

INDIAN DEFENSE INDUSTRY

J P Chawla & Co. LLP

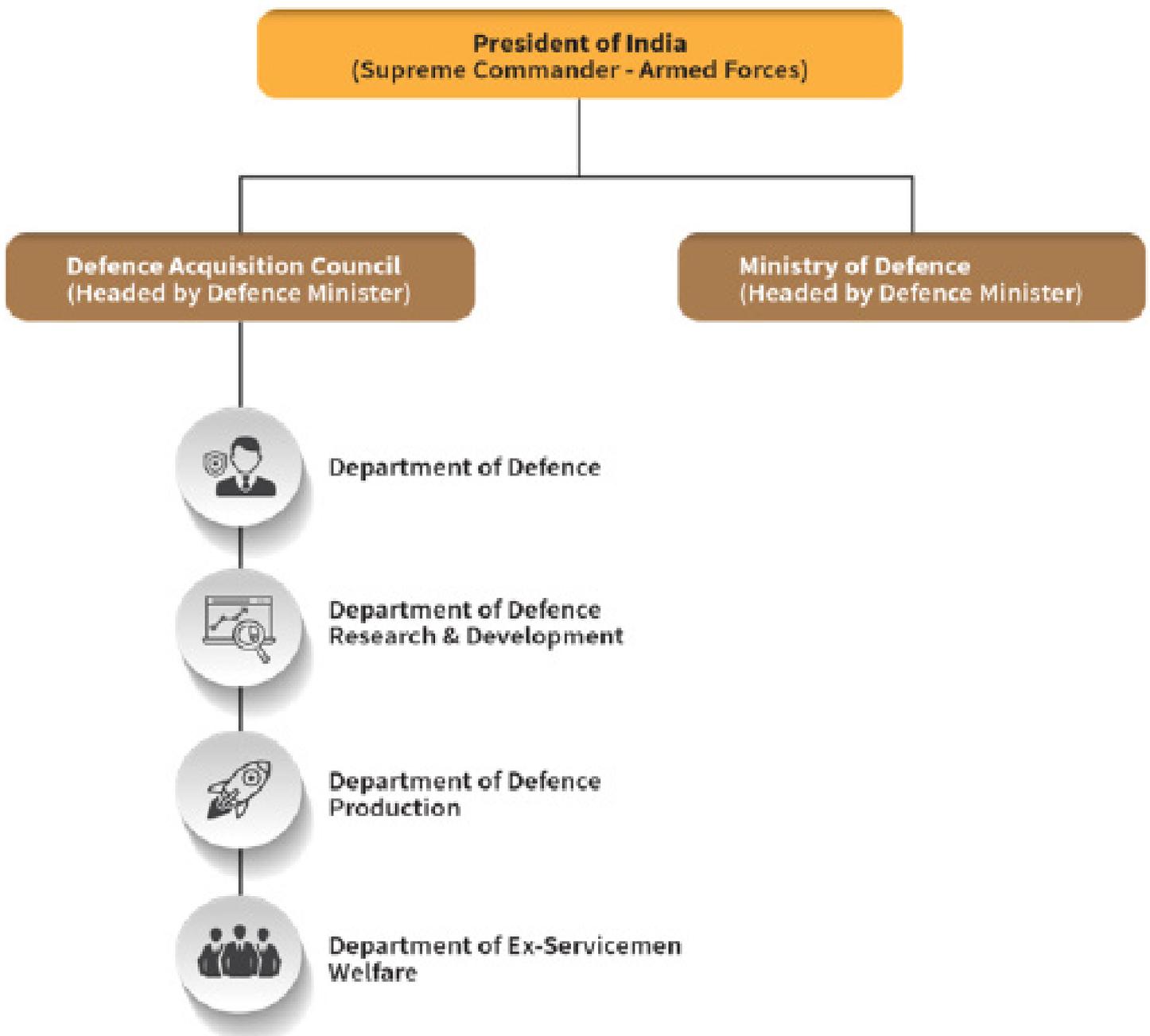
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Introduction to the Indian Defense Sector

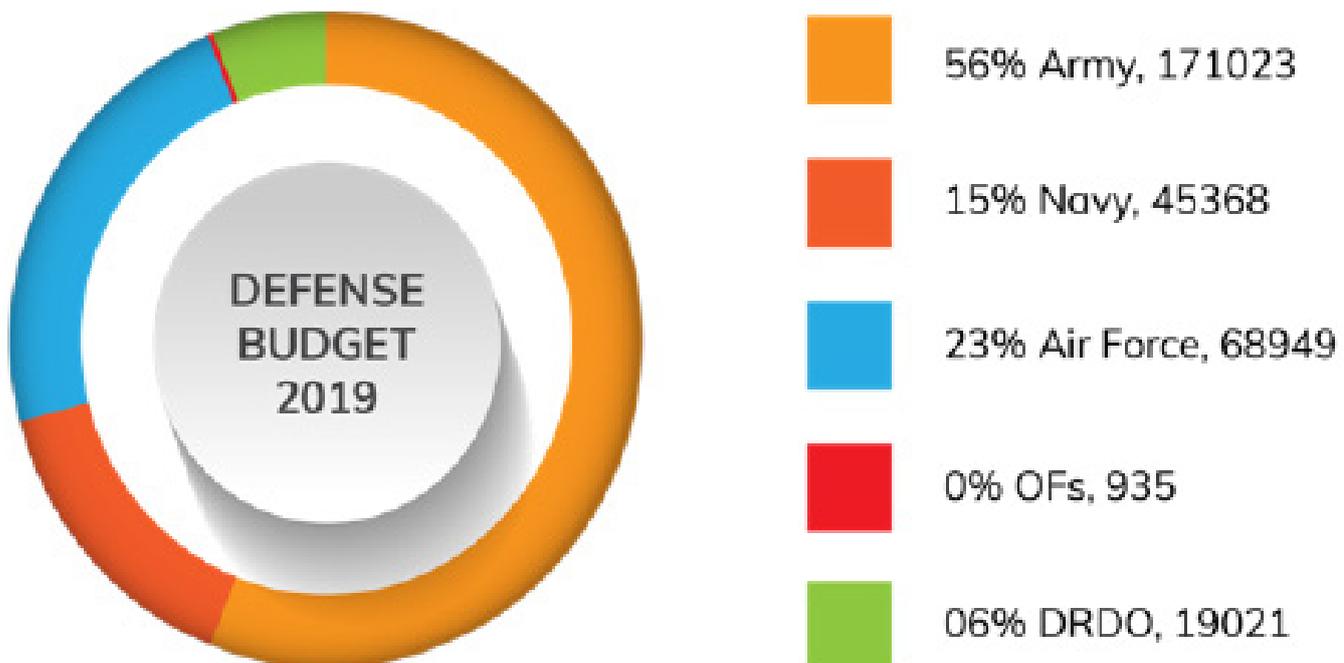
With the second-largest standing army in the world, India is the world's fastest-growing economy. Being the supreme commander of the armed forces, the president of India leads the Ministry of Defence (MOD) and the Defence Acquisition Council (DAC). The Ministry of Defence (headed by the Minister of Defence) includes the Department of Defence, Department of Defence Research and Development, Department of Defence Production and Department of Ex-servicemen welfare. The Defence Acquisition Council (DAC), headed by Minister of Defence, is taken care of by its three boards Defence Production Boards, Defence Procurement Boards, and Defence Research and Development Board. The defence function of the Indian government is taken care of by the Ministry of Defence. The Indian Armed forces can be primarily divided into four sub-sections, viz, the Army, Navy, Air Force and defence agencies.



Market Overview (Industry scenario)

Market attractiveness

In the financial year 2019-2020, the defence has been allocated a major share of 9% of the total budget. The government has allocated the US \$61.96 bn (Rs.4,31,011 crore) to the Ministry of Defence (MOD). Out of this, USD 43 billion (Rs. 3,05,296 crore) is allocated to the three armed forces and the rest USD 15.7 billion (Rs. 1,12,080) crore is for defence pensioners and other expenses. Service-wise allocation of budget amounts to USD 24.1 billion (Rs 1,71,023 crore) (56%) for Army, Navy USD 9.7 billion (Rs. 68,949 crore) (23%), Air Force USD 6.3 billion (Rs. 45,368 crore) (15%), DRDO USD 2.6 billion (Rs. 19,021 crore) (6%), OFs USD 131 million (Rs. 935 crore) (0%) (0.00%). With this budget at hand, India is the largest importer of arms in the world wherein 60% of its total defence requirements are imported. India ranks third in military pending with spent of more than US \$ 71.1 billion only ranked behind USA and China.. This makes Indian an attractive market for foreign defence manufacturers. The ongoing DRDO projects of India are worth \$7.3 billion and 2.30% of the GDP is spent on defence. 100% FDI is permitted with upto 49% FDI under automatic route and rest through approval route.



Emerging opportunities

Through its Make in India campaign, the government has opened doors for private sector participation to encourage indigenous manufacturing. About 30% of the total India's defence budget is spent on capital acquisition.

Out of the total, a worth of USD 320 million (Rs. 2,272 crores) was exported to 28 countries in the year 2015-16, and USD 281 million (Rs. 1,996 crores) was exported from the Ordinance Factory Board (OFB), DPSUs and the private sector in the year 2017. Today, USD 15.4 million (Rs. 110 crores) has been allocated to set up the 'Technology Department Fund. In the 2019 budget, USD 15.4 million (Rs. 110 crores) has been allotted for setting up the 'Technology Department Fund.

Defense Procurement Market Dynamics

Majorly dependent on imports for defence procurement, Being dependent on imports for a majority of its defense requirements, India is the world's largest importer of arms and ammunition as per data by Stockholm International Peace Research Institute (SIPRI) with 15% of global imports in its pocket. It has become an attractive market and a significant opportunity for foreign defence manufacturer.

India had imported arms estimating at USD 25.1 billion (Rs. 1,78,495 crores) between 2010 and 2016, which amounts to 12.5% of the global imports. Out of the 30% of procurement in arms, 21% is procured from state-owned businesses, and 9% happens to come from the Private sector. Today, the arms industry in India is dominated by state-owned companies: 39 Ordnance Factories (OFs) and the 8 Defence Public Sector Undertakings (DPSUs).

Investment Opportunities

While there was foreign participation in the production of India's defence goods and 50-60% of goods were imported, the government of India came up with the Make in India programme. This brought in the concept of indigenous production. With the reduction in imports, foreign companies started to enter the country via joint ventures with various Indian organisations. Since the defence industry has opened doors for private sector participation for indigenous manufacturing, it has allowed foreign manufacturers to partner with Indian companies. Few such conglomerates are:

1. Kalyani Rafael Advanced Systems (KRAS)

This is a joint venture between India's Kalyani Group and Israel's Rafael Advanced Defence Systems. In the coming years, this conglomerate plans to supply 1,000 units of 8 MR-SAM missile kits, worth \$100 mn, to India's state-run defence manufacturer Bharat Dynamics Ltd. (BDL).

2. Lockheed Corporation ties up with Tata Advanced Systems Ltd

Formed with the merger of Lockheed Corporation with Martin Marietta, Lockheed Martin is one of the largest security and aerospace companies in America. In September 2018, Lockheed Martin announced its partnership with Tata Advanced Systems Ltd for the procurement of F-16 wings exclusively for India's Air Force.

3. Tata Boeing Aeronautics Ltd. (TBAL)

In March 2018, The Boeing Company, one of the leading manufacturers of commercial and military aircrafts, announced its tie-up with Tata Advanced Systems Ltd. The Tata Boeing Aeronautics Ltd. (TBAL) delivered its first AH-64 Apache combat helicopter fuselage on June 1, 2018.

4. Sterlite Technologies

One of the leading power transmission developers across the globe, Sterlite Technologies bagged the order to design a communications network for the Indian Navy in February 2018. The project is worth \$539.0 mn. The Pune based network provider intends to design, execute, operate, and maintain the Navy's digital network.

5. Hindustan Aeronautics Limited (HAL)

In April 2018, India's only manufacturer of combat fighters Hindustan Aeronautics Limited (HAL) joined hands with The Boeing Company. With this tie up, these two intend to for manufacture F/A-18 Super Hornet for Indian Air Force. This shall contribute to the Make-in-India campaign and strengthen indigenous platforms in India.

The major foreign investors who have invested in the Indian Armed Forces are as follows:

1. Airbus (France)
2. BAE India Systems (UK)
3. Pilatus (Switzerland)
4. Lockheed Martin (USA)
5. Boeing India (USA)
6. Raytheon (USA)
7. Israel Aerospace Industries (Israel)
8. Rafael Advanced Defence Systems Ltd. (Israel)
9. Dassault Aviation SA (France) 27

Major Players

Defence Public Sector Undertakings (DPSUs) deal in production of warships, helicopters, aircrafts, submarines, heavy vehicles, missiles and earthmovers. Apart from this, they also provide alloys and special-purpose steel, components, electronic devices, etc. Of all the strategic requirements of the armed forces, DPSUs take care of 65% of the output from the public sector. There are about 9 Defence Public Sector Undertakings in work.

Defence Ordnance Factories Board (working under the Ministry of Defense) engages in research, development, testing, production, marketing and logistics for various products ranging from air, land and sea systems. There are about 41 ordnance factories, nine training centres, three regional centres, and four regional controllerates.

The 9 Defence Public Sector Undertakings:

1. BEML Ltd.
2. Bharat Electronics Limited
3. Mazagon Dock Shipbuilders Ltd.
4. Goa Shipyard Ltd.
5. Garden Reach Shipbuilders and Engineers Ltd.
6. Hindustan Shipyard Ltd.
7. Bharat Dynamics Ltd.
8. Hindustan Aeronautics Ltd.
9. Mishra Dhatu Nigam Ltd. (MIDHANI)

Private companies

Modernisation of the armed forces and indigenous manufacturing are the vital ideas to be worked upon under the Make in India programme. Bringing in the concept of self-reliance has led to growth in private sector participation for manufacturing technologically advanced equipment within the country. With this, favourable policies were introduced in the industry for private sector companies. Since then, many companies have started to operate and invest in electronics, aerospace products, land systems, and short-range missiles.

The private players from the domestic automobile such as Tata Motors, L&T, Ashok Leyland bagged contracts worth Rs. 1,200 crores for approximately 1600 Heavy Mobility Vehicles. Here is a list of private investors in the defence sector:

1. MKU
2. Tata Advanced Systems
3. Godrej Aerospace
4. Adani Defence & Aerospace
5. Ashok Leyland
6. Larsen and Toubro
7. Kirloskar Ltd.
8. Dynamatic Technologies Ltd.
9. Mahindra
10. Reliance Defence and Engineering Ltd.
11. Punj Lloyd

Competitive Landscape

Dominated by state-run entities such as Defence Public Sector Undertakings (DPSUs), Defence Research and Development Organisation (DRDO), and Ordnance Factories (OFs), the Indian defence industry has opened doors for private investors. With the entry barriers being liberalised, this industry is observed to be growing at a high rate. As a consequence, we notice an increase in competition as well. This is regarded as a positive change for the competitive atmosphere in the market shall assure excellent quality and technological advancement of goods.

Defence Research and Development Organisation (DRDO)

Formed in the year 1958 with the merger of Defence Science Organisation and Technical Development Establishment of the Indian army, Defence Research and Development Organisation (DRDO) has grown multi-dimensionally. It started with ten laboratories and has emerged as a strong organisation with 50 laboratories and establishments. DRDO has been the pioneer in the field of defence research and has successfully placed India amongst one of the four Multi-Level Deterrence countries globally. All these years, DRDO has been designing, developing, and producing projects ranging from unmanned aerial vehicles to combat vehicles to electronic warfare systems. India, today, has the ability to deliver a nuclear payload through a submarine-launched, airborne, missile or land-based delivery system. The organisation comprises of three certification agencies, namely, Centre for Fire Explosive and Environment Safety (CFEES) for fire and explosives, Centre for Military Airworthiness and Certification (CE-MILAC) for airworthiness products, and Scientific Analysis Group (SAG) to grade information security products.

With a vision to make the country self-reliant, DRDO intends to work towards enhancing the defence systems. It wants India to grow independent of foreign technologies and gain expertise in various scientific and technological spheres. Defence Research and Development Organisation (DRDO) transfers research developments based on their security sensitivity to the industry. Until now, over five hundred technologies have been transferred to the private sector. Its 2019-2020 budget is around Rs. 19,021 crore i.e., 6% of the total defence budget and its ongoing projects are worth US \$7.3 bn.

Defence Procurement

In Budget 2018-19, government of India announced its intentions of promoting indigenous production by bringing out a Defense Production Policy. Under this policy, the production shall be allotted to private sector units, public sector units and MSMEs. Focused on self reliance, draft of the Defense Production Policy 2018 proposes a rise in collaborations for acquisition of latest manufacturing processes, skills and advanced technology. This policy stresses to foster an innovative and competitive defense industry. The aim is to strengthen infrastructure, enhance defense exports by providing a to promote start-ups and MSMEs.

Road Ahead

The key focus of the Indian government at this hour is to make India self-reliant. For this purpose, India wants to encourage foreign investors to transfer their technology arrangements to their Indian partners completely. The government also plans to bring in investments and set them up in modernisation of the armed forces and create infrastructure, particularly in the aerospace and electronics segment. Hereby, the government plans to spend an amount of USD 130 billion (Rs. 9,22,486 crores) for modernisation by the year 2025. By the year 2025, the government intends to achieve a turnover of about USD 23.9 billion (Rs. 1,70,000 crore) and exports of approximately USD 4.9 billion (3,500 crore) in defence goods and services. By the next decade, the industry expects to acquire capital assets worth USD 211 billion (Rs. 15,00,000 crores). Apart from this, the defence is planning to set up a manufacturing cluster and park in Pune and Dholera. Defence aims to partner with more foreign companies for tie-ups, technology transfer arrangements, and joint ventures. With the new Strategic Partnership Policy, the government intends to capitalise and contribute to the Make in India programme.



Conclusion

Being one of the most sensitive areas concerned with national security, defence undoubtedly holds utmost importance for any nation. Therefore, it is observed that India has amended its policies in the defence sector. India is, indeed, witnessing a change its 'Make in India' programme. With the emerging private market, domestic manufacturing will have a multi-dimensional effect on the country. While it would save millions of dollars spent on imports, it will also create job opportunities for the locals. The aim is to build a nation that is self-sufficient and self-reliant, as opposed to foreign dependence. Further, Covid 19 is not going to have any significant impact on defence industry, though India might look at indigenous military projects, but many collaborations are also expected to ensure technology transfer. There is opportunity for innovations, which may lead to civilian use in future. Also recent stand offs with China, Pakistan may create more opportunities in this sector.

Dear Valuable Client / Colleague,

In case you require any further detailed analysis on above mentioned content, please do get back to us and we shall be happy to provide you the same.

With Best Regards,

Team JPC

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