



Make in India

An overview of Defence Manufacturing in India

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Foreword

It is in strategic interest of a nation aspiring to be the regional power to develop indigenous and internationally competitive defence industry base. Presently, India is one of the largest importers of conventional defence equipment. According to government statistics, roughly 60% of India's defence requirements are met through imports.



India has the potential to emerge as a global platform for defence research, manufacturing, supply chain sourcing, software development, and offsets, which will strengthen our defence capabilities and spur industrial development as well as exports in this sector.

Government is also carrying out reforms in defence procurement to increase efficiency, invite foreign players with excellent capabilities and encourage domestic industry. It has introduced policies to strengthen technology transfer, including liberalized FDI in defence production. The report of Committee of Experts for Amendments to Defence Procurement Policy (DPP) 2013 is a progressive step in this direction. Also, Make in India the new flagship program of Government of India has put a renewed emphasis on creating a conducive policy environment for improving domestic defence manufacturing.

These radicle initiatives present opportunities for the foreign companies 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 defence sector. India's existing wealth of talent, technology and cost advantages together can help make defence products globally competitive.

It is a proud moment for us to share with you the report on **“Make In India-An overview of Defence Manufacturing in India”** at the momentous occasion of **11th Indo- US Economic Summit: Taking the Bilateral Trade to USD 500 Billion**. Indian government is supporting the creation of a vibrant domestic defence manufacturing base in the country. Policy environment in India has never offered so many tangible opportunities to pursue co-development and co-production projects. We welcome you to come and Make in India!

A handwritten signature in blue ink, appearing to read 'R Singhania', with a stylized flourish at the end.

Ravi Singhania
Managing Partner



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A. INTRODUCTION

India has the third largest Army, the fourth largest Air force and the seventh largest Navy in the world. India is among the top 10 countries in the world in terms of military expenditure and world's largest arms importer. India allocates about 1.8% of its GDP towards defence spending, of which 40% is allocated to capital acquisitions and only about 30% of India's equipment is manufactured in India, mainly by public sector undertakings. Even when defence products are manufactured domestically, there is a large import component. All these factors make the Indian defence market one of the most attractive globally and provides an immense opportunity for both domestic and foreign players in the defence sector.

Country Wise Military Spending 2014

Region	Spending (\$ billion)	Change(%)
USA	610.0	3.5
Russia	84.5	4.5
China	216.0	2.06
India	50.0	2.4
World Total	1776	-

Source: Facilitating 'Make in India' in Defence Sector Through Defence Procurement Procedure July 2015

Top 10 Arms Importers 2010-2014

Importer	Share of international arms imports (%)		Main Suppliers (share of Importer's total Imports) 2010-14		
	2010-14	2005-09	1st	2nd	3rd
India	15	7	Russia (70%)	USA (12%)	Israel (7%)
Saudi Arabia	5	1	UK (36%)	USA (35%)	France (6%)
China	5	9	Russia (61%)	France (16%)	Ukraine (13%)
UAE	4	5	USA (58%)	France (9%)	Russia (9%)
Pakistan	4	3	China (51%)	USA (30%)	Sweden (5%)

Source: Facilitating 'Make in India' in Defence Sector Through Defence Procurement Procedure July 2015

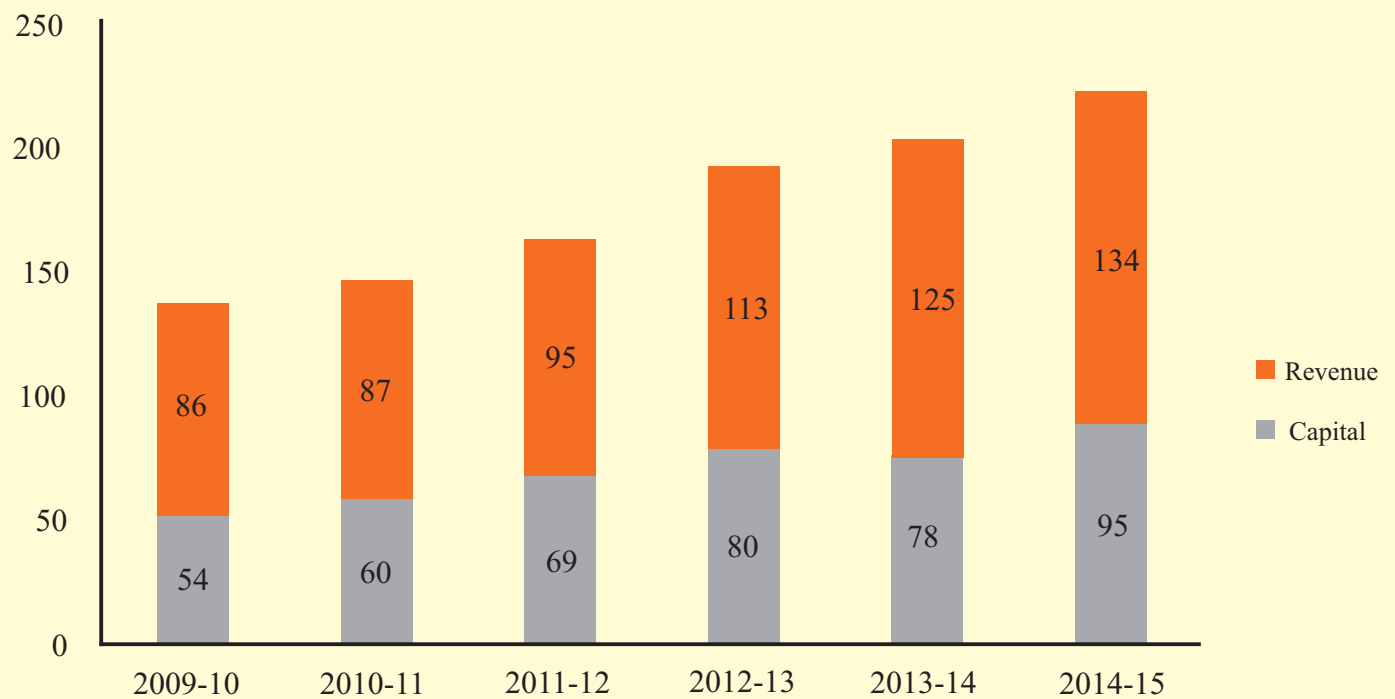
Total Defence Expenditure (India's)

(INR in Crore)

Year	Actual	Percent Increase (Actuals)	(%) GDP*
2007-08	91917.79	7.87	1.84
2008-09	114499.49	24.57	2.03
2009-10	141781.08	23.83	2.19
2010-11	154116.71	8.70	1.98
2011-12	170913.28	10.90	1.90
2012-13	181775.78	6.36	1.80
2013-14	203499.36	11.95	1.79
2014-15	174260.21	-	1.75

Source: Controller General of Defence Accounts.

Indian defence budget (Figures in '000 crore INR)



Source: SIPRI Arms transfers database



B. INDIA'S DEFENCE INDUSTRY

The post-independence industrial policy placed the production of defence items in the reserve List making it mandatory for production to be taken up only by the public sector. The sector for the first time was opened up to 100 percent Indian private sector participation in 2001. Reforms in the defence industrial sector and the acquisition policy have been one continuous process since then, beginning with the formulation of DPP 2002 and its successive revisions, formulation of the Defence Production Policy and the issuance of Joint Venture guidelines.

Indian defence industry is dominated by defence public sector undertakings (DPSUs) and ordnance factories (OFs) which contribute about 90% of the total domestic defence manufacturing output. The 41 ordnance factories are spread across 26 different locations and employ close to 1,25,000 people. The DPSUs and OFs manufacture a wide spectrum of equipment including small arms and field guns, ammunitions, explosives, armoured vehicles, transport vehicles, clothing, parachutes and general stores. DPSUs account for approximately 65 percent of the total industrial output of the defence public sector enterprises.

Combined, the DPSUs and OFs have played a critical role in building a domestic industrial base in this sector as they typically outsource 20 to 25% of their production requirements to private companies. In addition to the public undertakings, there is a small but growing number of medium large private companies that have already entered, or, are seriously evaluating entry into the market. These are in addition to about 6000 MSMEs that have largely depended upon the DPSUs for survival. The Indian defence industry's import export ratio is inferior to countries with a much smaller defence industrial base. India's arms imports are now almost three times as high as those of the second and third largest arms importers—China and Pakistan. India is among the top five arms importer, besides China, Pakistan, the UAE and Saudi Arabia.

Since opening up of the defence industry for private sector participation, the Department of Industrial Policy and Promotion (DIPP) has so far issued 222 Letters of Intents (LOIs) and issued Industrial Licences (ILs) to more than 150 companies for manufacture of a wide range of defence items. 46 companies have so far reported commencement of production. The licenses have been issued to the Indian private sector for manufacture of Military Aircraft, Unmanned Aerial Vehicles, Radars, Electronic Warfare Systems, Ship borne platforms, Armoured Vehicles etc. In the recent years, many Indian private industries have been involved in a small way with several defence 'Make' projects. These are Integrated Materiel Management Online

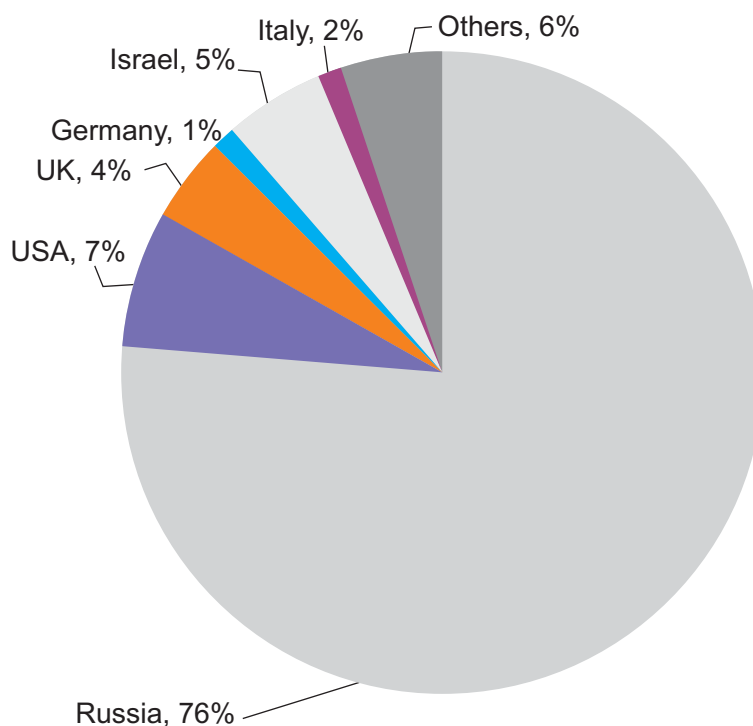
System (IMMOLS), Integrated Air Defence Command and control system (IACCS) Tactical Communication System (TCS), Battlefield Management Systems (BMS) and Futuristic Infantry Combat Vehicles (FICV). While (IMMOLS) and (IACCS) have been deployed, TCS, BMS and FICV are in the early stages of development. Award of major projects under 'Make' category to Indian private industries is a new beginning in Indian defence industrialization.

Larsen & Toubro, Tata group, Pipapav Defence and Offshore Engineering Ltd., Reliance Industries Ltd., Mahindra and Mahindra, Ashok Leyland Defence Systems, Piramal System and Technologies are some of the key Indian players in the defence industry.

MAKE IN INDIA

The Indian defence industry's import-export ratio is inferior to countries with a much smaller defence industrial base. The 'Make in India' policy for the defence sector aims to reverse the current imbalance between the import of defence equipment and indigenous manufacture of defence equipments without adversely affecting the requirements, capability and preparedness of the user. Therefore, achieving self reliance and reducing dependence on foreign countries in defence is a necessity today rather than a choice, both for strategic and economic reasons. The requirement for domestic production of defence equipment is more than for any other sector because it will not only save precious foreign exchange but will address the national security concerns. 'Make in India' policy aims at facilitating investments and fostering innovations for the manufacturing sector in India. Government being the only consumer, 'Make in India' in defence sector will be governed by the defence procurement policy of India. The Government policy of promoting domestic defence industry is adequately reflected in the Defence Procurement Policy, wherein preferential treatment is given to "Buy (Indian)" and "Buy and Make (Indian)" categories of acquisition over "Buy (Global)". As the Indian Companies may not have adequate capabilities in terms of technology, they are encouraged to partner with foreign companies for joint ventures, technology transfer arrangements and tie-ups

INDIA'S IMPORT BREAKUP



Source: SIPRI Arms transfers database

C. THE POLICY FRAMEWORK

1. DEFENCE PROCUREMENT PROCEDURE

Defence procurement is governed by the Defence Procurement Procedure (DPP), which came into effect from December 30, 2002. The latest policy, released in June 2013 (DPP 2013), made significant changes in the acquisition procedures as well as the offset policy. The most important change in DPP 2013 has been the stipulation of a hierarchy of categorisation of any new defence procurement with 'buy (Indian)' and 'buy and make (Indian)' being the first and second priorities. DPP 2013 also lays down the method for computing indigenous content: the cost of the equipment to be reduced by the cost of imported materials and cost of services received from non-Indian entities at all tiers.

The government has now decided to revise the DPP every year. Committee of Experts for Amendment to DPP-2013 Including formulation of policy framework, has submitted its report to the Government.

The defence security manual for the private sector defence manufacturing units have been finalized and put in public domain by the Department of Defence Production. The manual clarifies the security architecture required to be put in place by the industry while undertaking sensitive defence equipments. The Department has finalized a Security Manual for private sector defence industries. The security manual

provides for physical, documentation and IT security for the companies. The Security Manual is available on DDP's website (www.ddpmod.gov.in) under Publication/Reports. For the purpose of compliance, the security manual has been divided into three parts; Category A, B & C. Depending on the products/weapons/equipments, the companies will be required to comply with the security protocol. This is also available on DDP's website. Brief descriptions of Categories are as follows:

Category-A :The products under this category would be highly classified and sensitive from the security angle and the manufacturing of these items would require the highest level of security.

Category-B : The products under this category would include semi-finished products, sub-assemblies, sub-systems of main weapons/equipments/platforms and some finished products of lesser degree of sensitivity.

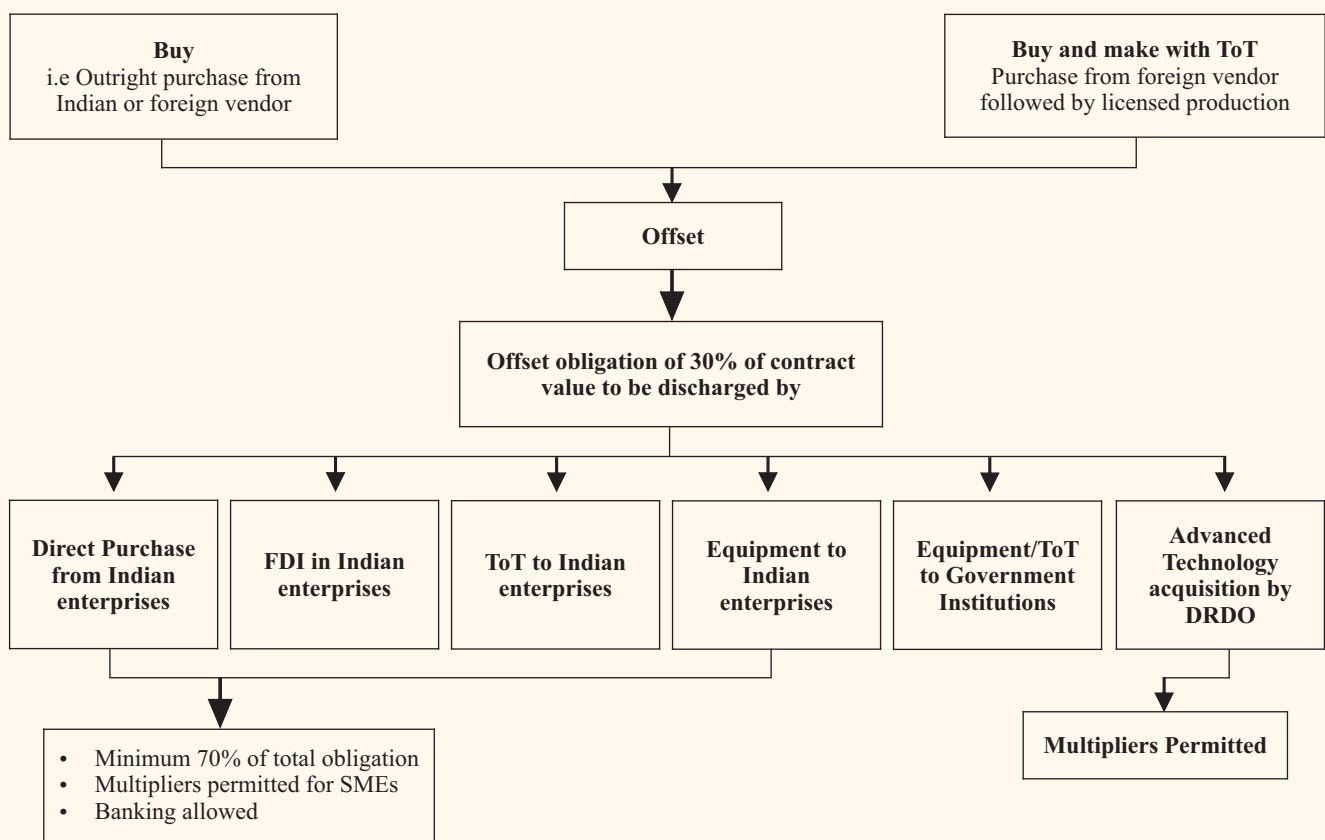
Category-C : The products under this category would include products which do not involve use of any classified/secret information and are very generic in nature. The products in this category would normally be not specifically designed or modified for military use and therefore would require only a very minimal level of security.



2. THE DEFENCE OFFSET POLICY

As per Defence Procurement Policy (DPP) 2011, at least 30% of the contract value (those exceeding 300 crore INR) has to be ploughed back into the Indian defence industry as offsets. This can be either in the form of direct purchase of components from the Indian industry, equity investment in a joint venture in the defence sector or investments in R&D. It is important to note that the government actually pays for the offsets as no OEM can or will be able to bear the programme cost. The policy exists to build a defence industrial base in the country. Given the massive acquisition programmes India has embarked upon, the offset policy presents an excellent opportunity to build a defence manufacturing base in the country. It requires foreign OEMs to collaborate with an Indian partner to plan sourcing, joint ventures, co-production arrangements, technical collaborations, etc.

MoD revises offset policy to include Transfer of Technology (ToT) in offset discharge obligation. If the technology is delivered to DRDO or MSME, the multiplier effect also comes in to play.



3. INDUSTRIAL LICENCE (IL)

Under the Industries (Development and Regulation) Act, 1951 (the Act), an IL is required to manufacture arms and ammunition and allied items of defence equipment, parts and accessories. The licence is granted under Rule 15(2) of the Registration and Licensing of Industrial Undertaking Rules, 1952. These rules have been issued under section 30 of the Act. This is also a mandatory requirement under the FDI policy for the defence sector. The licence applications are considered by the DIPP,

Ministry of Commerce & Industry, in consultation with the MoD.

Defence products list for industrial licensing, has been articulated in June 2014, wherein large numbers of parts/components, castings/forgings etc. have been excluded from the purview of industrial licensing. The same is available at the DIPP's website, www.dipp.gov.in.

Activities under the category of maintenance, repair and overhaul (MRO) may be treated as

Services and should not be subjected to the Industrial license under IDR Act unless it actually involves manufacturing of any components/sub-assemblies, which are licensable and that product should remain the property of the same customer after MRO operation.

The procedures for the grant of industrial licenses have been streamlined:

- The initial validity period of industrial licenses has been increased to three years from the present two years.
- Guidelines for the extension of validity of industrial licenses have been issued.
- Partial commencement of production is treated as commencement of production of all the items included in the license.

4. FOREIGN DIRECT INVESTMENT POLICY

In 2001, the Indian government opened up the defence sector to private participation, permitting Indian firms to invest up to 100% and foreign companies up to 26% in the sector.

Under the prevailing FDI policy, foreign investment is allowed up to 26% in the defence manufacturing sector under the approval route subject to provisions of industrial licensing under the Act. The licence under the Act is provided to manufacture arms, ammunitions and allied items of defence equipment as well as parts and accessories. The Foreign Investment Promotion Board (FIPB) approval and licence is granted in consultation with the MoD.

Now, up to 49% investment is allowed under the government route, above 49% on a case-to-case basis on approval by the Cabinet Committee on Security, wherever it is likely to result in access to modern and state-of-the-art technology. The government, vide Press Note 7 (2014) dated the 26th of August, 2014, has allowed FDI up to 49% on approval route in Defence sector with certain conditions, for e.g., the applicant company seeking FIPB approval be an Indian company owned and controlled by resident

Indian citizens. Above 49% the proposal will be routed to the Cabinet Committee on Security on a case-to case basis, wherever it is likely to result in access to modern and state-of-the-art technology in the country. Portfolio investments have been permitted in the Defence sector for up to 24% on automatic route. A number of conditions have been relaxed or removed, making the sector more investor-friendly. The provision is expected to result in technology transfer which would help in increasing the production base and providing impetus to the manufacturing sector and job creation in India. The measure is expected to not only reduce the heavy burden of imports and conserve foreign exchange reserves but also make domestic manufacturing an integral part of India's GDP growth.

Further, following policy measures have also been effected:

- Investments by foreign portfolio investors/FIIs (through portfolio investment) are permitted up to 24% under automatic route.
- The requirement of single largest Indian ownership of 51% of equity removed.
- A lock-in period of 3 years on equity transfer has been done-away with in FDI for defence.
- 100% FDI allowed in Defence sector for modern and state of the art technology on case to case basis.





5. EXPORT IMPORT POLICY

The Directorate General of Foreign Trade (DGFT) is the authority that regulates India's export policy. Under the Foreign Trade Policy (FTP), export of defence equipment falls under the restrictive Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) list and requires an export licence. Similarly, an import licence is required from the DGFT to import restricted items covered under the FTP. The licence is granted for specific defence items and comes with a fixed tenure. The exporter is also required to obtain a no-objection certificate from the Ministry of Defence for exporting military stores. For the first time, a Defence Export Strategy has been formulated and has been put in Public domain. The strategy outlines specific initiatives to be taken by the Government for encouraging the export of defence items. It is aimed at making the domestic industry more sustainable in the long run as the industry cannot sustain purely on domestic demand. A Standard Operating Procedure (SOP) for issue of NOC for export of military stores has been finalized and has also been put in public domain. Requirement of End User Certificate (EUC) to be signed and stamped by Government authorities has been dispensed with for most of the defence items, particularly parts, components, sub-systems and sub-assemblies. This will largely ease out the export by the domestic industry. A web-based online system to receive applications for NOC for export of military stores has been developed and has been put in place.



D. DISPUTE RESOLUTION MECHANISM

In almost all the contracts that are executed by the Government of India for procurement of defense hardware, technology etc. arbitration clause is incorporated to provide for resolution of disputes between the parties. These arbitrations are governed by the provision of Arbitration and Conciliation Act, 1996. Accordingly parties are able to resort to alternative dispute resolution mechanism as compared to the normal Civil Court remedies, which are long drawn and are technical in nature.

Arbitration clauses in defense contract generally provide for appointment of a Sole Arbitrator or a Panel of three arbitrators to act as Arbitral Tribunal. In cases where there is a provision for appointment of the Sole Arbitrator, the clause invariably empowers Ministry of Defense or their agencies to appoint such a Sole Arbitrator. This kind of provision gives rise apprehension about independence and impartiality of the arbitrator so appointed by the Ministry of Defense or their agencies. At time resolution of the issue regarding appointment of independence and impartial Arbitrator through Court consumes considerable times. In two such cases, where our firm was representing a foreign supplier, we got an independent arbitrator appointed from the Supreme Court. Contracts, which provide for Constitution of Panel of three Arbitrators, normally contain a stipulation that the Presiding Arbitrator shall be of a nationality other than those of the parties. Introduction of such a clause addresses the issue of independence and impartiality to a great extent and the arbitration proceedings moved at relatively faster pace.

Sometime also gets consumed in preventing actions on the part of the Government of India/Ministry of Defense of invoking bank guarantees, which are furnished by the foreign supplier as per the provisions of the contract. Though arbitration has come up remarkably well as alternative dispute resolution

mechanism, but in practice it is felt that even arbitration proceedings get delayed for multiple reasons.

Now, in line with intent to evolve a pro-arbitration and speedy disposal dispute redressal mechanism, the Government of India has decided to amend the Arbitration and Conciliation Act, 1996 by introducing the Arbitration and Conciliation (Amendment) Bill, 2015 in the Parliament. The Union Cabinet chaired by the Prime Minister, Shri Narendra Modi, has given its approval for amendments to the Arbitration and Conciliation Bill, 2015 taking into consideration the Law Commission's recommendations, and suggestions received from stake holders.

The salient features of the amendments being:

- a) Insertion of a new provision that the Arbitral Tribunal shall make its award within a period of 12 months, that the parties may extend such period up to six months. Thereafter, it can only be extended by the Court, on sufficient cause.
- b) To insert a provision for fast track procedure for conducting arbitration. Parties to the dispute may agree that their dispute be resolved through fast track procedure. Award in such cases shall be given in six months period;
- c) Amendment of Section 34 relating to grounds for challenge of an arbitral award, to restrict the term 'Public Policy of India' (as a ground for challenging the award) by explaining that only where making of award was induced or affected by fraud or corruption, or it is in contravention with the fundamental policy of Indian Law or is in conflict with the most basic notions of morality or justice, the award shall be treated as against the Public Policy of India, as well as reducing the interference of Indian courts in applications challenging enforcement of foreign awards under Section 48;
- d) A new provision to provide that application to challenge the award is to be disposed of by the

Court within one year and that mere filing of an application for challenging the award would not automatically stay execution of the award. Award can only be stayed where the Court passed any specific order on an application filed by the party;

- e) Amendment to the effect that the appointment of arbitrator shall be done by High Court or Supreme Court as expeditiously as possible within 60 days;
- f) Comprehensive provision for costs to avoid frivolous and meritless litigation/arbitration;
- g) Empowering arbitral tribunals to grant all kinds of interim measures which the Court is empowered to grant and such orders being enforceable in the same manner as if it being order of court;
- h) Provisions ensuing in more clarity about seat of arbitration;
- I) Providing for a robust framework promoting institutional arbitration over ad-hoc arbitration.

Thus, to address the dispute resolution aspect of the commercial transactions in the defence sector as well as to ensure the scheme of Make-in-India is a success story, the Government of India is taking steps to fulfill its commitment of ensuring an efficient and effective dispute resolution mechanism for a stable legal and business environment.

E. KEY PROVISIONS IN THE UNION BUDGET

- Provision of INR 2,290 Billion for defence services.
- Capital outlay for defence increased by INR 50 Billion including a sum of INR 10 Billion for accelerating the development of the railway system in the border areas.
- INR 1 Billion is provided to set up a Technology Development Fund for defence.
- INR 22.5 Billion has been provided to strengthen and modernise border infrastructure.
- The scope of exemption for granting full exemption from Basic Custom Duty (BCD) and Countervailing Duty (CVD) on goods imported for use in the manufacture of aircraft for the Ministry of Defence is being clarified to the effect that the exemption is available to all materials in any form and articles thereof, subject to the overall condition that they conform to aeronautical specifications accompanied with a certificate of conformance and/or a release note.

- Either of the following two deductions can be availed:

- 1) Investment allowance (additional depreciation) at the rate of 15% to manufacturing companies that invest more than INR 1 Billion in plants and machinery acquired and installed between 01.04.2013 to 31.03.2015 provided the aggregate amount of investment in the new plants and machinery during the said period exceeds INR 1 Billion.
- 2) In order to provide a further fillip to companies engaged in the manufacture of an article or thing, the said benefit of additional deduction of 15% of the cost of new plants and machinery, exceeding INR 250 Million, acquired and installed during any previous year until 31.3.2017.

TAX INCENTIVES:

- R&D Incentives – Industry/private sponsored research programmes.
- A weighted tax deduction is given under Section 35 (2AA) of the Income Tax Act.
- A weighted deduction of 200% is granted to assesseees for any sums paid to a national laboratory, university or institute of technology, or specified persons with a specific direction that the said sum would be used for scientific research within a programme approved by the prescribed authority.
- For companies engaged in the manufacture of an in-house R&D centre, a weighted tax deduction of 200% under Section 35 (2AB) of the Income Tax Act for both capital and revenue expenditure incurred on scientific research and development. Expenditure on land and buildings are not eligible for deduction.

STATE INCENTIVES:

- Apart from the above, each state in India offers additional incentives for industrial projects. Incentives are in areas like subsidised land cost, relaxation in stamp duty exemption on sale/lease of land, power tariff incentives, concessional rates of interest on loans, investment subsidies/tax incentives, backward areas subsidies, special incentive packages for mega projects.

F. MAJOR DEVELOPMENTS IN THE DEFENCE SECTOR

- The Defence Acquisition Council, the apex decision making body of the Defence Ministry, has been aggressively clearing orders for defence wares since last year and a majority of this will be manufactured in India by the foreign companies in collaboration with Indian firms. During FY15, the DAC approved projects worth Rs 178,036 crore (\$28 billion) to kickstart the programme to modernise armed forces.
- Since June 2014, the government has issued 70 industrial licenses in the defence sector while another 60 applications were as on July 2015. So far, India has issued a total 287 industrial licenses in defence sector.
- In October 2014, the DAC cleared projects worth over Rs 80,000 crore including plans to build six submarines in India at a cost of about Rs 50,000 crore and purchase over 8,000 Israeli antitank guided missiles and upgrade 12 Dornier surveillance aircrafts. Of the Rs. 80,000 crore, more than Rs. 65,000 crore will be part of Make in India initiative with private sector. DAC also approved the purchase of Integrated Anti Submarine Warfare Suites (torpedo decoys and active towed array sonars) to be fitted on seven stealth frigates and four destroyers, which are to be built in India.
- Global aircraft maker Boeing and Tata Advanced Systems have signed a pact to collaborate in aerospace and defence manufacturing as well as to tap into integrated systems development opportunities, including unmanned aerial vehicles.
- With India close to choosing Grigorovich frigates for its navy, Russia is partnering Pipavav Defence to build these ships under "Make in India" initiative.
- Madhya Pradesh has approved a policy aimed at helping firms willing to invest USD 81.60 billion or more for setting up public and private sector defence production units in the vicinity of the towns of Katni, Itarsi, and Jabalpur where ordnance factories already exist. Under the policy, a 50-acre undeveloped government land will be provided. Also, land belonging to the closed down and sick units would be purchased for setting up defence equipment manufacturing units. The policy also has a provision for providing subsidy for transporting goods and raw material to and fro the ports.
- Honeywell Aerospace has signed a licensing agreement with Tata Power Co. Ltd's strategic engineering division, enabling it to produce Honeywell's Tactical Advanced Land Inertial Navigator, or "TALIN", in India. This Honeywell-patented technology enables vehicles and artillery to navigate precisely, even where Global Positioning System satellite guidance is not available, to increase troop safety and maximize mission success. Aligning with the Indian government's objective of organically growing its defence industry and the call for Make in India, Honeywell will license the design, hardware and expertise to assemble, test and, in future, build the production kits for TALIN.
- The Department of Industrial Policy and Promotion (DIPP) has cleared applications for industrial licences for defence production from major players such as Reliance Aerospace Technologies, Bharat Forge, Mahindra Telephonic Integrated Systems Ltd, Punj Lloyd and Tata Advanced Materials Ltd. DIPP also discussed the possibility of removal of stipulation of annual capacity in the industrial licence and also to permit sale of licensed items to other entities under the control of the Home Ministry, State Governments, PSUs and other valid defence licensed companies without requiring approval of Department of Defence Production.
- **Global aerospace defence and security leader Safran and Pune-based high technology components company Bharat Forge have announced a long-term partnership** to supply critical high integrity forged and machined components for commercial aircraft applications to Safran's global affiliates. The first step of this partnership is a purchase order issued by Safran. Over the past 18 months, Safran and Bharat Forge have successfully collaborated on a demonstrator phase for initial trial production of critical forgings in a variety of materials; including titanium, nickel based and steel alloys, for use in aerospace. Both companies will also seek to explore and address other opportunities in Indian aerospace for civil and military sectors.
- Government has also cleared 10 proposals for manufacturing defence equipment and explosives, besides several industrial licences of companies including Tata Motors, Punj Lloyd and Pipavav that had been pending for the past several years. **The licensing committee by the department of industrial policy and**



promotion (DIPP) cleared most of the 35 projects listed for grant of industrial licence.

Applications for defence production from major players like Piramal Systems and Technologies, Bharti Shipyard, Tata Motors, M&M, Bharti Shipyards, Punj Lloyd and Pipavav got approval, along with the permission to procure foreign direct investment.

- Eight minesweeper naval vessels will be built by Goa Shipyard Limited with maximum indigenous technology under the 'Make in India' campaign, Earlier, similar kinds of vessels were being brought from outside India and later modified here, Foreign collaborations would be restricted to hi-tech items and technological transfers, The government, is decreasing the dependence on foreign countries for defence-related procurements. The construction of the minesweepers, also referred as the mine countermeasure vessels, had recently run into controversy after the government withdrew a contract awarded to a firm due to violation of a clause. A minesweeper is a small warship designed to counter the threat posed by naval mines and keep the waterways clear for shipping.
- Announcing Gujarat's Defence Manufacturing policy, the government stated that **Gujarat, through its Defence Manufacturing Policy, is eyeing to build up its economy by grabbing a share in the Indian defence production.** The state Government will try and attract investments from defence companies in building warships and submarines, defence vehicles, artillery, and aircraft making, among others. Currently, the State has attracted investments in the ship building segment with private players like Pipavav Defence & Offshore Ltd. and L&T Shipbuilding having invested in the state. The state government is

identifying areas in Kutch, Banaskantha, Sabarkantha, Ahmedabad and other coastal districts where the defence facilities can be promoted along with plans of developing a special defence manufacturing zone in the State.

- **Kalyani group to set up defence manufacturing unit in Gujarat** - The Kalyani Group will invest Rs. 6 billion in a defence manufacturing facility at Dholera in Gujarat. Likely to employ about 2,500 people, it will include the capacity to upgrade and overhaul armoured vehicles, with a plan to also make defence electronics and radar. According to a memorandum of understanding signed with the state government at the Vibrant Gujarat Summit, the operations are likely to commence by 2016. Kalyani Group, plant would be in line with Prime Minister Make in India vision. The group is targeting USD 30-40 billion worth of iron and steel products that are currently imported for the defence, energy, automotive, construction and mining equipment industries. The group is undertaking its defence business through a subsidiary, Kalyani Strategic Systems. The land at Dholera has been offered by the state government for putting up the plant. Kalyani Group's annual turnover is Rs 120 billion and the plan is to increase the business three to four times over the next 10 years, by embracing Make in India. Beside the forging and engineering business of its flagship company, Bharat Forge, it is focusing on the non-automotive segments of the power, railway, aerospace, oil and gas, and defence industries. A large part of this will be on defence and aerospace.

G. KEY CHALLENGES

- Level playing field between Public and Private enterprises –Under the customs laws, exemption from customs duty is available if the defence equipment is imported by the government of India, the contractors of the government of India, state governments, public sector undertakings of the central government or the state governments and the subcontractors of such PSUs but not for the subcontractors of private companies. Therefore, private sector Indian enterprises are left at a disadvantage as they will have to suffer higher costs due to the levy of customs duty, particularly on inputs. The direct fall-out of such non-exemption of customs duty on inputs in the case of private sector enterprises is that they have to absorb the customs duty paid on imports, thus becoming non-competitive. Also, no specific exemptions are provided from the levy of excise duty on inputs and capital goods procured for use in defence manufacturing. Consequently, **the private sector has an inherent cost disadvantage that makes it non-competitive to foreign OEMs, DPSUs and sub-contractors of DPSUs.**
- Increase in FDI limit-. While the announcement to scale up the FDI limit from 26 per cent to 49 per cent in the last budget has been a step in the right direction, it is unlikely to enthuse reputed global manufacturing houses to set up manufacturing bases and bring in front-end technology. Countries such as China and South Korea have become major manufacturing hubs in aeronautics and ship building technology by being very liberal in their FDI policy and providing high modicum of 'Ease of Doing' business compared to India. DIPP has circulated a discussion paper proposing to increase the FDI level to 74%.
- Positioning of the sector on par with Infrastructure to ensure serious players are able to secure long term finance at competitive pricing.
- Linkage between "Make in India" initiative of the DIPP and the "Make" category of the Defence Procurement Procedures. Large programmes which can define Indian Aerospace and Defence Industry need to be accessible to Indian Industry and should become vehicles for creating an 'Indian' military-industrial ecosystem for the future. Committee of Experts for Amendment to DPP-2013 including formulation of policy framework, has submitted its report to the Government recommending various measures in this regard.
- Clarification and structuring of basic sectoral guidelines like product codes, export guidelines etc.
- Shortage of a skilled workforce- It is a serious challenge to the growth of the Indian defence industry. There is the need for better training and education infrastructure with a pragmatic policy to build an industry-academia ecosystem to tap the huge employment potential in the industry. Skill development is critical for achieving self-reliance in defence production. With an urgent requirement to upgrade existing facilities at training and diploma centres so as to produce technically sound and skilled personnel, it is necessary to strengthen the industry-institute partnership framework for the A&D sector through PPPs.
- Exchange rate variation-Another key variable that makes Indian industry uncompetitive is exchange rate variation. It is well known that much of the raw material in the aerospace industry is not produced in India and has to be imported. Besides, a number of components and sub-systems also have to be imported. The government used to allow exchange rate variation to DPSUs but not to private Indian companies. It has withdrawn this facility for DPSUs thus disadvantaging both against foreign OEMs who are paid in foreign currency.

About Rajani, Singhanian & Partners

Rajani, Singhanian & Partners (RSP) is one of the leading law firms of India with offices in New Delhi, Mumbai, Bengaluru and Hyderabad. The firm takes great pride in consistently adopting the highest professional standards and is identified as a highly-acclaimed law firm by Chambers and Partners, Legal 500 and Asialaw in different practice areas. RSP provides legal services in Corporate and Commercial, Dispute Resolution (Litigation & Arbitration), Employment & Labor laws, Infrastructure, Intellectual Property, and Project Finance.

RSP was established in 1999 by Mr. Ravi Singhanian who is the youngest lawyer to be felicitated with the “National Law Day Award” for Corporate Laws (2006) by Prime Minister Dr. Manmohan Singh. Ravi is a board member in CRISIL Ltd. and Indian subsidiaries of numerous Fortune 500 companies such as McGraw-Hill, AOL, American Bureau of Shipping, National Instruments etc. He is a governing board member of Indian Council of Arbitration and TerraLex, Inc. (USA), which is a global network of more than 158 top law firms and more than 17,000 attorneys in nearly 100 countries.

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