

# Quantity, Not Technology

## Investment limits will restrict technology transfer to India

BRADLEY PERRETT/NEW DELHI

India looks like it is failing in one of the key objectives of its defense industrial policy—its desire to bring advanced Western technology into domestic-foreign joint ventures on its own territory.

Unless New Delhi changes its policy, limits on foreign investment in such businesses will ensure that the flood of work coming to the country as offsets to Indian arms purchases will be limited to non-sensitive technology.

There is pressure for change, however, and industry executives are watching to see whether that change comes, since evolution of the rules on offset spending and foreign investment will be critical in guiding the technological development of the Indian defense industry.

As the rules stand, local makers of aerostructures and components will be the main beneficiaries of the offsets policy, which requires foreign arms suppliers to buy 30-50% as much from India as the Indian government buys from them.

Electronics firms are also benefiting, but not at the leading edge of technology. "The offsets budget is going to come out of hardware," says Boeing India President Dinesh Keskar, looking at the \$2.3 billion his company must spend in India to offset the country's orders for airliners and P-8I Poseidon maritime patrol aircraft.

Indeed, the rise of privately owned Indian aerostructures companies is making it all the easier to spend that money. In the past, foreign suppliers would have been largely limited to the government's Hindustan Aeronautics as a destination for offset spending. Now privately owned manufacturers are proliferating and competing for business.

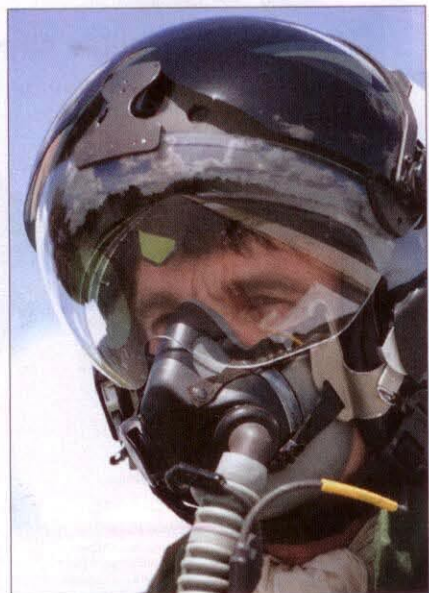
This all adds up to a thriving and efficient aerostructures industry. But it does not add up to a great deal of advanced defense technology.

Executives of Western defense suppliers interviewed for this report all made the same comment: A 26% limit on foreign ownership of defense companies ensures that they will not transfer advanced technology into local joint ventures.

Much is at stake. The government is expected to spend about \$100 billion on defense equipment over the coming 10

years, most of it imported, and wants to use that spending to lure technology to India. Accordingly, it encourages the formation of Indian-foreign companies.

But ownership and control of advanced technology is the heart of a defense contractor. To ensure it is not shared with rivals, the most valuable know-how will be put only in the hands



Samtel will work with Thales to develop helmet-mounted displays for the Indian military.

of a company that the foreign contractor can control—usually implying 50% ownership or more.

In Australia, for example, there is no limit. That nation is comfortable with its biggest defense businesses being fully owned branches of companies from its Western allies. But India is not Australia. It has serious current threats to its security, for decades had an uneasy relationship with the West, and it sees itself as a future great power. So it is not surprising that parts of the government, notably the defense ministry, want to maximize Indian control over the industry. And state companies such as Hindustan Aeronautics and Bharat Electronics fear flourishing joint ventures will stifle their growth.

The Industrial Policy and Promotion Department disagrees. It suggested on

May 17 that the limit should become 74% or even 100%. The department argued that strong joint ventures will work with state companies that might otherwise lose business to imports, that the global defense industry was so dispersed that India would not rely on any one country, and that, if necessary in an emergency, the government could seize factories.

Defense Minister A.K. Antony rejected the department's proposal, saying the arms sector was not ready for it. But the policy was still evolving and a higher limit could not be ruled out forever, he added. Higher foreign investment in India would be allowed on a case-by-case basis, he said, but it is unclear whether that was a reference to more joint ventures or higher foreign shareholdings in them.

The offsets policy could also do more to encourage Indian manufacturers to move into the most advanced technology. Here a key problem is that it gives credit for goods but not services, excluding R&D and even the software that Indian companies have become so famous for producing.

"We have argued for a broad-based offset policy," says Anil Shrikhande, president of Rolls-Royce India. Like other Western companies, the British engine maker is taking advantage of India's abundant engineering talent and undertakes advanced development work in the country. That work, enlarging the experience of India's engineers, cannot be counted against offset obligations—though it might be argued that, since the foreign companies are buying those services anyway, India does not need to change rules to encourage them.

Rolls-Royce has been buying components from Hindustan Aeronautics since 2003 and now has a joint venture with it that makes compressor shrouds for civil engines.

Samtel Display Systems is an example of a company with an electronics business that is benefiting from the defense offsets policy. Samtel has a joint venture with Thales that is locally developing and producing helmet-mounted displays and other avionics. The program, which does not yet have a production order, includes some technology transfer from Thales. ☛