India’s Foreign Direct Investments Policy in the Defence Sector

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Introduction:

India is among the world’s top 10 spenders on defence. Currently, India allows only 26 per cent Foreign Direct Investments (“FDI”) in the Defence Sector. The Indian Government is considering a proposal to allow 100 per cent FDI into the Defence Sector (albeit, the Ministry of Defence has strongly opposed FDI in the Defence Sector due to security concerns). However, the Parliamentary Standing Committee (Parliament may refer certain matter to the Parliamentary Standing Committee for a detail study and its recommendation, after giving close consideration to all the legislative and other matters) has already proposed raising the cap from 26 to 49 per cent on the Defence Sector. It is interesting to note that the Department of Industrial Policy & Promotion, (“DIPP”) (DIPP is under the Ministry of Commerce and Industry, the Government of India and is responsible for formulation of FDI Policy and promotion, approval and facilitation of FDI) is interested in 100 per cent FDI in this sector.

Current Position:

FDI is permissible up to 26%, under prior approval route subject to Industrial license and the certain conditions including:

- Application for the approval for FDI is required to submitted to the Foreign Investment Promotion Board (“FIPB”) (FIPB is under the Ministry of Finance, the Government of India) and for the licences is required to submitted to DIPP. All approval is given in consultation with the Ministry of Defence.
- The applicant is required to be either an Indian company or Indian partnership firm. The management of the applicant is required to be in Indian hands with majority representation on the Board as well as the resident Indian Chief Executives. Preference is normally given to original equipment manufacturers or design establishments, and companies having a good track record of past supplies to Armed Forces, Space and Atomic energy sections and having an established R & D base.
- There would be a three-year lock-in period for transfer of equity from one foreign investor to another foreign investor (including NRIs & erstwhile OCBs with 60% or more NRI stake) and such transfer would be subject to prior approval of the FIPB and the Government.

Benefits for India:

- Defense involves a lot of proprietary technology, which India is required in long term to sustain. Since arms and equipment manufacturing mostly involves assembling, a lot of activities concerning systems integration would take place in India engaging Indian technocrat, which would eventually lead to transfer of technical know-how to India.
- Foreign firms would set up vendors in India, which would compel them to source increasingly from India. Once they start outsourcing from India, technological penetration would automatically take place. Indian companies are also benefit from the opening up of the sector since there would be outsourcing opportunities for them. Presently, only three Indian companies (Hindustan Aeronautics Ltd, Ordnance Factory Board and Bharat Electronics Ltd), make it to the list of the top 100 defence companies in the world accounting for 1.1 per cent share of the global industry.
- India is already a huge market for defence equipment and opening it up would mean the creation of an entire industry all together, mainly in terms of creation of an ancillary industry, engineering services outsourcing and research and development.
- The Government of India is the sole purchaser of defence equipment, spending around 15 per cent of its total expenditure on the sector.
- Several global players are waiting to enter the (Indian) market, which is full of potential and if India do not open up soon, global players might go to some other country.

Comments:

India might choose new FDI policy in Defence Sector either directly or in a gradual manner by first lifting the cap to 49 per cent, then to 100 per cent after addressing the security concerns and sensitive issues.

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