



## TAKING FORWARD INDIGENIZATION

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Today, India can retrospect on a decade of significant political, economic and demographic transformation and see itself stand as the world's fifth largest economy and the second most populated nation. Playing a key role here is the country's defence industry. According to industry reports, the Indian Armed Forces are one of the largest users and importers of conventional defence equipment and accordingly India ranks eighth among the top ten countries in the world in terms of military expenditure.

The Indian defence market presents an attractive prospect for Indian and foreign companies across the value chain. Presently, India is the third-largest defence spender in the world after the US and China according to the India in Business report by KPMG, with a defence budget of about 1.90 percent of its GDP. India imports almost 70 % of its defence requirements ranking it the world's largest arms importer. The volume of Indian imports of major weapons rose by 111% between 2004-08 and 2009-13, and its share of the volume of international arms imports increased from 7% to 14% according to the international arms transfers released by Stockholm International Peace Research Institute (SIPRI).

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and sourcing capabilities; leveraging India's technological and relatively low-cost manufacturing strengths.

With numerous opportunities in the sector, the Indian Government is both the market and the market maker. Historically, the design and production of defence equipment has largely been a government function. The design, development and prototyping handled by one set of government agencies and the serial production by another set of entities. However, this scenario is gradually changing with the growth of an increasing number of private players who are keen on investing in this sunrise industry. These players range from large Indian industrial houses, that come with vast experience in manufacturing and engineering and possess the financial strength to shoulder complete product/sub assembly production, to smaller boutique houses that specialize in niche design, manufacturing and testing segments.

Apart from this, there are also several global technology giants - OEM's, Sub assembly and Component makers - that are present in India - and have invested in trading, designing and manufacturing. With the objective of improving India's self-reliance in defence equipment and technologies, every successive version of the Defence Production Policy (DPP), places greater emphasis on manufacturing more of the country's defence needs indigenously. The policy for Foreign Direct Investment (FDI) in the sector was first notified in 2001, wherein the defence industry was opened up to 100 percent, for Indian private sector participation, with FDI permissible up to 26 percent, both subject to licensing and Government approval.

#### A CALIBRATED APPROACH

Across the globe, the Defence Industry is highly technology driven, complex, capital intensive and with long gestation periods to product realization. In the last several decades India's own defence organizations have made good progress in developing indigenous technologies and products with great success in certain areas. Arguably, however, it would still take much time, investment and effort to evolve local products/technologies in line with the global.

India could well save by adopting a calibrated approach on Indigenisation. A path that encompasses technology sharing between established global players and Indian organisations - thereby cutting short the product realisation times and investments. India can accelerate substantially by raising

the FDI cap in defence - thereby providing a significant incentive for transfer of know-how/technology and associated best practices by foreign OEMs to India. This would lead to rapid improvement in technological expertise as well as drastically reduce the time to deliver products/equipment to the end customer.

Typically high capital investments in R&D are a challenge in the development of high end defence technologies and products. Greater FDI participation from companies that have been rooted in India and have shown commitment towards the local economy, would help the local industry in defraying some part of this - thereby making more products viable in shorter lead times

Indian engineering skills are globally recognised and a greater involvement of global defence technology players would also open the doors for these skills to be used as a global service pool - much like in the case of IT, automotive and the telecom industry segments. Global OEM's see India as a great market and a huge talent pool. Greater FDI inflows here will provide utilitarian economic advantages. It leads to more employment opportunities for the local population; it also means that taxes and other revenues will flow back to the local economy.

#### THE NEGATIVES

On the flip side, it could be argued, that there are several concern areas that persist in discussion, especially from a national security perspective. Today, the FDI cap is one of the constraints faced by foreign firms desirous of investing in the Indian defence market. Although Russia, Israel, the UK and the US have been the prime investors in India, foreign firms are hesitant to invest resources in a venture where they would have limited control,

product constraints, purchase guarantees, open access to other markets (including exports). Moreover, when the government is already buying directly from foreign suppliers there is limited incentive for the foreign firm to create a 26% owned company in this country. In some ways, this could also have affected India not being able to access the latest high-end and critical technologies available in the global defence market.

The question therefore arises, just what is the right path for India defence to strengthen its equipment acquisition initiative as well as accelerate its indigenous technology capabilities? An all out local focus at one end or a heavy import strategy at the other? The answer perhaps lies in taking a calibrated approach that definitely uses the well established local development / manufacturing footprint and also allows a more focused infusion of global capital and technology - thereby kicking off a virtuous cycle of rapid technology deployment, absorption, development and realisation.

A path that could be encouraged by relaxing the FDI cap in a judicious manner based on technology and need; by recognising the contribution/role of foreign players that are invested heavily in the country in terms of people and by leveraging the already robust local footprint of development and manufacturing units (government owned and private) and lastly by increasing the speed of decision making.

The outcome of such a calibrated approach

would yield short and long term benefits to all the stake holders in this sunrise industry: the Armed Forces that are the end customer, could look forward to accessing state of art products faster; the local development/manufacturing units could benefit from faster technology development and learning at a lower investment level, and global players would benefit from the rapid growth of their market as well as leveraging local engineering skills for global needs. A perfect win-win-win opportunity!

