

Don't Change Course

Domestic defense industries want New Delhi to keep foreign direct investment low

NEELAM MATHEWS/NEW DELHI

As the government considers increasing the foreign direct investment (FDI) cap in the defense manufacturing sector to 74% from the existing 26%, Indian industry has vociferously opposed the proposal.

Opportunities arising from growing obsolescence of military hardware, limited indigenous production, domination by government-backed manufacturers and India's growing defense capital plan of \$12 billion up to 2012, have led private industry to call for leveling of the playing field by permitting them to seek participation in every defense project.

Presently, private companies are allowed to bid for only certain categories of sensitive defense projects; the rest are taken by monopolistic government-owned companies.

The government's plan—introduced three years ago to recognize 11 Indian private companies that met certain criteria, including being at least five years old and having a minimum of \$220 million in revenue—is still lying in abeyance. "Labor unions and over 40 ordnance factories owned by the government would be in jeopardy if the private sector was allowed to bid for all projects," an official says.

"The current policy is not capped and allows a higher percentage on a case-to-case basis. . . .26% is a good start. . . . Studies indicate that post-9/11 there is a global trend to restrict FDI in this sensitive area. We have to be cautious in moving forward," says Amit Mitra, secretary general of the Federation of Indian Chambers of Commerce and Industry (Ficci), an organization that represents major private sector corporations.

Avionics and systems manufacturer Samtel holds 74% and Thales 26% of a joint venture for development, production and support of helmet-mounted and multifunctional displays for the Indian air force.

However, the government remains hesitant and has not been transparent in its commitment to clearing projects on a "case-to-case basis." For instance, recent proposals by BAE Systems and EADS for increasing equity with Indian partners Mahindra & Mahindra and Larsen & Toubro were rejected.

Ficci claims that despite the cap, the defense sector has attracted investments from OEMs including BAE, EADS, Sikorsky, Lockheed Martin and Electronica Defense Systems.

Foreign vendors have complained that these investments are not in the high-end technology sector, which India says is its priority. "For technology transfer, the OEM will need a bigger stake in the equity of a joint venture to be involved in board decisions," says an OEM representative.

"Let's face it. Most high-end technologies are cleared only by governments and not by companies and they aren't going to come so easily. The issue is whether India will get only the low-hanging fruits," a defense analyst commented.

Concern has been expressed that with most platforms having around 70% embedded software, increasing FDI stakes for OEMs with Indian IT companies as subcontractors may drive

software projects to foreign competitors. "Creation and owning intellectual property is critical to the growth of Indian defense industry. Do we want OEMs to establish production facilities in India only to leverage its low-cost advantage? We need OEMs to partake in this process by sharing 'know why' and just not 'know how,'" says a Ficci member.

"Allowing foreign companies control greater than 26% would be equivalent to selling out our international defense interest for short-term gain at the cost of strategic, tactical and economic loss to the nation. We should formulate our own growth path for the development of our indigenous resources and capabilities," argues Bharat Malkani, chairman of Maxaerospace.

"This is a sector that needs to develop indigenous capabilities over the long-term. . . . It is a policy that has to be driven forward," says Mitra. There is widespread sentiment among private companies that the cap should not go beyond 49%, even in exceptional cases, and the percentage must be based on:

- Higher FDI to be linked with full platforms being produced in India with a minimum capitalization of \$100 million.
- Proprietary technology content in joint ventures should form the basis of further indigenous technological development.
- Joint ventures should be permitted to source 50-70% of components/subsystems from Indian vendors.
- An export obligation of 10 times the equity stake must be committed by the OEM within 10 years of entering the venture.
- Once transferred, no retroactive law should be allowed to restrict technology exploitation. ☉



SAMTEL DISPLAY SYSTEMS