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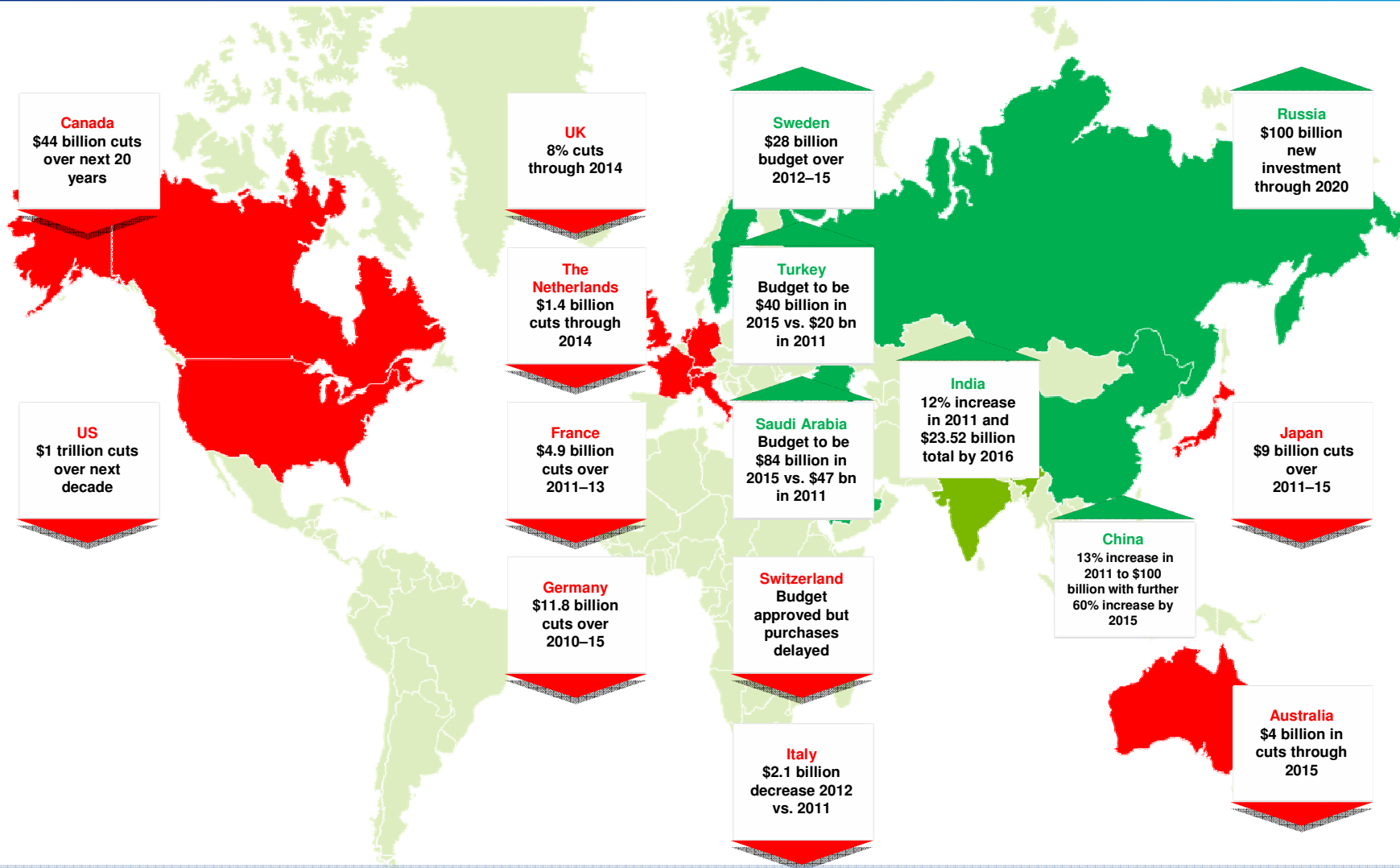
India Global MSME Summit

Defence offsets: An MSME perspective

31st October 2012



India is one of the most lucrative defence market in the world.....



India's defence expenditure on capital acquisition has been growing at a CAGR of 15% in the last 10 years

MoD Contracts - Analysis

By any standards these numbers are a sharp contrast to the global trend

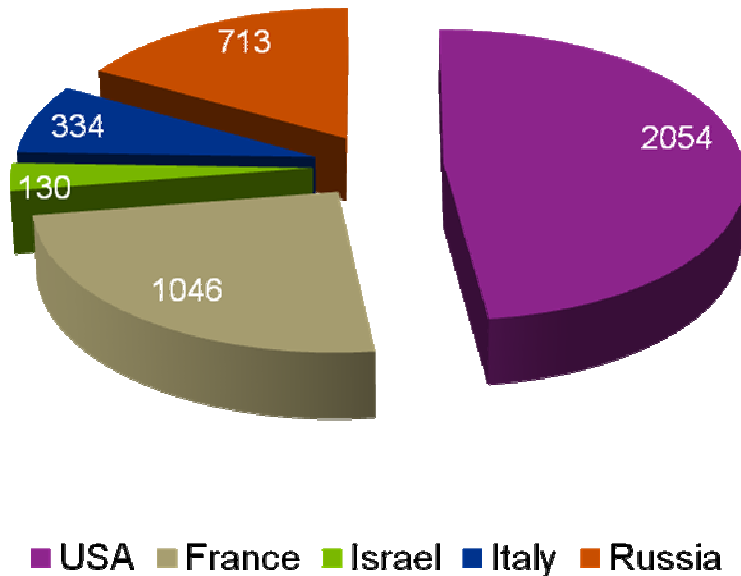
Branch	Contracts since 2007	RFPs in the process
Air force	30.0	24.0
Navy	5.7	11.4
Army	1.4	19.6
Coast Guard	.6	-
Total	37.7	55.0

Offset Contracts - Analyzed

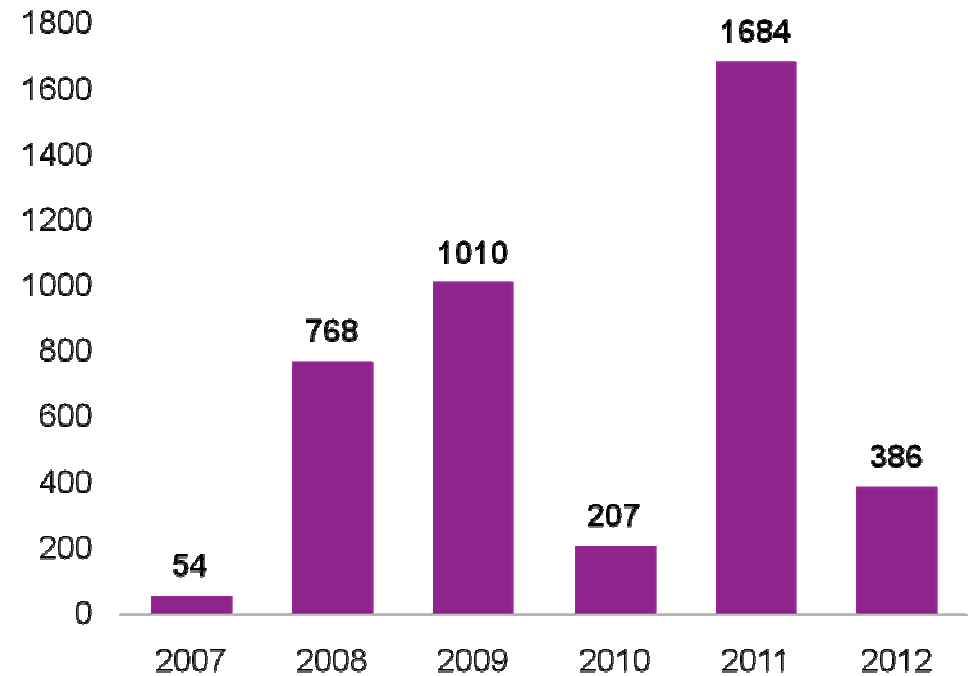
The offset policy was introduced in 2005 and the first offset contract was signed in 2007, and since then:

The US has signed offset contracts worth over \$2 billion till date, while France has signed contracts worth \$1 bn

Value of offsets in \$ million by country



Value of offset contracts in \$ million by year



Key Providers of arms and armament in the Indian defence sector

DPSUs

- Legacy tie ups with foreign OEMs for domestic production through Transfer of Technology. Eg. MIGs, Sukhois, T-72
- Have developed and acquired new technologies
- Grown tremendously through protection, monopoly
- SMEs have been supporting these programs by providing small scale components

Foreign OEMs

- India is the largest importer of weaponry in the world
- Foreign OEMs have been providing equipment to the armed forces directly or through Technology transfer to mainly Indian DPSUs
- The OEMs have predominantly had a buyer – seller relationship with the MoD
- India's Large defence requirements are now linked to offsets and therefore OEMs are now evolving the Indian private sector

Limited involvement of private sector and MSMEs

- Indian private sector typically relatively less involved in the Indian defense market compared to public firms
- However, in recent times, private Indian firms aggressively expanding their interest in becoming India's partners for the development of indigenous programs (through offsets)
- As of now, a large portion of offset related contracts have been signed by large corporate which will eventually be outsourced to the SMEs
- Hence, there is a clear need to develop Indian, small, and medium enterprises (in the development and manufacture of defense equipment) and help these firms augment their size and core competency

Defence MSME SWOT

- Flexibility and efficiency in operation
- Innovative technologies
- Specialised capabilities
- Minimal engineering costs

- Inability to provide end to end supply chain support
- Inability to export sub-assemblies independently of OEMs
- Delay in R&D investment and achieving returns
- Insufficient capital

Strengths

Weaknesses

SWOT Analysis

Opportunity

Threat

- Large and growing domestic market
- Indigenization thrust from Government of India
- Defence offset policy
- Outsourcing of global defence manufacturing to India
- Collaboration with Foreign vendors to become part of the global supply chain

- Foreign SMEs in India
- Lack of information on current and future capability requirements and partnering opportunities
- Delay in responding to market needs
- Ambiguous regulations - IL, FDI, EXIM

MSMEs – Current status check and need of the hour

Current status

- ~ 5,000 SMEs operate in the defence sector in India, supplying components and sub-assemblies
- Primarily come into existence due to outsourcing requirements of the government DPSUs
- Have acquired basic quality certifications and supply chain capabilities, however growth highly dependent on the order inflow from government companies

Indian MoD's aim
To increase the interest of foreign companies and bring in more investments in India through joint ventures (JVs), and partnerships, and formation of an industrial base to develop indigenous / localized programs

Need of the hour

- Strong need for skill, process and infrastructure development to help upgrade functioning while performing offset projects with global partners
- Develop the requisite long term mindset to have a sustainable play in the defence sector
- Develop quality and cost control mechanism
- Follow strict accounting, financial and regulations

MSME specific Multipliers introduced

The government realizes that Indian micro, small and medium scale organizations would play a pivotal role in India's quest for self reliance in developing defence manufacturing capability through effective offset policy implementation

Category	Export	FDI	TOT to Indian Enterprise	Transfer of equipment to Indian enterprise
Description of category	Executing export orders for eligible products/ services.	FDI in Indian enterprises, for manufacture and / or maintenance of eligible products / services.	TOT to Indian enterprises for manufacture and / or maintenance of eligible products / services	Investment in 'Kind' in Indian enterprises through the non-equity route for manufacture and / or maintenance of eligible products/ services
Valuation of offset credits	<ul style="list-style-type: none"> Amount of exported products/ services subject to value addition in India Value addition = export amount – (imported component + Fee/ Royalty) 	Amount of FDI (equity investment)	10% of value of buyback of eligible products/ services to the extent of value addition in India.	-
Multiplier	1.5 if IOP is a MSME	1.5 if IOP is a MSME	1.5 if IOP is a MSME	1.5 if IOP is a MSME
Discharge	70% minimum			

Challenges remain

Single customer: MSMEs working for the defence sector are generally solely dependent on the defence departments such as DPSUs and DRDO etc for their orders. Moreover, as production targets vary on an annual basis, sourcing of components/sub-assemblies from SMEs is not a constant and sustained activity.

Technology Limitation: Most defence systems are based on foreign design and the complete technology is not available with the production agency. Hence MSMEs are often unable to gain access and guidance on the desired technology. They also lack awareness of IPR and other legal issues.

Limitations in innovation: The SME segment, with limited business support and research base, is not always competent to meet the current requirements.

Certification and quality issues: Getting certifications for processes and quality checks, which are an essential requirement for OEMs is a challenge for India-based MSMEs

Small capital base: MSMEs have a small capital base and generally require immediate cash payment. They cannot withstand payment delays, which are inherent in government accounting and audit procedures.

MSME Expectations from the Government

Even though the government has been active in supporting the development of MSMEs..a lot more is desired

- Governmental support in the form of **Cluster Development** for SMEs
- Encouragement from the Government to focus on areas of strategic importance and gradually **integrate the MSMEs** into non-strategic areas.
- Promote the MSME sector to **plan their investments and supply chain** in advance through close involvement in planning and project categorization.
- **MSME participation in defence R&D** should be actively encouraged and primarily financed by the government, given the fact that defence R&D is expensive and marked by an element of uncertainty
- The **licensing procedure** for defence manufacturing should be streamlined to encourage entry of MSMEs in the defence industry.



Thank You

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