# DEFENCE PROCUREMENT: CHALLENGES AND NEW PARADIGM SHIFT

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## INTRODUCTION

Defence procurement has been a challenging task from the beginning. The reasons for the peculiar characterstics of procurement for the armed forces emanate from the fact that they are capital intensive, have long gestation periods, involve detailed and meticulous planning, and are prone to public scrutiny, hence, transparency is desirable in today's scenario. The armed forces need to acquire fresh capabilities to optimise their operational effectiveness, in tune with the country's growing economy and rising role in world affairs. India is one of the largest importers of defence products. Russia continues to be the biggest supplier of defence equipment and technology, with backlog valued at more than $ 8 billion, including the $ 1 billion refit of the *Admiral Gorshkov*, $ 750 million for the 16 MiG-29 Ks that will be based on the carrier, $ 850 million for upgrading 67 MiG-29s in the service of the Indian Air Force (IAF), $ 700 million for upgrading 140 Mi-17 helicopters, and $ 900 million for acquiring 80 new Mi-117s. Israel has emerged as a valuable partner in meeting India's modernisation requirements. The US, the biggest arms producer and exporter in the world, is also keen to enter the Indian defence market. Both countries signed a 10-year Indo-US defence framework in June 2005, for collaboration on multinational operations of common interest, including ballistic missile defence. The UK, Australia and some of the Commonwealth of Independent States (CIS) countries are also supplying defence goods to India.

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The government has been repeatedly declaring that it wants to procure 70 per cent of its defence requirements from indigenous sources by 2010. However, the road is difficult and despite the best intentions and policy shift, the target looks distant. The process of opening of the Indian defence industry to the private sector began in 2001. It gathered pace with the constitution of the Kelkar Committee. In the recent past , the Ministry of Defence has introduced many bold and innovative policy initiatives through periodic revision of the defence procurement procedure. Offsets have since been made mandatory for all all high value imports costing more than Rs 300 crore. The government is keen to push the procurement process in the direction where the objective of hastening of the procedural intricacies with a view to ensure optimal utilisation of the allotted budget is coupled with the required transparency which is so very essential after the impact of cloud of kickbacks in previous major defence deals.

The process of globalisation and competitiveness has brought a discernible shift in the defence production with the emergence of joint ventures and conglomerates with networked dual use production. In such an environment, the Indian defence industry and defence procurement have to become increasingly collaborative with the private sector, in order to enhance the capabilities and core competencies in the emerging military technology sectors. The security concerns of India, due to its strategic location, its long coastline, distant island territories, and the continuing acts of terrorism from across the border, require India to maintain a high level of vigilance and defence preparedness. To this end, the armed forces are required to be adequately equipped with the best equipment available in the world, within the shortest possible time because in modern, state-of-the-art warfare, speed is the key to success in operational matters.

The aim of this paper is to examine the intricacies of the defence procurement, look at our experience so far, discuss the procurement policies and analyse various steps taken by the Government of India to streamline the procurement regime and steps needed to fine tune the process.

**BACKGROUND**

Defence procurement in India has been the subject of consistent and intensive scrutiny by Parliament as well as by the media. Attempts have been made from time to time to refine and improve the procurement process so as to ensure the purchase of the latest equipment in the shortest possible time and to get the 'best' value for the money spent. The criticism of defence procurements either on account of charges of corruption or not taking timely decisions, resulting in cost over-runs and delays in inductions, have surfaced at regular intervals. This was in a large measure due to the lack of transparency in procurement as well as because of the complaints and counter-complaints made by vested interests, including vendors as well as non-vendors who represented them in the country.

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Defence expenditure accounts for nearly 13 per cent of total central government expenditure, 23 per cent of non-Plan expenditure and around 2 per cent of gross domestic product (GDP) as of financial year 2008-09 budget estimates. In order to ensure better management of public money and procure defence equipment in the shortest possible time, a fast and transparent defence procurement policy is the need of the hour. Acquisition of defence equipment is a complex and intricate process which has evolved over the years taking into account the threat perceptions, security environment and requirements of the defence forces. Unlike procurement of other items, it is a long, deliberate and arduous process involving a number of steps like evolution of qualitative requirements (QRs) by the Services, acceptance of necessity,

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identification of suitable vendors, issuance of requests for proposals (RPFs), technical evaluation of offers, invitation for trials of selected equipment, General Staff evaluation and, finally, opening of the commercial quotes of the acceptable equipment. Care has to be taken at each step to maintain transparency and probity to ensure that the country gets best value for the money.

After the Kargil War in 1999, the government had set up a task force under Shri Arun Singh, former minister of state for defence, to look into the various aspects of defence management.This was in the light of the serious deficiencies which had been identified in India's security management system by the Kargil Review Committee (K. Subrahmanyam Report). The main focus of the task force's recommendation was "on bringing about improvements in the organisations, structures and processes through integration of civil and military components and by ensuring jointness amongst the armed forces to the extent desirable." This included defence procurement also.

The Group of Ministers that went into the recommendations of the Arun Singh Report felt that the system governing defence procurement suffered from a lack of integrated planning, weaknesses in linkages between plans and budgets; cumbersome administrative, technical and financial evolution procedures; and an absence of a dedicated, professionally equipped defence procurement structure within the Ministry of Defence. The Group of Ministers also came to the conclusion that the existing structure for procurement, has led to the sub-optimal utilisation of funds, long delays in acquisition and has not been conducive to the modernisation of the Services. They recommended the creation of a separate and dedicated institutional structure to undertake the

entire gamut of procurement functions, which was expected to facilitate a higher degree of professionalism and cost-effectiveness in the process. It was felt that such a structure would also enable an institutional memory to be built up and taken advantage of to obtain best value for the money spent by the government. While on the one hand, the Procurement Board, as envisaged, would ensure much closer participation by the armed forces in the entire process of decision-making, on the other hand, it would also result in higher operational efficiency and cost-effectiveness with better coordination and flow of information.[1]

The process of major defence procurement involves consultations, concurrence and approval of all departments under the Ministry of Defence (MoD), that is, the Departments of Defence Research, Defence Production, Defence Finance as well as the user organisations under the Department of Defence, namely, the army, navy and air force.

Parliament has also, from time to time, been examining defence procurements. The Parliament's Standing Committee on Defence in its 10th, 11th, 15th , 16th and 19th Reports had critically commented on the defence procurement procedures. It had recommended that the inefficiencies and bottlenecks in procurement processes and procedures, which had been identified by the government, should be removed. The committee had also repeatedly stressed the need to simplify, rationalise and bring transparency into the acquisition procedure together with ensuring timely procurement of defence equipment. In its report to the government, it had brought to the notice of the Defence Ministry that the defence procurement procedures were coming in the way of time-bound acquisitions of the armed forces where time was an important factor in equipping them , especially when India is facing a hostile security situation.

**The defence procurement procedures were coming in the way of time-bound acquisitions of the armed forces where time was an important factor.**

A large quantity of defence equipment is procured by the Ministry of Defence from diverse sources every year. In the earlier years, the procurement

1. Dr. Yogendra Narain, *Indian Defence Review*, vol. 18, October-December 2003.

**It is not possible to have all equipment of the same generation at any given time as complete inventories cannot be turned over en-masse.**

used to be mainly from the erstwhile Soviet Union. Even today, nearly 70 per cent of the hardware and weapons are of Soviet/Russian origin. An important factor in the earlier purchases from Russia was the 'friendship prices' at which India received all the equipment. Russia also offered easy payment terms stretched over 15 years. However, with the end of the Cold War, these simpler terms have given way to the successor nations wanting hard cash in dollars for their equipment and spare parts. It is now strictly business. The need, therefore, is for the MoD to lay down standard formats for different types of contracts. These standard formats should lay down the detailed structure as well as basic terms and conditions of the contracts. Although, efforts should be made to conclude contracts in the standard formats, the need for flexibility based on the country of origin, type of supply, length of contract and urgency of requirement would have to be catered for. The details of the contract can be jointly worked out. The factual modalities will follow. The Group of Ministers has recommended that the Ministry of Defence may, as far as possible, use the system of rate contracts.

## CHALLENGES IN DEFENCE PROCUREMENT

India is heavily dependent on imports to meet its military hardware requirements for the three Services. Even after over 60 years of independence, cutting edge technologies have have not been developed in the country. This has resulted in the large scale dependence on foreign suppliers for defence procurements which are subjected to various constraints like technology denials, sanctions, higher costs, to name a few, by the exploiting countries. The reasons for the limited role of indigenous sources for high end technology hardware required by the three Services are many. Some of the unique features of defence equipment are as discussed below.

- **Cutting Edge Technology.** Most of the important defence equipment pertains to high end technology. It is quite natural since the Services seek the latest

high-tech systems with cutting edge technology with a view to maintaining superiority over a potential adversary. But the procurement of such technology is not easy as it is well protected and not available freely.

- **System Integration.** No original equipment manufacturer (OEM) produces a complete system. Invariably, sub-systems based on different types of hardware and software are to be procured from varied sources and then integrated into complex weapon systems. This entails close coordination amongst various agencies, making it a time consuming process.
- **Rapid Upgradation of Equipment**. It is not possible to have all equipment of the same generation at any given time as complete inventories cannot be turned over en-masse. Modernisation is a continuous process and is implemented in a planned phase and for which a three-tier approach is adopted. At the lowest tier is equipment of obsolete technology whose useful life-cycle is over and which needs to be phased out. The middle tier consists of the equipment which still has considerable residual life. Their technology is mature but still relevant. Most of our inventory falls under this category. The upper tier consists of the state-of-the-art equipment which acts as a force multiplier and is generally expensive.

Moreover, evaluation of such frontline technologies to ascertain their suitability to our environment is a time consuming process. The three-tier system implies maintenance and overhaul and upgradation of various systems assumes significance. Availability of spares and product support has to be ensured.

- **Constraints of Transparency.** Procurement of any major military equipment cannot be carried out by open advertisements most of the time. The degree of secrecy required to be maintained would vary. Also, the defence sector is usually under close government monitoring.On the other hand, transparency demands that maximum publicity be given and open competition be generated. These are contradictory requirements necessitating delicate handling.
- **Limited Vendor Base.** Due to unique requirements and restricted market friendliness, the vendor base for most of the defence equipment is limited. This often results in either a single vendor situation or a clear case of OEM dependence.

- **Quality Imperatives.** The defence equipment has to be of very exacting standards due to operational requirements and is usually ruggedised for use in extreme terrains and manoeuvring conditions. This often results in repeated user trials and frequent rejections, thereby, upsetting the supply chain.
- **Unique Requirements.** The requirements of defence spares are usually specific in nature and very rarely have commonalities of use elsewhere. Therefore, competitive manufacturing and vendor development practices prevalent in the automobile or retail industry may not always be applicable here.
- **Maintainability Costs.** The product's cost and its life span are considerably high. Typically, a combat aircraft has a life span of about 30 to 40 years. Therefore, after sales support is revenue intensive. Maintainability and system reliability are the key considerations in determining life cycle costs.[2] The product support is also governed by a very rigid and tight resupply window, particularily in operations.
- **Procurement Time.** Due to a combination of the factors enumerated above coupled with administrative and procedural requirements and related financial sanctions, the lead time of procurement in most of the cases is considerably high. This results in multi-layered and multi-tier holding of stocks to meet user criteria. This obviously jacks up the inventory carrying cost, a phenomenon which is scrutible in a democracy.
- **Insurance Holdings.** Quite often, the Services are forced to stock and maintain assets for which there may be no requirement in the foreseeable future; however, holding of the stocks becomes mandatory either due to OEMs going out of the supply line, denial regime scenario, lack of alternate sources of supply or due to operational reasons where non-availability ex-stock would be prohibitive when the chips are down. This results in financial strain and political leveraging by interested countries.
- **Problem of Obsolescence.** The rapid advances in military technology and frequent upgrades result in faster obsolescence of military equipment. This calls for a balanced and well thought out strategy to manage obsolescence to

2. Samir Chabra, *Air Power,* vol.3, no.3, Monsoon 2006 ( July-September).

avoid a situation of landing up with non-moving and surplus inventory. The management of spares holdings has to be, therefore, well calibrated.

The procurement for the defence sector is undertaken under capital and revenue heads and budgetary allocations are made accordingly. The ratio of procurement from imported sources and that from indigenous sources has been gradually tilting favourably towards the indigenous component.[3] The ratio also varies from Service to Service. As per the data available from sources of the MoD, the percentage-wise break up of procurement made through imports and from indigenous sources during the last five years starting 2001 is as follows (Table 1).

**Table 1: Percentage-wise Break up of Procurement from Imported and Indigenous Sources**

| Year | Navy | | Army | | Air Force | |
|---|---|---|---|---|---|---|
| | Imported | Indigenous | Imported | Indigenous | Imported | Indigenous |
| 2000-01 | 36 | 64 | 46 | 54 | 81 | 19 |
| 2001-02 | 49 | 52 | 34 | 66 | 74 | 26 |
| 2002-03 | 50 | 50 | 65 | 35 | 70 | 30 |
| 2003-04 | 58 | 42 | 52 | 48 | 76 | 24 |
| 2004-05 | 58 | 42 | 42 | 58 | 62 | 38 |

From the data given above, it is evident that there has been a gradual but steady increase in percentage of indigenous procurement except in the case of the Indian Navy. Hopefully, this trend will continue and with new initiatives, including the offsets clause, the indigenous defence industry will flourish. Details of capital and revenue procurement from imported and indigenous sources between 1995-2005 are as follows (Table 2).

As evident, the sum total of capital and revenue procurement is also tilting in favour of the indigenous sources.

## DISTINCTION BETWEEN ACQUISITION AND PROCUREMENT

At times, the terms acquisition and procurement are used synonymously. There is a difference as acquisition includes design, engineering, test and evaluation,

3. Sixth Report Standing Committee on Defence (2005-2006), December 2005.

| Table 2: Percentage of Capital and Revenue Procurement Imported Vs Indigenous 1995-2005 | | | |
|---|---|---|---|
| Year | Procurement Stores(Revenue+ Capital) (Rs. in crore) | Percentage of Indigenous Procurement | Percentage of Imported Procurement |
| 1994-95 | 12,610 | 31% | 69% |
| 1995-96 | 14,857 | 31% | 70% |
| 1996-97 | 15,953 | 31% | 69% |
| 1997-98 | 18,006 | 44% | 56% |
| 1998-99 | 20,882 | 54% | 46% |
| 1999-2000 | 26,674 | 54% | 46% |
| 2000-01 | 27,440 | 53% | 47% |
| 2001-02 | 31,353 | 58% | 42% |
| 2002-03 | 31,089 | 54% | 465 |
| 2003-04 | 34,021 | 59% | 41% |
| 2004-2005 | 40,347 | 58% | 42% |

production, operations and support of defence systems. The term "defence acquisition" generally applies only to weapons and related items, such as military specialised vehicles, and information technology systems, processes, procedures, services and end products. An acquisition programme is a directed, funded effort that provides a new, improved, or continuing material, weapon or information system or service capability in response to an approved need. On the other hand, procurement is the act of buying goods and services from the government. Procurement is, in fact, one of the many functions performed as part of the acquisition process. For example, non-weapon and non-information technology items required by the MoD, such as passenger vehicles, office supplies, and maintenance items are "procured", they are not subject to the full range of functions inherent in the acquisition process of weapons and information technology systems. Information technology systems include both national security and automated information systems. National security systems used for intelligence and cryptogenic activities and command and control, are integral to a weapon system, or critical to the direct fulfillment of a military or intelligence mission. On the other hand, information systems that are usually

associated with performance of routine administrative and business tasks such as payroll and accounting functions are to be procured.

**DEFENCE PROCUREMENT ORGANISATION**

The defence procurement organisation consists of the Defence Acquisition Council (DAC), Defence Procurement Board (DPB), Defence Production Board (DPB), Defence R&D Board, and Acquisition Wing. The composition and functions of each of the above are given below.

***Defence Acquisition Council (DAS)***

It is an overarching structure under the Raksha Mantri (RM). It consists of the Raksha Rajya Mantris, Chief of Army Staff (COAS), Chief of Naval Staff (CNS), Chief of Air Staff (CAS), defence secretary, secretary, department of defence production (DP), secretary, research & development (R&D), secretary (defence finance), Chief of Integrated Defence Staff (CIDS) and special secretary (acquisition). The DAC has been tasked to give approval in principle to capital acquisitions in the Long-Term Perspective Plan (LTPP) covering a 15-year time span at the beginning of a Five-Year Plan period. It also approves all capital acquisition projects, identifying them as "buy" and "make" cases (purchase followed by licensed production). Monitoring the progress of projects based on the feedback from the Defence Procurement Board is also its responsibility.

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The decisions of the RM, based on DAC deliberations, flow down for implementation to the Defence Procurement Board, Defence Production Board and Defence R&D Board.

***Defence Procurement Board (DPB)***

It functions under the defence secretary and has the secretary (defence

production) secretary (defence R&D), secretary (defence finance), vice chiefs of the three Services and special secretary (acquisition) as members. It oversees all activities related to "buy" and "buy and make" decisions of the DAC. It is responsible for the coordination , supervision and monitoring of the acquisition process. It has been tasked to examine proposals from the Acquisition Wing regarding procurement procedures and make necessary changes in the procurement process after obtaining the approval of the RM.

***Defence Production Board***

It functions under the secretary (DP) and oversees all activities related to the indigenous manufacture under the Department of Defence Production flowing from the "buy" and "make" decisions of the DAC.

***Defence R&D Board***

It is chaired by the secretary (defence R&D)and is responsible to progress, monitor and report on all indigenous proposals flowing out of the "buy" and "make" decisions of the DAC. The board is responsible for providing project specific recommendations for the "design, production, induction" planning process, for the approval of the RM.

***Acquisition Wing***

The Defence Procurement Board is assisted in its functioning by an Acquisition Wing in the Department of Defence. All matters concerning acquisition of capital nature are dealt with by it. it is an integrated set-up, with officers from the Department of Defence and Finance Division and Services Headquarters. It is headed by an additional/special secretary (acquisition) and is assisted by financial adviser (acquisition) who also functions as the integrated financial adviser and heads the finance branch in the Acquisition Wing. The wing consists of four divisions namely land, maritime, air force and systems. Each division has a joint secretary designated as acquisition manager, and a Service officer of two-star rank designated as technical manager.

*Need for Changing Defence Procurement Procedure 2002 (DPP 2002)*

With the experience gained in the last three years, the Ministry of Defence realised that there are some problems in implementation of DPP 2002 that need to be resolved to further streamline the process of acquisition. This has been necessitated due to the realisation that there is a need to compress the time-frame and delineate clear time-frames at each stage of acquisition to ensure optimal utilisation of the capital budget allocation, reduce the time taken at the acceptance of the 'necessity' stage, evolve a system of open tendering for non-sensitive security equipment, and put in place a nodal mechanism for formulating joint qualitative requirements (QRs) for equipment of tri-Service nature. In addition, it is required to provide guidelines in regard to application of discounted cash flow (DCF) for evaluating offers with different payment terms and involving cash flow over a period of time and exchange rate variation (ERV) in respect of Defence Public Sector Undertakings (DPSUs) in order to make the procurement process more transparent and objective, expedite processing of indents placed on the Ordnance Factory Board (OFB) and schemes entrusted to the Defence Research and Development Organisation (DRDO) and include "offsets" in the request for proposal (RFP) on a case to case basis to avail of direct benefits like technological transfer and exports, etc. and integrity pact as part of the standard conditions of contract.

**DEFENCE PROCUREMENT PROCEDURE 2006**

The Defence Procurement Procedure 2002 (version June 2003) needed a review in the light of experience gained over the years and also to incorporate suggestions received from the Central Vigilance Commission, Comptroller and Auditor General, and Ministry of Finance from time to time, to streamline the procedure and to remove the impediments in the acquisition process. In order to meet the objectives of greater transparency and accountability in all acquisition processes, and reduction in the acquisition time cycle as also in view of the mandatory requirement of a review of DPP-2002 after two years, the government brought forward a new DPP-2006. DPP-2006 has come into effect from July 1, 2006. The salient features of the DPP-2006 have made the qualitative requirements further broad-based to avoid single vendor situations, and provisions have been incorporated to obtain up to 30 per cent direct

offsets in acquisition cases of more than Rs. 300 crore. This is in line with the Kelkar Committee's recommendation and has been incorporated to benefit Indian industry. Provision for an integrity pact has been made in the RFP for purchases over Rs. 300 crore, and the standard contract document has been made a part of the RFP soliciting techno-commercial offer. This will provide a level playing field to the bidders and, in addition, bring objectivity and transparency into the process of preparation of joint Services qualitative requirements for common equipment of the three Services. Also, evaluation criteria have been made more objective, incorporating some of the suggestions made by the Ministry of Finance, and a broad time-frame for the completion of different procurement activities has been prescribed for processing procurement cases to expedite the acquisition process.

**DEFENCE PROCUREMENT MANUAL-2006**

While the Defence Procurement Procedure addresses predominantly the procedure for capital acquisition flowing out of "buy" or "buy or make," with the transfer of technology (TOT) option, there was no uniform manual for revenue expenditure, which accounts for nearly 55 per cent of total revenue expenditure of the Government of India. The government, therefore, announced the Defence Procurement Manual-2006 for revenue procurement.

The salient features of the Defence Procurement Manual-2006 (Revenue Procurement) have made the RFP for both indigenous and foreign procurement transparent, enumerating short listing and award criteria; uniformity has been brought in for the interpretation of various contracting clauses and issues. A broad time-frame has been prescribed for each state and process of procurement so as to cut down delays and bring in accountability and general guidelines for assessing reasonability of prices.

***Procurement Objectives***

The procurement agency is responsible and accountable to bring efficiency, economy and transparency in procurement and to provide fair and equitable treatment of suppliers and promotion of competition in public procurement. Hence, the procedure must conform to the criteria that invitation of offers

should be fair, transparent and well disseminated, the specifications must incorporate the quality, less superfluous and non-essential features, and quantity, to avoid unwarranted expenditure. Further, the selected source should meet the requirement in all respects, ensure that the price of the selected offer is reasonable and consistent with the quality required, bring transparency at each stage of procurement and, the facts to be recorded, in precise terms, including the considerations which weighed with it while taking the procurement decision.

## TYPES OF PROCUREMENT

Defence procurement is mainly of the following types:

### *Capital Procurement*

The procurement which increases the assets of the material, for example, new construction equipment or its initial maintenance. The detailed procurement procedures for capital procurement are given in the DPP-2006. The revised DPP-2008 has also been issued.

### *Revenue Procurement*

All expenditures relating to maintenance and working activities such as renewal, replacement for equipment sub-systems components to maintain and operate already sanctioned assets are called revenue procurement. These are procured under the delegated financial powers as per rules.

### *Indigenous Procurement*

Most of the defence equipment is of foreign origin. Government policy is to achieve self-reliance through indigenising systems and sub-systems of such equipment. The indigenous firms are encouraged to produce and supply goods conforming to the specifications.

### *Foreign Procurement*

The procurement of equipment ex-foreign origin or a foreign source, where the

technology or knowhow is not available from indigenous sources falls in this category.

***Central Procurement***

Central procurement is done for items which are beyond the local purchase powers of the functionaries and against the indents resulting from the provisioning process. This is being done by a central agency to cover the entire requirement of the item during the provisioning period.

***Local Procurement***

This is restricted to urgent requirement of the department and is undertaken under the powers of the local authority.

## PURCHASE POLICY

The salient features of the purchase policy of the government contain three important clauses pertaining to product reservation, price preference and purchase preference. The product reservation clause entails that certain items have been reserved for the small scale and handloom sectors and Khadi Bhandars. Such units are also exempted from payment of security deposit as per the financial rules 2005. The price preference entails that as per the government rules, the small scale industries (SSIs) sectors are given price preference upto 15 per cent, subject to certain conditions. The purchase preference clause contains that the central public sector units are given purchase preference in case the Central Purchase Scrutiny Committee (CPSC) quoted price is within the 10 per cent of the L1 (lowest bidder) price. This is applicable in the case of procurement is over Rs. 5 crore and where the government holding in the CPSC/joint venture is more than 51 per cent, and certain other conditions.

## FAST TRACK PROCEDURE (FTP)

With a view to facilitating acquisition of defence equipment in a shorter time-frame, a need was felt to have in place an FTP to ensure quick procurement during a crisis situation. Thus, an FTP was promulgated in September 2001

after its approval by the Cabinet Committee on Security (CCS). The salient feature of the FTP is that the need for adoption of FTP must emanate from the Service chief. It is routed through the DPB for the consideration of the RM. The requirement should relate to an imminent operational situation or a crisis without warning. The procurement process starts only after the RM's approval. Further, it is confined to items which are likely to be available within the laid down time-frame of 12 months. Items should preferably be those which are in service or which have already been trial-evaluated. In exceptional cases, a trial team may be sent to the vendor's premises for a quick evaluation. The financial powers of the various competent financial authority (CFA) under the fast track procedure entail the powers of the RM as Rs 300 crore, the RM and FM from Rs 300 to 400 crore and the Cabinet Committee on Security (CCS) for all purchases above Rs 400 crore.

During the period between October 2001 and July 2006, a total of 62 cases were approved under the fast track procedure. An analysis of the time taken in the process of procurement in these cases is as follows (Table 3).

It is evident from the above information, that in 31 per cent of the cases approved by the DPB under the FTP, it had taken more than 12 months to finalise the contract, hence, they qualify to be processed under the FTP. However, these cases were for meeting urgent operational requirements on the recommendations of the chiefs of the concerned Services. It is true that in 31 per

**Table 3**

| | Cases Approved | Contracts Signed | Contracts Signed Within 06 Months | Contracts Signed Within 7-12 Months | Contracts Signed Within Over 12 Months | Deliveries Completed | Deliveries Partially Completed | Total |
|---|---|---|---|---|---|---|---|---|
| Army | 50 | 37 | 14 | 11 | 12 | 21 | 13 | 34 |
| Navy | 7 | 7 | 6 | 0 | 1 | 5 | 1 | 6 |
| Air Force | 5 | 5 | 3 | 0 | 2 | 5 | 0 | 5 |
| Total | 62 | 49 | 23 | 11 | 15 | 31 | 14 | 45 |
| | | (79%) | (47%) | (22%) | (31%) | (63%) | (29%) | (92%) |

**A well documented offset policy envisages that any contract with a foreign concern for defence equipment over Rs 300 crore must have a minimum offset of 30 per cent.**

cent of the cases approved by the DPB under the FTP, it had taken more than 12 months to conclude the contract. However, as per the MoD, the delay in signing the contracts occurred due to reasons which include that substantial time was taken in negotiating the contract, in a few cases the decisions were taken to conduct trials at a later stage, and verifying/confirming the claims and allegations of competitors about the capability of the vendor to supply the item .

Regarding the shortcomings of the fast track procedure, it was revealed that it was made with a certain kind of situation in mind. It is not supposed to be the normal procedure, to be carried out on a day-to-day basis. It was meant to meet certain unforeseen eventualities or situations which create a kind of an emergency or when something is imminent. In such circumstances, the MoD could not afford to have a long drawn out process. If the Services need something in an emergency situation, it has to be procured fast. For such contingencies, the fast track procedure was envisaged. It was supposed to be put into effect only under certain given situations and the chief of the defence force concerned, the army, navy or air force, and the minister would have to certify that it is an urgent, operational, imminent emergency kind of a requirement.

It is only then that the fast track procedure was to be adopted. Somehow, down the line, it got into situations which were not really falling strictly into the category. Therefore, a number of cases that were initiated under the label of fast track procedure were not really falling into the category. While implementing them, it took longer than expected and the whole idea of having a fast track procedure seemed to be defeated in that sense. So the RM has recently directed to see how this whole business of fast track procedure could be made more relevant and streamlined, and made applicable only in the required conditions—accordingly, these are being reviewed.

## OFFSET PROVISIONS

A well documented offset policy envisages that any contract with a foreign concern for defence equipment over Rs 300 crore must have a minimum offset of 30 per cent. This implies that the vendor has to compulsorily invest a minimum 30 per cent of the order amount through the purchase of sub-systems or services from India. The reciprocal trade or offset can be directly or indirectly related to the purchased system and related services, such as sub-contract for sub-systems, co-production, technology transfer, licensed production, credit assistance, foreign direct investment, services such as maintenance, overhaul, upgradation, life extension, engineering, design, testing, defence related software or quality assurance services, etc. Initially, offsets may be used by companies for the manufacture and assembly of defence systems within the country. Eventually, the arrangement will be expanded to include technology packages—these provisions will apply to all capital acquisitions categorised as "buy (global)," i.e outright purchase from foreign /Indian vendor, or "buy and make" with transfer of technology, and purchase from foreign vendor, followed by licensed production, where the indicative cost in the RFP is Rs 300 crore or more.

## DEFENCE OFFSET FACILITATION AGENCY (DOFA)

The Department of Defence Production (DDP) has set up the Defence Offset Facilitation Agency (DOFA), as a single window agency functioning under the chairmanship of the joint secretary (exports), to facilitate implementation of the offset policy. The DOFA will assist potential offset vendors in interfacing with the Indian defence industry for identifying potential offset products/projects as well as to provide the requisite data and information for this purpose.

## PROCEDURE FOR IMPLEMENTING OFFSETS PROVISIONS

These provisions will apply to all capital acquisitions categorised as "buy (global)," i.e. outright purchase from foreign/Indian vendor, or "buy and make" with transfer of technology, i.e. purchase from foreign vendor followed by licensed production, where the indicative cost in the RFP is Rs 300 crore or more.

Initially, a uniform offset of 30 per cent of the indicative cost of acquisition in the "buy (global)" category acquisitions and 30 per cent of the foreign exchange component in the "buy and make" category aquisitions will be the minimum required value of the offset. Based on a review of the experience of implementing these provisions, the minimum offset percentage for the following two years will be prescribed with the approval of the DAC.

The DAC may, after due deliberation, also prescribe varying offset percentages above 30 per cent for different classes of cases or for individual cases, depending upon the factors involved such as strategic importance of the acquisition or technology, enhanced ability of the Indian defence industry to absorb the offset, export potential generated, etc. These provisions will also apply with appropriate modifications to "buy" and "buy and make with TOT" components for warship construction, where the value of individual contracts is Rs 300 crore or more. In such cases, references to the Acquisitions Wing will mean the DDP or shipyard which is building the ship and procuring the systems or sub-systems.

## DEFENCE OFFSET OBLIGATIONS

For the purpose of defence purchase made under DDP-2006, offset obligations shall be discharged by any combination of the following methods:

- Direct purchase of, or executing orders for, defence products and components manufactured by, or services provided by, Indian defence industries, i.e.; DPSUs, the Ordnance Factory Board, and any private defence industry manufacturing these products or components under an industrial licence granted for such manufacture. For the purpose of defence offsets, "services" will mean maintenance, overhaul, upgradation, life extension, engineering, design, testing defence related software or quality assurance services.
- Direct foreign investment in Indian defence industries for industrial infrastructure for services, co-development, joint ventures and co-production of defence products.
- Direct foreign investment in Indian organisations engaged in research in defence R&D as certified by the DOFA.

The Indian defence industries or organisations are often referred to as the Indian offset partner.The offset obligations are to be fulfilled co-terminous within the period of the main contract. All offset offers which satisfy the minimum eligibility conditions will be placed on par, and no preference will be given for any extra amount offered. The advisability of giving additional weights to offers having multiplier effects in terms of exports generated or building indigenous capability in strategic technology products, or other issues, may be considered after reviewing the experience of implementing the above policy.

The offsets policy of India was enunciated for the first time in DPP-2005. The scope was enlarged in 2006. The minimum threshold for the offsets has been kept at all arms purchases over Rs 300 crore and at 30 per cent of the total deal. The offsets provisions entailed aim at the defence industrial development of the country. The provisions of the clause in DPP-2006 talk of direct offsets involving export of defence products and services in addition to direct foreign investment in the defence sector industries and R&D establishments. However, a closer examination of the actual provisions would suggest that India has adopted a middle path as a combination of both direct and indirect offsets.

The DOFA will assist potential vendors in interfacing with the Indian defence industry for identifying potential offset products/projects as well as provide requisite data and information for this purpose. The agency will function under the supervision of the designated joint secretary of the Department of Defence Production, and have representatives from Service HQ, HQ IDS, DRDO, and DPSUs and OFB as well as from the Confederation of Indian Industry (CII), Federation of Indian Chambers of Commerce and Industry (FICCI) and Association of Chambers of Commerce (ASSOCHAM) and other agencies as deemed necessary. The DOFA may set up committees and sub-groups as considered necessary or based on the inputs received from DRDO. The DOFA may also engage, following a fair, rational and transparent process, reputed independent professional expert bodies, to assist in its functions, and commission studies by such bodies on offset policies, their implementation, utility and impact.

The Indian experience in the field of defence offsets is yet to truly commence. In fact, the first such effort has been made in the upcoming medium multi-role

combat aircraft (MMRCA) deal which is in the pipeline. The DOFA has been formed under the MoD to facilitate implementation of the offset policy. However, TOT, which is a very important issue in offsets, has not been included. Another important issue of providing banking of offsets credit has also not been incorporated in the policy.

The current policy is limited to direct offsets, involving only export of defence equipment and services. There is a need to expand the scope of the current policy to the entire Indian aerospace industry, both military as well as civil industry. Also, the offsets policy needs to be flexible in nature. The fine tuning of various clauses, including the penalty clause, will make the policy a win-win situation for the vendor as well as the arms importing country. Further, there is no monitoring agency envisaged to actually ensure and assess the impact of offsets utilisation. The DOFA is more of a facilitation agency and may not be in position to monitor the implementation of offsets. There is a need to have a proactive approach and identify the areas wherein defence offsets would be gainfully utilised. The present policy leaves this initiative to the prospective vendors, to identify potential areas for offset utilisation.

## E- PROCUREMENT INITIATIVE BY DGS&D

The Director General of Supplies and Disposals (DGS& D) has taken an initiative on e-procurement for the obvious advantages. A well designed and comprehensive DGS&D website[4] facilitates the indenters, and vendors, and the staff indenters/DDOs (direct demanding officers) are advised to place supply orders, issue consignee receipt certificates, report complaints and other related activities through the website. All new users are advised to install web support files to enable them to access the application software for the above activities. Details regarding use of the vendor's page, including sending the notice for inspection calls and uploading of details, are available on the vendor's page. The vendor's page gives a brief introduction to rate contracts, advantages in associating with DGS&D, benefits of DGS&D, computerisation project to vendors, requirements and expectation from vendors, obtaining digital certificates for

4. http://www.dgsnd .gov.in

secure transaction, and guidelines to vendors for usage of the vendor's page.

The website provides a single access point for DGS&D staff, suppliers and customers, besides availability of the details on the net, including the DGS&D Manual, forms, conditions of contract, circulars and notices, agenda and minutes of consultative meetings, summary and the full text of parallel rate contracts. Also, there is provision for supplier's registration online. The e-procurement process has the sub-processes which include e-purchases, e-registration, store coding, technical particulars, evaluation of bids and award of rate of contract. The e-inspection and supply clause includes the details of supply orders, inspection, and dispatch and receipt details. The e-tendering system has online availability and download facility of tender enquires, supplier registration, bid submission by suppliers, bid opening and the spot price comparative chart e-payment system has components of documents receipt, bill submission, processing, payments and debit adjustments. For e-payment, all supporting documents for bills have to be submitted through the software available in the vendor's page of the website. The vendor's page also has the provisions of sending notice for inspection calls, entering dispatch particulars, online submission of bills and suggestions for bringing new items on the rate contract (RC). Indentors and DDOs are advised to place supply orders, issue consignee receipt certificates, report complaints and other related activities through the indenter's page. Details are available on the DGS&D web.[5] The indenters and vendors are advised to familiarise themselves with the complete e-procurement. All new users are advised to install web support files to enable them to access the application software for the above activities.

**The Indian experience in the field of defence offsets is yet to truly commence.**

## EMERGING OPPORTUNITIES IN ELECTRONICS AND IT

The world over, there has been a discernible shift in defence products and the market through the process of internationalisation, with focus on competitiveness and profitability. The process of restructuring leads to the

5. https://dgsnd.govtprocurement.com

**Despite having an advantage over others due to the large domestic market which provides strategic opportunity and competitive advantage, sadly, India is the largest importer of defence systems.**

emergence of international joint ventures and growth of defence conglomerates, with networked dual use production and financial leverage. As on date, our infrastructure in defence production and R&D does not have the capabilities and core competencies in the emerging military technology sectors. The recent policy framework related to offset business creates business opportunities for the Indian information technology (IT) and electronics industry. The reciprocal trade or offset can be directly related to the purchase system and related services, such as subcontract, purchase, co-production technology transfer, licensed production, credit assistance, overseas investment, training, etc.

Despite having an advantage over others due to the large domestic market which provides strategic opportunity and competitive advantage, sadly, India is the largest importer of defence systems, despite high investment and time. In such an environment, the Indian defence industry can take advantages of the opportunities by partnering with the IT sector. The new products, with world class dual use technology, necessitate significant shifts in the nature, scope and working of the Indian defence industry. The offsets can, indeed, create economic value by adoption of a proper policy approach and selecting partners with the right capabilities. It is essential that the IT industry take advantage of emerging business opportunities for the IT and electronics industries through defence offsets. They need to understand the requirements and expectations of actual users in the field and integrate with global/Indian defence industries, and fill the gap. Indian companies have to move up the outsourcing value chain by being able to cater to a wide range of IT activities such as application software, engineering technology, digitisation of engineering design, and equip themselves with capabilities as per international standards . Some of the future technologies/areas need exploitation.

## CONCLUSION

The defence procurement policies and procedures have been revised, especially after the Kargil experience. However, it is significant to note that for nearly 25 years after 1962, capital expenditure on defence procurement grew at an average rate of 16.17 per cent. During the next 10 years, that is, from 1978-1987, the growth rate had gone up to 20.4 per cent. However, immediately after 1987, the average annual growth rate of capital expenditure came down to nearly about 11.96 per cent. This apparently is due to the Bofors fallout. The present position is that in the previous three to four years, the defence allocations have been more than what the ministry could spend. The Defence Procurement Board has to ensure that the amounts allocated for such capital expenditure are fully utilised. This will depend upon the initiative and vision of the members who constitute the board.

It is well known that thousands of crores from the Ministry of Defence budget have been surrendered over the 10th Defence Plan (2002-07) because of slow defence procurement procedures. The Comptroller and Auditor General of India, in a performance audit of the MoD's capital acquisitions between 2003 and 2006, has also examined the reasons for the MoD's surrender of over Rs 3,500 crore between 2003 and 2006 (Rs 600 crore were additionally surrended on March 31, 2007). The ministry advised that the surrenders were due to complexities involved in the acquisition process. Sometimes, the cases could not be finalised due to various factors such as delays in equipment trial evaluation, commercial negotiation and approvals.

The defence minister announced at the inauguration of Defence Expo 2008 in February this year that India will bring its procurement procedures for purchasing military hardware in line with the best international practices. Based on the experience gained during the two years since implementation of the DPP-2006, a number of suggestions (over 40 in all) for improvement in capital and revenue procurement have been received. He added that a revised and improvised document, the DPP-2008, is almost ready and will be issued in May or June this year.[6] The offset policy that was part of the Defence Procurement Procedure announced in 2006 was at a nascent stage and was still evolving. He

6. http://www.domain-b.com/defence/general/20080218_procurement.html

**India plans to spend US $ 100 billion on capital expenditure during the Seventh Plan period (2007-2012).**

stated that the discharge of the offsets will give the necessary fillip to the participation of the private sector in a big way. The DPP-2008 is being fine tuned with a great degree of diligence and raking in all inputs from the stakeholders, that is, the Services and the industry. The new policy will address issues related to banking of offset credits, ToT, licensing requirement for software industry, and so on. There is a greater need for synergy between the private players and the government. The government is keen to maintain transparency in defence procurements. Defence procurement procedures are very arduous as the requirements of the sector are for high-end technology, stringent quality control and commercial negotiations, which require transparency and integrity of the highest order.

India plans to spend US $ 100 billion on capital expenditure during the Seventh Plan period (2007-2012). Imports account for close to 70 per cent of capital expenditure and offsets are required equal to 30 per cent of import contracts. Thus, India expects offset trade worth US $ 21 billion during the next five years. Currently, Indian defence exports amount to a paltry US $ 50 million annually, i.e. US $ 250 million in five years. From US $ 250 million to US $ 21 billion, it will be a quantum jump of enormous proportions. The public sector cannot handle it by itself. The private sector has to be closely integrated and its potential fully harnessed for beneficial absorption of the proposed offset business.

Finally, it is also necessary to set up an institutional mechanism whereby the working of the Defence Procurement Board is reviewed every two years and further improvements brought about. The efficiency of the board will, to a large extent, affect the modernisation of the Services.