

**Indian Acquisition Policy and Defense Public Service Undertakings:  
Implications for U.S. Companies**

By

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## **INTRODUCTION**

I want to thank Ambassador Inderfurth and Amer Latif for inviting me to participate in today's roundtable on U.S.-India defense trade. From 2001 to 2007, during my tenure as Principal Director for Security Cooperation Operations in the Defense Security Cooperation Agency (DSCA), I spent a great deal of time working on the U.S.-India defense relationship and traveling to India, and I maintain a strong interest in U.S.-India defense relations.

I must confess I would be more comfortable discussing Indian considerations for buying U.S. hardware, U.S.-Pakistan relations, and Indian perspectives on U.S. reliability as an arms supplier. My interaction with the Indian defense establishment over the years has principally been on the government-to-government side rather than with Indian defense companies outside of conferences and seminars. I have interacted a great deal, of course, with representatives of U.S. defense industry who do business in India and some of my current clients are involved in the Indian defense market.

My first visit to India was in November 1977. I was a young U.S. Army Major living in Taiwan studying Chinese. The People's Republic of China (PRC) was still out of bounds in those pre-recognition days. Young Foreign Area Officers like myself were permitted to travel just about everywhere on the periphery of China but not to the PRC itself. During that 1977 trip I traveled around India and Pakistan and learned much about the roots of the India-Pakistan conflict. I recall an Indian gentleman sitting next to me on the long bus ride from Delhi to Agra who lectured me extensively on the Kashmir problem. I still remember that conversation vividly; and it sparked my continuing interest in India and Pakistan over the years.

My next visit to India, however, was 26 years later in December 2001. I accompanied Under Secretary of Defense for Policy Doug Feith for the first meeting of what became the U.S.-India Defense Policy Group (DPG). At that meeting I was given the task of establishing the Security Cooperation Committee (SCC) as a subcommittee of the DPG. The SCC later became the Defense Procurement and Production Group (DPPG). During my time in DSCA I made a total of six official trips to India.

The work of the SCC/DPPG, of course, was to discuss issues, principally related to Foreign Military Sales (FMS) to India. Our first program during that period was the sale of AN/TPQ-37 FIREFINDER artillery locating radars to the Indian Army. Following that, we transferred an LPD (the former USS Trenton) to the Indian Navy with Sea King helicopters, we also sold the Indian Army Special Forces equipment, six C-130J aircraft to the Indian Air Force. A C-17 sale is currently underway. On the direct commercial side there has been the sale of eight Boeing P-8I

Poseidon aircraft and the down-select of the GE 414 engine for the LCA. The Chinook helicopter is a consideration in the Indian heavy lift helicopter competition.

I don't have to tell anyone at this roundtable that India is a large but challenging market for U.S. defense products. Each of the sales I just mentioned involved long and often frustrating negotiations with the Indian Ministry of Defense and the Indian military services. Who among us hasn't heard the expression that the British invented bureaucracy but the Indians perfected it. I always found my Indian counterparts, however, to be friendly, gracious, and engaging.

### **INDIA'S DEFENSE PRODUCTION PROCEDURE (POICY)**

As for India's new Defense Procurement Procedure (DPP) 2011,<sup>1</sup> it is ambitious and intended to establish a robust indigenous Indian defense industry. Any country as large as India and with a military as large as India's that relies on foreign arms suppliers for the majority of what it needs to meet its requirements does so at its disadvantage and at higher cost. India must procure some high-tech/high-cost items like fighter aircraft, for example, because they are too costly and difficult to develop and manufacture domestically. India necessarily must purchase them and their co-production rights from a country that already produces them and achieves the economies of scale necessary to make them affordable.

Currently, according to Asia-Pacific Business Technology Report,<sup>2</sup> Indian defense imports amount to nearly 70 percent of its total defense expenditures. While it has "been on a quest to become militarily self-reliant in producing equipment and systems that feature the indigenous 'Made in India' tag, it has thus far failed to achieve strategic autonomy." The report goes on to say that "A plethora of reasons have hampered the creation of a strong industrial base for the defense sector, not the least of which has been the half-hearted policies of the Indian government that have prevented private players from investing in this crucial sphere."

The new DPP 2011 announced by Defence Minister Shri AK Antony on January 13, 2011, is intended, therefore, to move India further along the self-reliance path and "act as a catalyst to enhance potential of Small and Medium Enterprises (SMEs) for indigenisation as also for broadening the defence research and development base of the country." Releasing the document, "Shri Antony said the Policy aims to achieve maximum synergy among the Armed Forces, Defense Public Sector Undertakings (DPSUs), Ordnance Factory Boards (OFBs), Indian Industry and Research and Development institutions." It gives preference to indigenous design,

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<sup>1</sup> <http://mod.nic.in/dpm/DPP2011.pdf>

<sup>2</sup> <http://www.biztechreport.com/story/1299-india%E2%80%99s-growing-defense-industry>

development and manufacturing of defense equipment. These are admirable goals but they will be difficult to achieve.

I won't attempt to summarize all the changes in the new 291-page DPP 2011. There are many good analyses out there including ones by Price Waterhouse Coopers and Ernst & Young. I also refer you to an article by Colonel KV Kubar, founder of the Indian Defense Offset Facilitation Agency (DOFA) and Director of Capital Acquisitions and Offsets in the Ministry of Defence from 2005 till 2009,<sup>3</sup> at India-Defense.com. I want to try and stand back and look at the forest and not the trees.

The key paragraph in Colonel Kubar's analysis, and one I believe captures the big picture from my perspective, is this:

There is a huge gap between what our indigenous industry can offer, to what is expected of them by the nation's Forces. This gap is addressed by two divergent stakeholders. One is the foreign industry which can temporarily fill-in these gaps with what could quench the thirst and a DRDO (Defense Research and Development Organization) which relentlessly works to fill in the gaps in technology the industry so desperately needs. . . . one works on a fast track with short term gains and the other necessarily needs to be slow and sure to address the medium and long term goals of the nation's industry.

Col Kubar provides two bulletized lists in his article which I've included here. They summarize what was included in the 2009 amendment to the 2008 DPP and what is included in the 2011 DPP.

#### **Inclusion from DPP 2009 (amendments to DPP 2008 in 2009)**

- Introduction of new category for acquisition "Buy & Make Indian". This is indeed a progressive step towards encouraging Indian industry to forge relationships with foreign OEMs and manufacture the product indigenously; the RFP will be issued to Indian companies only.
- Sharing of information with Indian Industry - The government has entrusted the headquarters Integrated Defence Staff, to share a public version of the long term integrated perspective plan (15 year plan) through wide publicity and by placing the same on the MoD web site.<sup>4</sup>
- Enhancing role of Independent Monitors - This was done by mandating nomination of adequately senior members into the Technical Oversight

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<sup>3</sup> <http://www.india-defence.com/>

<sup>4</sup> <http://www.mod.nic.in/>

Committee ( TOC ) for a more detailed examination of the adherence to the process.

- Removal of ambiguity regarding EMD (earnest money deposit) in signing the Integrity Pact.
- Formulation of SQRs including issue of Request for Information (RFI) - mandating broad based SQRs and seeking detailed information with regards to the transfer of technology both in range and in depth, as identified by the DRDO.
- Offsets requirement in Option Clause will follow the mandated requirement in the original RFP.
- Cases for a change of offset partner will be justified by the OEM and approval accorded in exceptional cases by MoD.

### **Inclusions in DPP 2011**

- The discharge of offset obligations have been expanded to include Commercial aerospace and Internal security due to the similarities and synergies observed.
- The scope of services have been enhanced to also include Training and related services so very essential for each procurement.
- There have been a number of RFP related refinements such as extending the validity of AON (Acceptance on Necessity) for RFPs that are retracted, nomination of private industry for absorbing Maintenance ToT (Transfer of Technology), providing grace period for field trials, improving the quality of oversight in procurements, defining timelines for effective monitoring, extension of time in Fast track procurements etc.
- Extending the exchange rate variations to private industries, reducing risks by halving the performance cum warranty bond, linking the BG (Bank Guarantee) to the commercial offer, replacement of the PLR by the base rate of the SBI (State Bank of India), renaming the EMD (Earnest Money Deposit) as Integrity pact bank guarantee and allowing letter of credit to be opened from only four nominated banks, etc.

The DPP 211 is a quantitative improvement to the old policy. It provides a more streamlined and more flexible set of procedures with a much broader scope of allowable offsets, including such categories as internal security, simulators, and civil aerospace. The new offset policy does not tie foreign original equipment manufacturers (OEMs) to one DPSU. It improves timelines. The validity of Acceptance of Necessity after retraction of RFP has been extended by one year. Timelines for procurement cases have been hastened by approximately 6 months. In Fast Track Procedures an additional grace period of 30 days has been given for submission of

technical/commercial offers, and the penalty of blacklisting for non-performance has been removed. The Technical Oversight Committee (TOC) will have higher rank officers

Industry friendly measures include performance bank guarantee bonds and warranty bonds have been clubbed at 5%. The exchange rate evaluation clause has been made applicable to all Indian vendors in 'Buy global' cases. The base rate of Reserve Bank of India (RBI) has replaced the prime lending rate. Integrity pact bank guarantee has been linked to the validity of the commercial offer, thus the vendor need not deposit the same for 5 years. And a grace period is now 45 days to produce equipment for trials.

All this is very technical, as acquisition regulations usually are. If you think the Indian DPP 2011 is difficult to wade through, you should read the U.S. Defense Federal Acquisition Regulation (DFAR) sometime.

### **DPSUs AND INDIAN DEFENSE COMPANIES**

I have no doubt that over the longer term the new DPP will benefit India's domestic defense industry. Nevertheless, India continues to have a problem absorbing the offsets available to it. This is not a problem unique to India. It's a common phenomenon that larger government-owned companies like HAL, where government-owned companies exist, get the lion's share of offset arrangements while smaller companies struggle to take advantage of limited opportunities and to absorb the work. The new policy is intended to correct that. Time will tell how successful it will be.

As the Asia Pacific Business Technology Report notes, in past years, successive Indian governments kept private players out of defense equipment production due to the strategic and sensitive nature of the sector. It didn't open the defense sector to private companies until 2001. The country opened up its economy in the early 1990s and thanks to economic reforms private sector started flourishing, helping to write India's economy success story. Defense-related items were removed from the reserved category and transferred to licensed category. Private players in the defense sector, however, continue to lag. Companies such as L&T, Tatas, and Mahindra ventured into this industry, but according to reports I read in preparation for this roundtable, the overall response was lackluster. Col Kumar says that there are as many as 5,000 Indian companies that are eligible to participate in offset arrangements. I expect nowhere near that many companies are in a position to take advantage of the opportunity.

As is the trend in other countries, India appears to be moving toward de-investment in DPSUs and more privatization, but this will remain a sensitive political topic. It is important to address the issues of their rivalry with the civil sector and amicably disaggregate the leverages of the

country's defense industry (OFs and DPSUs) and the scientific community, which have increasingly contributed to this rivalry. In the meantime, DPSUs will remain major offset partners.

## **IMPLICATIONS FOR U.S. DEFENSE INDUSTRY**

So what are the implications of India's new DPP for U.S. Defense companies? U.S. defense industry now has ten years of experience dealing with the Indian Ministry of Defense and the Indian defense sector since the reset of U.S.-India defense relations. There have been some notable successes as I have indicated above. But there is one outstanding failure for the U.S., and that was India's decision not to down-select either Lockheed Martin's F-16 or Boeing F/A-18 in the Medium Multi-Role Combat Aircraft (MMRCA) competition. Instead it turned to Rafael and the Eurofighter.

I've heard several different opinions as to why neither U.S. company was down-selected. As I was very much involved in this program before I departed DSCA, I have my own opinion. I believe it likely was a combination of two reasons. First, the inability of the United States to transfer all the technology and manufacturing capability the Indian Air Force wanted and, second, insufficient political lobbying by the highest levels of the U.S. government. I may be wrong about the second reason because I know that both Secretary of State Hillary Clinton and President Barack Obama weighed in on this issue. I suspect, however, that they failed to provide Indian leaders with sufficient incentives to outweigh their concerns about U.S. technology transfer and reliability. Indian concern about U.S. Pakistan relations no doubt also as a factor, but not having access to a record of those high level discussions, I can't comment on this with specificity.

I do not believe that the failure of the Indians to down-select a U.S. company or to ultimately win the MMRCA competition should be viewed as a big setback of U.S. forward momentum in the Indian defense market. U.S. defense products are the best in the world and the Indians who don't already believe that are slowly coming to understand that fact. Furthermore, U.S. technical and logistics support for the defense products and services it sells are superior to our competitors. With time the Indians will come to understand this as well. Given the two countries million-man armies, there is a broad spectrum of U.S. products from communications equipment to vehicles that the Indians should find desirable and beneficial to them and around which cooperative coproduction programs can be formed.

As for interaction with Indian defense companies and offset arrangements. U.S. defense industry has extensive experience and expertise in this area. Most large U.S. defense companies have experts in this area who do an excellent job in understanding foreign procurement and offset policies. I have no doubt that they are on top of the new Indian DPP and will adjust accordingly. Hopefully the additions to the DPP will make it easier for U.S. companies to interact with the

MoD, the military services, and both private and government-owned Indian defense companies. I expect we will see an increase in the number of U.S. companies that maintain a permanent presence in New Delhi, as this is necessary if U.S. and Indian defense companies are to form long-term partnerships.

Nevertheless, the Indian bureaucracy remains a daunting challenge for U.S. defense industry. The one great frustration I had in dealing with the MoD was that the Directors General for Acquisition and other senior civilian MoD officials were not career defense officials but Indian government civil servants that moved from ministry to ministry. They were great technocrats, but they came to Indian defense procurement with a lack of understanding of Indian defense requirements and the internal Indian military bureaucracy. They lacked the skills, that must be developed over many years of dealing with Indian military officers and foreign defense officials, necessary to sort through the complexity of overlaying Indian military requirements with what foreign governments were capable of providing.

This appears to be changing. The Joint Secretary for Air has been in place for some time now, and Mr. Sharma, the former DG acquisition was recently brought back as Defense Secretary. So, hopefully, the tide is turning.

In conclusion, once again I cite the Asia-Pacific Business Technology Report's assessment. "Indian defense industry is still in its nascent stage. The market is highly lucrative but requires huge investment to make India self-reliant in defense production. For this to happen, transfer of critical defense technology, less bureaucratic hurdles and policy flexibility are required." For the U.S. government and U.S. defense industry this means patience, perseverance, and determination are necessary. Their strategy should be one that seeks long-term partnerships rather than short-term sales and the most convenient short term offset partner.