

# India's journey towards self-reliance in defence manufacturing: the way forward

1 September 2020

**By Abhishek Verma, Partner—Aerospace and Defence, Infrastructure, Government and Healthcare, KPMG in India**

(3.2 minutes read)

India's war against COVID-19 has brought about a renewed focus on self-reliance, especially in manufacturing. Even as the virus outbreak takes a heavy toll on the economy, it also presents an opportune moment to advance India's long-harboured ambition of emerging as a world-class defence manufacturing hub. This journey, which begins with strides towards self-reliance, will be shaped by the government's ability to foster innovation and technology development.

The Ministry of Defence (MoD) opened its doors for the private sector in 2001, permitting 26 per cent foreign direct investment (FDI) in equipment manufacturing organisations.<sup>1</sup> In 2002, the MoD revised the Defence Procurement Procedure (DPP) to set up new procurement management structures and systems. Keeping the requirements of the armed forces in mind, the DPP underwent several subsequent revisions until 2016.<sup>2</sup> Another revisional draft for DPP was introduced in March 2020 followed by one more round of revision in July (*titled as: Defence Acquisition Procedure (DAP) 2020*) seeking stakeholder suggestions and feedback.<sup>3</sup>

The revised draft policy sets the tone for the 'Make in India' initiative in the defence sector, and aims to speed up the procurement process.<sup>4</sup> As per the policy, procurement of goods and services will be broadly classified as 'buy', 'buy and make', 'leasing', 'make', 'design and development (D&D)' and 'strategic partnership model' (SPM). To reduce costs and extend service life, a Simplified Capital Expenditure Procedure (SCEP) may also be followed for recurring repairs or refits of 'in service' equipment and systems.

The MoD is sensitive to the issue of time delays that has historically been an area of concern for procurements in the defence sector. In order to address this issue, a Project Management Unit (PMU) has been proposed as part of the procurement process. It is, however, important that the PMU is empowered adequately to ensure accountability from various stakeholders.

While the draft builds on the government's plans to boost indigenous capability, it also encompasses reforms that aim to develop a robust defence industrial base facilitating greater participation of Indian industries. Among the major categories that DPP include are categorisation of defence procurement, capital acquisition, and a revamped offset policy.

Apart from several procedural changes, the draft also envisages an assortment of new ideas – such as the integration of artificial intelligence (AI) with platforms and systems and the use of indigenous high-end material. These developments are an amalgamation of incremental changes over existing procedures and an introduction of new acquisition categories for defence needs.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

The salient features of the policy draft include:

- The addition of the 'lease' category which will enable the faster acquisition of assets by obviating the delays in the outright procurement of equipment while also addressing to some extent budgetary constraints for capital procurements
- The introduction of a subcategory 'Make III' "to encourage lifetime support for assets through local manufacture of components and sub-systems that will enable import substitution of these items from the foreign OEM or Tier 1 suppliers
- The introduction of a new subcategory under the 'buy' category viz. Global-Manufacture in India wherein the outright purchase of equipment shall be made from a foreign vendor with an obligation on the vendor to have a minimum 50 per cent Indigenous Content (IC) on a cost basis of the total contract value
- The intent for greater self-reliance is signaled through enhancement of (IC) across all procurement categories
- A directed approach towards increasing the local manufacturing of military materials through a reward system and removal of products of civil aviation and software development from the eligible list of offsets
- While manufacturing locally can address aspects related to meeting the armed forces requirements, in the long-term indigenous design and development is necessary to achieve self-reliance. For this, a new category for design and development has been created. This category aims to foster innovation by developing an innovation ecosystem for entrepreneurs, start-ups and MSMEs and to use open competition to promote out-of-the-box thinking to develop indigenous systems and platforms
- Dedicated chapters have been added to address procurement from DRDO/OFB/DPSUs and the procurement of Information Communication Technology (ICT) systems as both these cases have unique features that merit such specialised handling. The chapter on ICT procurement addresses the fast pace of ICT systems development and encourages open or modular architectures that will allow new technologies, both hardware and software to be added to the backbone infrastructure.

## Conclusion

The new procedure at its core aims for a more indigenous manufacturing base and places emphasis on the perspective of self-reliance.

Given this direction, global OEMs would need to either establish manufacturing facilities in India (facilitated by the proposed increase in FDI through automatic route to 74 per cent from 49 percent)<sup>5</sup> or partner with local suppliers both large and medium scale. The participation of global OEMs should lead to the accrual of technology transfer benefits. India is also positioning itself as a manufacturing hub for OEMs, offering cost arbitrage along with skilled manpower and developed infrastructure, to address the South Asia market.

The policy revisions are a step in the right direction towards strengthening the "Make in India" initiative in defence production, and further supports the larger ambition of making India an exporter of defence equipment that can compete with the offerings of established global players.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

---

<sup>1</sup> Relaxation of FDI norms in Defence Sector, Ministry of Defence, 23 March 2020

<sup>2</sup> Defence Procurement Procedure 2016 Capital Procurement, Ministry of Defence, 29 July 2016

<sup>3</sup> Second draft of Defence Acquisition Procedure 2020 placed in the public domain inviting suggestions, Ministry of Defence, 28 July 2020

<sup>4</sup> Amended Draft DAP 2020, Ministry of Defence, 27 July 2020

<sup>5</sup> Finance Minister announces new horizons of growth; structural reforms across Eight Sectors paving way for Aatma Nirbhar Bharat, Ministry of Finance, 16 May 2020

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.