



# Centre for Air Power Studies

## STEPS TOWARDS DEVELOPMENT OF A VIABLE INDIGENOUS DEFENCE INDUSTRY

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### **Introduction**

Development of a viable indigenous armament industry able to deliver equipment required by the Indian Armed Forces has been a long standing requirement. Since 1947 the Public Sector Undertaking (PSU) based nature of the current industry has failed to deliver the goods. Signs of change are evident since the formation of India's new government earlier this year. The high risk nature of defence industries has resulted in state support to such industries all over the world.

### **Background**

The inability of India's PSUs to deliver equipment required by the armed forces led several Indian governments to explore other alternatives. India's armed forces have also tried to get the private sector of India's industry involved in the production of defence related equipment. These attempts started with trying to get small fast moving items such as seals, nuts and bolts, filters etc. made by Indian private sector industries in lieu of importing these items. However, the need for the private companies to invest heavily in the required technology to design and manufacture the items, which items being usually cutting edge required heavy investment; coupled with the relatively small numbers required by the Indian armed forces led to most such requests not fructifying. There have been a few notable exceptions of Indian private companies that stepped in once the Indian Government relaxed the PSU bias somewhat in the early 1990s. One example of private

industry's entry and success in this field is Samtel which started off making monitors for computers. Samtel exploited its economies of scope to manufacture multifunction cockpit displays in partnership with Hindustan aeronautics Limited (HAL). Several other endeavours by private industry met with little success given the myriad restrictions in place that biased the choice towards PSUs. The recent decisions of the current Indian Government have rekindled prospects for private industry in the defence equipment manufacturing field. This has been written about on this website earlier also.

### New Developments and Implications

There appears to be a change in thinking regarding the means of encouraging private sector entry into this field. In 2009 the Indian Ministry of Defence (MoD) envisaged a program to indigenously design an Infantry Fighting Vehicle (IFV) to replace the obsolete Soviet era IFVs in use by the army. After initially shelving the project to design and manufacture indigenous IFVs in view of a Russian offer of their latest such vehicles the program was resurrected in December 2013. The new proposal is reported to involve a project in which the MoD will finance 80% of the cost of building two prototypes, one each by two contenders. The expression of interest (EoI) is likely to be despatched to at least nine Indian companies. These companies are allowed to enter into collaborations with foreign companies in order to obtain technology and know why as well as knowhow. After selection of proposals two companies will be selected to build prototypes; the process is likely to involve assessments of the contending companies' facilities and infrastructure available. After extensive testing and evaluation of

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#### More In Focus

the two prototypes built, one will be selected as the winner. The final order will involve the winner of the competition between the two prototypes getting to build and supply approximately 60% of the army's requirement while the other company which had built a prototype but lost in trials would build and supply the remaining 40% of the requirement.<sup>1</sup> This system is very similar to what is followed by the US where usually two companies compete for military contracts. However, in the US system the winner takes all and the loser gets no part of the contract at all. In the US given the fact that all defence industry companies are well established and have healthy finances and deep expertise this US system works well. In India, given that the Government is attempting to obtain equipment indigenously while at the same time building a viable private sector defence industry the changes to the US system in order to develop a private industry entry into the defence equipment design and manufacturing field with Indian characteristics as it were are required. In the Indian system reported above for the IFVs both the initially shortlisted companies that build prototypes will share the final contract thus ensuring that both remain going concerns available in more robust form for future needs as well. In this Indian modification of companies competing for contracts over a few such equipment contracts the indigenous companies should develop into capable defence equipment manufacturing organisations able to stand on their own without government support. Till such time as this occurs Government support as envisaged through sharing of the final contract between the two contenders is a practical and pragmatic manner of building an indigenous defence industry spanning both the public and private sectors of the industry. In addition the MoD has undertaken to finance up to 80% of the cost of developing the prototypes. Thus the MoD is declaring its commitment to such projects by putting its money on the table. This would also help the new entrants to this field overcome the high entry barriers due to cost of R&D and prototype development.

A similar system if followed for other weapons projects for the Indian armed forces should be able to assist in a faster build-up of indigenous capabilities to develop and manufacture cutting edge defence equipment. Over time, say in the next 15 to 20 years, it could be expected that Indian companies would apply their own innovations to the existing products they are manufacturing to increase value and capture domestic defence orders on

their own strength without requiring to resort to collaborations with foreign companies. These Indian companies could even after about 20 to 25 years even compete for global contracts to supply other countries' armed forces.

### Conclusion

India's defence industry has been based upon PSUs since 1947. Attempts to induce private industry to enter the field were stymied by the high entry barriers and low volumes. It has been reported in HIS Jane's that there appears to be a change in terms of the MoD providing support to private industry through cost sharing and a modified competitive system to win contracts for the Indian Defence Forces. This new system holds promise of supporting private companies at least till such time as they are able to hold their own in the face of better established players in the field. Further similar steps could be expected in the near future to incentivise the entry of private companies with the inherent expertise to take up defence equipment projects.

*(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies [CAPS])*

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### End Note

<sup>1</sup> Rahul Bedi, India Resurrects Indigenous FICV Program", *HIS Jane's Defence Weekly*, Vol 51 Issue 30 23 July 2014, pp16

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