



2nd INDIA REGIONAL OFFSET CONFERENCE '09

INDUSTRY VIEW

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....long-term partners to Indian Defence

- Buy
 - Buy (Indian) – Minimum 30% Indigenous Offset Applicable
 - Buy (Global) - Maintenance ToT

- Buy & Make (ToT – Local Production) Offset Applicable
 - CKD 30% Indigenous, IM 60% Indigenous
 - No single sub assembly > 10% without ToT

- Make – Indigenous Development
 - Strategic – Thru DRDO
 - Low Tech Mature 50% Indigenous
 - High Tech Complex – 80:20 funded development, Role to Foreign Technology Provider possible p143

- DPP 2008, Discharge of Offset (Page 43 Offset Schedule point 2

discharge of Offset)

- a) Direct purchase of, or executing [export orders](#) for, defence products and components manufactured by, or services provided by, Indian defence industries, i.e., Defence Public Sector Undertakings, the Ordnance Factory Board and private defence industry. For the purpose of defence Offset, “**Services**” will mean **maintenance, overhaul, up gradation, life extension, engineering, design, testing of defence products, defence related software or quality assurance services**”.

Offset programs have to be defence related
but not necessarily supporting MoD Global tenders

- **DPP 2008, Discharge of Offset** (Page 44 Offset Schedule point 2 (b&c) discharge of Offset)
 - b) “Direct foreign investment in Indian defence industries for industrial infrastructure for **services, co-development, joint ventures and co-production** of defence products and components”.
 - c) “Direct foreign investment in Indian Organisations engaged in research in **defence R & D** as certified by Defence Offset Facilitation Agency (DOFA)”.
 - d) **Offset Banking** - creation of offset programmes in anticipation of future obligations. Offset credits so acquired can be banked and discharged against future contracts.
 - Banked offset credits would not be transferable except between the main contractor and his sub-contractors within the same acquisition programme.

Why Offsets for Value Above Rs. 300Cr

- Only Major Defence Systems and Platforms covered
- Build operational self reliance thru “**Defence Product Strategy**”
 - Indian Defence Products with Foreign Content but essentially the control of Product Life Cycle in Indian hands
 - Ability to do maintenance and obsolescence management
 - Ability to upgrade
 - Ability to protect our Doctrines of war fighting

Cost of Offset

Indian Industry participating in the life cycle to create a win win for Armed Forces, Indian Industry and the foreign OEM.

- Acquire state-of-the-art military technologies.
- Provide opportunities of manufacturing and exporting components and parts of acquired equipment.
- Acquire depot maintenance technology, facilities, equipment, tools for service.
- Develop upgrades of weapons systems.
- Export defence industrial products, sub-systems, engineering design and testing services
- Acquire foreign maintenance works.
- Facilitate joint participation in the major R&D projects.
- Harness higher value through manufacturing & exporting the items.
- Acquire investment in infrastructure supporting defence production.
- Provide infrastructure relating to defence industry.

Product Strategy as Envisaged by Kelkar Committee

- “Components *and Part of Acquired equipment*” to be made in India.
- Armed Forces to gain through improved life cycle support through indigenous “*maintenance*” and “*upgrade.*”
- Maturing Indian defence Industry will lead to “*Export of defence industrial products, sub-systems, engineering design and testing services*”.
- This is the way to “*Harness higher value through manufacturing & exporting the items.*”

Confusion with respect to Technology Transfer and Multipliers



- The DPP 2006 /08 identifies Technology Transfer “BUY & MAKE” categorization. This Technology Transfer is paid for and included in the bid (Each Subsystem > 10% in Value).
 - TOT thru offsets is irrelevant if this **Technology was not identified under “Buy & Make”**. **Efficacy of this technology in Indian context is unknown**.
 - If during categorization process MoD has not identified and included the ToT in Buy & Make, how can a technology offered by a Foreign vendor be relevant? This will not be a transparent process.
- Valuing of technology is complex and best left to the market
 - For Technology Transfer under automatic approval RBI allows TTA payment upto \$500,000 and royalty payment upto 5% for domestic sales and 8% for exports. Any Industrial undertaking can approach RBI/FIPB for higher Technology Transfer fee.
 - The TTA fee can be capitalized. Thus it can be included as part of the 26% FDI in Indian Defence Industries in Infrastructure for services, co-development, Joint Ventures, Co-Production of Defence Products. **This is covered under Offsets**.
 - Like any licenced Defence industrial manufacturer, the end product of technology transfer will be available to MoD through the tendering process. The market thus values the efficacy of the TOT through the product Indian Industry delivers at competitive prices.
- No multipliers specified to simplify the scheme
 - Worldwide, Offsets programs with multipliers have obligation between **90%-170%**

Reading DPP 2006 /08 Offset Schedule with Kelkar Committee recommendations, Operative issue “**Acquire investment in infrastructure supporting defence production**” makes it clear that the Current Offset policy ensure Market Mechanism for ToT, ensuring competitiveness for **Exports and Defence Product Maintenance and upgrade – “Defence Product Strategy”**

Change in Offset Eligibility Through DPP2008



- Offset Banking
- Offset Penalty for Indian Prime in “Global Buy” tenders
- Minimum eligibility criteria for offsets:
 - Industrial Defence Licence requirement has been redefined

A no RFP issued under DPP 2008 hence no optional explanation / learning on above issues so far
MRCA & Guns covered by DPP 2006

Offset Banking – yet to be implemented

- A journey of thousand miles start with first step. As no RFP yet under DPP 2008, Offset Banking yet to Start.
- Industry has supported this even with DPP 2005 & 2006.
- Long standing request of Indian Industry on:
 - **Relief on Duty & Tax** ~31.4 % of offset value for support to Foreign Prime in Indian MoD contract
 - and
 - **“Offset Banking”** to start exploring Indian Industry participation in “Global Supply Chain” of Foreign OEM
- **Yet to be implemented.**

DPP 2006 Page 38 clause 6.5

6.5 For 'Buy (Global)' category procurements, where offset is applicable, if an Indian firm is bidding for the proposal and is offering an indigenously developed product, then for such a case offset would not be applicable. However, to ensure that the offset obligation is not circumvented by joint ventures (of Indian and foreign firms) where Indian firm is bidding, the foreign firm concerned will have to discharge offset obligation as per the RFP requirement.

- DPP 2008 Page 46 clause 6.5 For 'Buy (Global)' category procurements, where offset is applicable, if an Indian firm including a Joint Venture between an Indian Company and its foreign partner is bidding for the proposal and is offering an indigenously developed product, then for such a case offset would not be applicable. For applicability of this clause, **indigenous content in the product has to be a minimum of 50 percent**. In case the indigenous content in the product is less than 50 per cent, the Indian firm or the Joint Venture has to ensure that the offset obligations are fulfilled on the foreign exchange component of the contracted value.

Is this about Protecting Low Tech Offset?

The 50% applicability of indigenous content should be made equal to the 30% content as listed under "Buy" Indian. This will allow Indian Cos including JV to emerge as System Integrators and Prime Contractors supporting indigenous Product Capability.

Implication of the Small but Significant Change between DPP2008 and DPP2006

- DPP 2006, Page 105 Offset Schedule point 1 discharge of Offset
 - a) Direct purchase of, or executing export orders for, defence products and components manufactured by, or services provided by, Indian Defence industries, i.e. Defence Public Sector Undertakings, the Ordnance Factory Board, and any private defence industry manufacturing these products or components under an industrial license granted for such manufacture. For the purpose of defence Offset, Services will mean maintenance, overhaul, up gradation, life extension, engineering, design, testing, defence related software or quality assurance services”.
- DPP 2008, Page 43 Offset Schedule point 2 discharge of Offset
 - a) Direct purchase of, or executing export orders for, defence products and components manufactured by, or services provided by, Indian defence industries, i.e., Defence Public Sector Undertakings, the Ordnance Factory Board and private defence industry. For the purpose of defence Offset, “Services” will mean maintenance, overhaul, up gradation, life extension, engineering, design, testing of defence products, defence related software or quality assurance services”.

DPP 2006 through the need for licences ensured that Offset benefited the Defence Forces thru **“Defence Product Strategy”**:

- Licensing requirement ensured that Components and Services relate to equipment required by Indian Defence Forces get Offset benefits. This will have pushed Foreign Primes to invest in life Cycle - maintenance and upgrade infrastructure ensuring life cycle support for the Armed Forces

- Minimum eligibility criteria for offsets:
 - Industrial Defence Licence requirement has been redefined
 - The Indian offset partner shall, besides any other extant regulations in force, also comply with the guidelines/licensing requirements for the defence industry issued by the Department of Industrial Policy and Promotion.
 - A list of defence products through which offset obligations can be met is given at Annexure VI (Page 54) Including Software and Services
 - Hence interpretation of MoD view “No License Required for Components and Services including Software and Design Engineering Services”

Clarification on Press Note 2 on Licencing for
“Arms & Ammunition” including Non Lethal Items and
DPP 2008 Annexure VI (Page 54) indicating “Defence Products” need

Press Note 2 - Private Sector Participation



Government of India
Ministry of Commerce & Industry
Department of Industrial Policy & Promotion
SIA (FC Division)

PRESS NOTE NO. 2 (2002 SERIES)

Subject: Guidelines for licensing production of Arms & Ammunitions

In pursuance of the Government decision to allow private sector participation up to 100% in the defence industry sector with foreign direct investment (FDI) permissible up to 26%, both subject to licensing as notified vide Press Note No. 4 (2001 series), the following guidelines for licensing production of arms and ammunitions are hereby notified:

1. Licence applications will be considered and licences given by the Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, in consultation with Ministry of Defence.
2. Cases involving FDI will be considered by the FIPB and licences given by the Department of Industrial Policy & Promotion in consultation with Ministry of Defence.
3. The applicant should be an Indian company / partnership firm.

Press Note 2 - Private Sector Participation



14. Purchase preference and price preference may be given to the Public Sector organizations as per guidelines of the Department of Public Enterprises.
15. Arms and ammunition produced by the private manufacturers will be primarily sold to the Ministry of Defence. These items may also be sold to other Government entities under the control of the Ministry of Home Affairs and State Governments with the prior approval of the Ministry of Defence. No such item should be sold within the country to any other person or entity. The export of manufactured items would be subject to policy and guidelines as applicable to Ordnance Factories and Defence Public Sector Undertakings. **Non-lethal items would be permitted for sale to persons / entities other than the Central or State Governments with the prior approval of the Ministry of Defence.** Licensee would also need to institute a verifiable system of removal of all goods out of their factories. Violation of these provisions may lead to cancellation of the licence.
16. Government decision on applications to FIPB for FDI in defence industry sector will be normally communicated within a time frame of 10 weeks from the date of acknowledgement by the Secretariat for Industrial Assistance in the Department of Industrial Policy & Promotion.

If the Changed Policy does away with SIA licences for Defence Product Defined in DPP 2008



- 100% subsidiary Foreign Prime and its tier 1 supplier can open / have opened Defence Software and Design Engineering Services Center in India for work on a foreign defence program (export from India) with entire IPRs resting with the foreign company
- As per DIPP, IT/ITes/Software/Design services does not require a licence, this 100% foreign owned entity is now allowed to do defence exports on which it can claim for Offset credits
- As this is a IT/ITes service, for exports, it is eligible for IT Tax holiday, allowing tremendous flexibility to Foreign primes to indulge in appropriate “Transfer Pricing” and meet Offset obligations

Annexure VI to Appendix D
(Refer to Para 2.1 a)

List of Defence Products

- .Small arms, mortars, cannons, guns, howitzers, anti tank weapons and their ammunition including fuze.
- Bombs, torpedoes, rockets, missiles, other explosive devices and charges, related equipment and accessories specially designed for military use, equipment specially designed for handling, control, operation, jamming and detection.
- Energetic materials, explosives, propellants and pyrotechnics.
- .Tracked and wheeled armoured vehicles, vehicles with ballistic protection designed for military applications, armoured or protective equipment.
- Vessels of war, special naval system, equipment and accessories.
- Aircraft, unmanned airborne vehicles, aero engines and air craft equipment, related equipment specially designed or modified for military use, parachutes and related equipment.
- Electronics and communication equipment specially designed for military use such as electronic counter measure and counter counter measure equipment surveillance and monitoring, data processing and signaling, guidance and navigation equipment, imaging equipment and night vision devices, sensors.
- Specialized equipment for military training or for simulating military scenarios, specially designed simulators for use of armaments and trainers.
- Forgings, castings and other unfinished products which are specially designed for products for military applications and troop comfort equipment.
- Miscellaneous equipment and materials designed for military applications, specially designed environmental test facilities and equipment for the certification, qualification, testing or production of the above products.
- Software specially designed or modified for the development, production or use of above items. This includes software specially designed for modeling, simulation or evaluation of military weapon systems, modeling or simulating military operation scenarios and Command, Communications, Control, Computer and Intelligence (C 4 I) applications.
- High velocity kinetic energy weapon systems and related equipment.

If the Changed Policy does away with SIA licences for Defence Product Defined in DPP 2008



- DOFA can consider Case by Case investments in these centers to be allowed for Offset or not. However, as far as export of products/services from these entities, the current offset policy does not have any stipulation of a DOFA vetting, except the project being registered at the time of offset credit claims
- In the past, DIPP has issued defence industrial licences to Indian companies for Repair of Radar Apparatus and Electronic System / Sub-system including Embedded Application Software

If misuse of Offset on account of Transfer Pricing is to be eliminated and instead of Case by CASH, a transparent offset policy is to be ensured then MoD has to clarify the issue with a clear guidelines or earlier position on licensing needs to be restored

Exclusion of SME's - No provision for Facilitators

- Although world over agents and facilitators are natural part of Defence Industry – both for supplies and meeting offsets obligations, given the Indian circumstances we have a **clear preference to work with the OEM's only.**
 - **DOFA is the facilitation agency it must not be folded back in Department of Defence Production as seems to be implied in DPP 2008.**
- SME's will be included as Tier II / Tier III by Tier I System players
 - SME's who are Tier II /III vendors to DPSU's and companies with Defence manufacturing license will participate through the respective OEM in Supply & Offsets
 - Major Sub System should be given Licenses for **genuine value add.**
- However, as Defence Production requires scale. FDI cap of 26% will limit options for SME's to Scale up for the Offset Game.
 - Hence, **schemes financing SME for investments in infrastructure** for defence related production in SME's must be encouraged by DOFA. **This is will make Offsets more inclusive.**

Criticism - Co-terminus offset obligation and Offset Banking



- Time for RFP evaluation, award of contract and supply to start from the foreign source takes at least 3 years.
- **Offset banking** will allow the interaction to start now and grow to meet the \$4 -\$5bn offset requirement in the 12th plan period.
- Time is required to develop understanding between the foreign supplier and the Indian Defence Production Agencies to meet the offset requirements. **The industrial logic demands this stepped approach and immediate implementation of Offset Banking**

Thank you.

We take pride in being
.....long-term partners to Indian Defence

Backup Slides

Impact of Indigenous Defence Production

- Kelkar Committee Calculations: Economic Impact of reducing Defence Imports

% Reduction	Incremental increase p.a.	Acceleration in Manufacturing GDP Growth rate	Additional Jobs
25%	8,500 crores	8%	120,000
50%	11,100 crores	11%	150,000
75%	14,200 crores	14%	200,000

- FDI inflow in India are comparable to the Defence Imports

Last three years Indian Defence imports worth **\$10.50Bn**, almost comparable to the FDI flow into India of **\$13.60Bn**

Source: RBI report, FDI numbers relates to only the equity capital under Automatic route and Government route.

Why Offsets

- FY04 to FY06 Indian Defence imports worth \$10.5Bn, almost similar to the FDI flow into India \$11.88Bn.
- Economic impact of reducing Defence imports:

% Reduction	Incremental increase p.a.	Acceleration in Manufacturing GDP Growth rate	Additional Knowledge workers
25%	8,500 crores	8%	120,000
50%	11,100 crores	11%	150,000
75%	14,200 crores	14%	200,000

- Defence is a Strategic Industry – more than mere commerce
 - Issues of obsolescence, technology denial and restricted trade operate here

Leveraging India's buying power in Defence Procurement to build Defence Manufacturing Industry for Self Reliance and Exports

Criticism- Offset obligations too large

- Estimates of “EXPORT POTENTIAL” of Indian Industry
- ITES & Engineering Service

USD Billion	FY 2004	FY 2005	FY 2006	FY 2007 E
ITES-BPO	3.4	5.2	7.2	9.5
-Exports	3.1	4.6	6.3	8.3
-Domestic	0.3	0.6	0.9	1.2
Engineering Services & R&D, Software Products	2.9	3.9	5.3	6.5
-Exports	2.5	3.1	4.0	4.9
-Domestic	0.4	0.8	1.3	1.6

- Auto Components exports will double to US\$ 18.7 billion by 2009 and reach \$40 billion by 2014 – (We do not include these in 30% defence offsets however this shows the robustness of Indian Industrial capability)

Defence industry needs to fulfill only \$10 bn cumulative offsets by 2012

India – Most liberal Offset Regime



Source: GOCA, DIOA, DMA, GOI - Sridhar. Nadupalli's Presentation on Midterm Offset Review

	Austria	France	UK	Brazil	Canada	Israel	S.Africa	S.Arabia	UAE	Australia	India
Min Value Million US\$	1	1	18	5	1.7	0.5	2	All	10	10	70
Min Offset %	100	Negotiable	Negotiable	10	100	35	50	35	60	100	30
Max Offset %	200	Negotiable	100	100	200	100	150	35	100	100	30
Term of Offset contract	Contract	Negotiable	Contract	Contract	Contract	Contract	Contract	Contract	7 yrs	7 yrs	Contract
Multiplier	03-10	SME only	None	02-10	None	None	SME	None	01-04	None	None
Penalty	03-07	Negotiable	Black List	Black List	LD	None	5	LD+5	7	10	5
Focus	Hitech R&D	Purchases & Investments	Investment	Defence Industry	Hitech R&D	Hitech R&D	Tech Transfer	Investments	Investments	Hitech R&D	Defence Industry
Direct / Indirect	Both	Both	Both	60-40	Both	Direct	Both	Both	Indirect	Both	Direct

Category	US\$ Billion	%
Direct Purchase	14.1	40.4
Sub contracts	8.5	24.4
Tech.Transfer	6.1	17.5
Co-Production	2.4	6.9
Credit Assistance	1.4	4.0
Investments	1.4	4.0
Training	0.8	2.3
Licensed Production	0.2	0.6
Total	34.9	

Foreign suppliers complaints about our policy are merely negotiating tactics.

TATA POWER

STRATEGIC ELECTRONICS DIVISION

Experiences of other countries

- **Israel:** As a direct impact of defence R&D, Israel moved from a non-entity amongst defence suppliers 10 yrs ago with less than US\$ 3 million p.a. defence supplies to India to greater than **US \$ 900 million p.a. today**
- **Turkey:** - **60 offset agreements** have been signed for **\$ 6.1 billion** in 10 years
 - - **20 programs** successfully completed - **\$ 3.2 billion** and
 - - **40 programs** are active - **\$ 2.98 billion**
- **Saudi Arabia** *has embarked on a Consortium Approach*
 - - Turnover from offset projects – **30 billion SR**
 - - Indirect imports to India from AEC have reached
 - ~ **US\$ 100 million** in last 2 yrs.

Recommendation

- Acquire state-of-the-art military technologies.
- Provide opportunities of manufacturing and exporting components and parts of acquired equipment.
- Acquire depot maintenance technology, facilities, equipment, tools for service.
- Develop upgrades of weapons systems.
- Export defence industrial products, sub-systems, engineering design and testing services
- Acquire foreign maintenance works.
- Facilitate joint participation in the major R&D projects.
- Harness higher value through manufacturing & exporting the items.
- Acquire investment in infrastructure supporting defence production.
- Provide infrastructure relating to defence industry.

This Offset Policy as an Instrument has been implemented thru DPP 2006

Defence Offsets - Indian context

- The offsets was/is conceived as a tool for leveraging India's buying power in **Defence Procurement to access Technology and Global Markets for Defence related Products & Services.**
- **Offset Procedure is part of DPP 2006**
 - Capital procurements of greater than Rs.300 crores under MAKE, BUY & MAKE (includes Technology Transfers). Offset to the extend of 30% (or higher) of the foreign exchange content.
 - by procuring goods and services from DPSUs, OFB or Private Sector Industries having Defence Manufacturing Licenses.
 - Direct Foreign Investments in Indian Defence Industry in Infrastructure for services, co-development, Joint Ventures, Co-Production of Defence Products and investments in Defence R&D.
 - related to Defence but not necessarily related /limited to the project that the foreign prime is executing in India

**No announced Offset Policy - hence context is not established
leading to multiple interpretation**