is considered not just a sound economic option but a strategic imperative to minimize dependence on imports and infuse self-sufficiency in defense manufacturing.



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