



Defence exports: Untapped potential

June 2020

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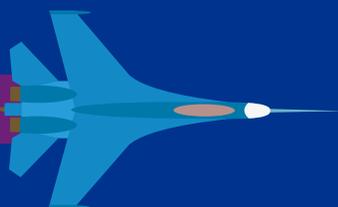


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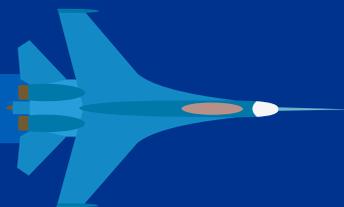
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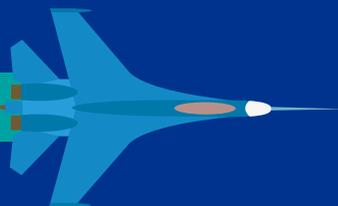
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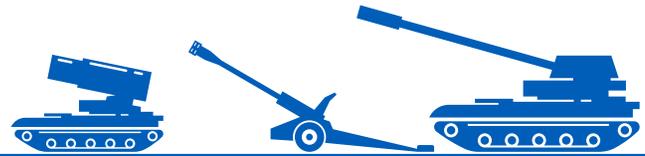
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List of abbreviations



Abbreviations	Expansion
CAT	Conventional Arms Transfer
DCS	Direct Commercial Sales
DoD	Department of Defense
DPSU	Defence Public Sector Undertaking
FMS	Foreign Military Sales
G2G	Government-to-Government
GoI	Government of India
IDF	Israeli Defence Force
IMoD	Israeli Ministry of Defence
IP	Intellectual Property
JV	Joint Venture
LATAM	Latin America
LWT	Light Weight Torpedoes
MBRL	Multi Barrel Rocket Launcher
MoD	Ministry of Defence
MSME	Micro, Small and Medium Enterprises
OEM	Original Equipment Manufacturers
OFB	Ordinance Factory Board
OPV	Offshore Patrol Vessels
SIPRI	Stockholm International Peace Research Institute

01

Current scenario



The silver lining emanating from the dark clouds of the past few COVID-19 months has been the series of reforms that were announced by the Finance Minister to spur growth in the defence manufacturing sector. The pandemic has provided perspective to the planners to chalk out a future that is perhaps better protected against vagaries of supply chain shocks.

The Atmanirbhar Bharat Abhiyan has underscored the need for self-reliance to meet the security needs of India. It has also accentuated the current scenario where bulk of our security needs is met through import of platforms or sub-systems.

While the theme of self-reliance is being carried forward, there is also a dire need to focus on developing a credible and structured defence export programme that functions as an extension of Indian diplomacy.

While India is one of the key defence markets driven by increasing defence spend, military modernisation plans, and strong engineering base, its focus on exports has so far been negligible.

India's capital expenditure for defence procurement is expected to be around INR15,00,000-18,00,000¹ crore (USD200-250 billion) over the next 10 years and 'Make in India' has been the government cornerstone to promote indigenous defence production in the country.

Given the increasing focus on self-reliance, the Ministry of Defence (MoD), has set a target of doubling the defence production to INR180,000² crore (USD25 billion) by 2025.

The current indigenous defence production is estimated to reach

INR90,000 crore³ (USD12.5 billion) in 2019-20 and in order to achieve the targeted annual growth rate of ~15 per cent the MoD is focusing on boosting defence exports. The increase in defence exports will result in: -

- Consistent revenue for defence companies
- Better economies of scale
- Increase in savings and forex reserves
- Increased competitiveness among domestic industries
- Reduced dependency on other nations.



1. KPMG analysis
 2. Press Information Bureau/Government of India/Ministry of Defence/May 2020
 3. DDP dashboard/Ministry of Defence/March2020

Over the last decade, India has developed robust defence production capabilities especially in the South East Asian region, though the country is yet to fully realise the available potential of defence exports.

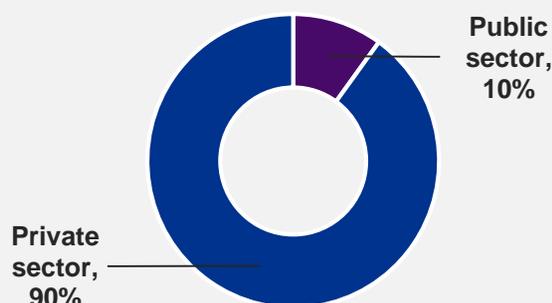
As per the data published by the Stockholm International Peace Research Institute (SIPRI), in March 2020, India is ranked 23rd in the list of major arms exporters for 2015-2019.⁴

While the significant progress accomplished over the last five years is commendable, India's share of the global arms exports is still only 0.17 per cent.⁵ Frugal engineering, cost-arbitrage due to the availability of high-quality competitive engineering talent, IT infrastructure and labour provides India an opportunity to upend this dismal indicator.

Given the potential for defence exports, the MoD targets exports of INR35,000 crore (USD5 billion) till 2024⁶ and in order to achieve this target, the exports have to grow at a CAGR of >40 per cent till 2024.

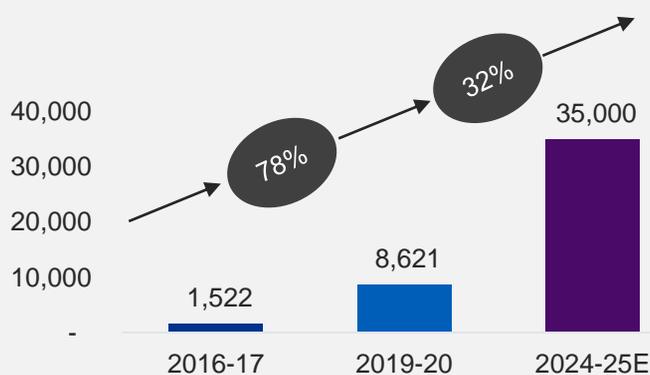
Several factors, such as simplification of procedures for defence exports, offset obligations (and subsequent linkage to global supply chains) and increased participation of private industry in the sector, has resulted in exports to the tune of INR8,620.6 crore⁷ (USD1.2 billion) in 2019-20 (~10% of total production), which is nearly six times the amount of exports achieved in 2016-17, registering a phenomenal Compounded Annual Growth Rate (CAGR) of 78.3 per cent.

Defence exports by public and private sector⁸



Over the last couple of years, the private sector been at the forefront of defence exports and a major portion is attributable to the discharge of offset obligations held by OEMs. While the public sector has been mandated to generate 25 per cent⁹ of its top line from exports, there has been limited success in increasing defence exports.

Defence exports (in INR crore)



Source: KPMG analysis, DDP dashboard/Government of India/Ministry of Defence/April 2020

In order to increase exports, the component level manufacturers would need handholding from the government while the OEMs (both public and private) will need assistance in identification of opportunities as well as support from various ministries for platform/sub-system level exports. Exploiting G2G relationships that India and its embassies across the world possess would be key to this transformation.

While sustenance from MoD and other agencies is quite crucial, the OEMs in their own capacity should also identify key opportunities especially in the major arms/equipment importing economies of the world, and subsequently engage with MoD for assistance.

Countries that are global export hubs, have an established means to assist their defence manufacturers to not only identify opportunities but also realise the same. It is therefore quite pertinent to examine the structures and methodology followed by these countries and develop a system that suits Indian requirements.

4. Trends in international arms transfer, 2019/SIPRI/March 2020

5. KPMG analysis, Trends in international arms transfer, 2019/SIPRI/March 2020

6. Press Information Bureau/Government of India/Ministry of Defence/March 2020

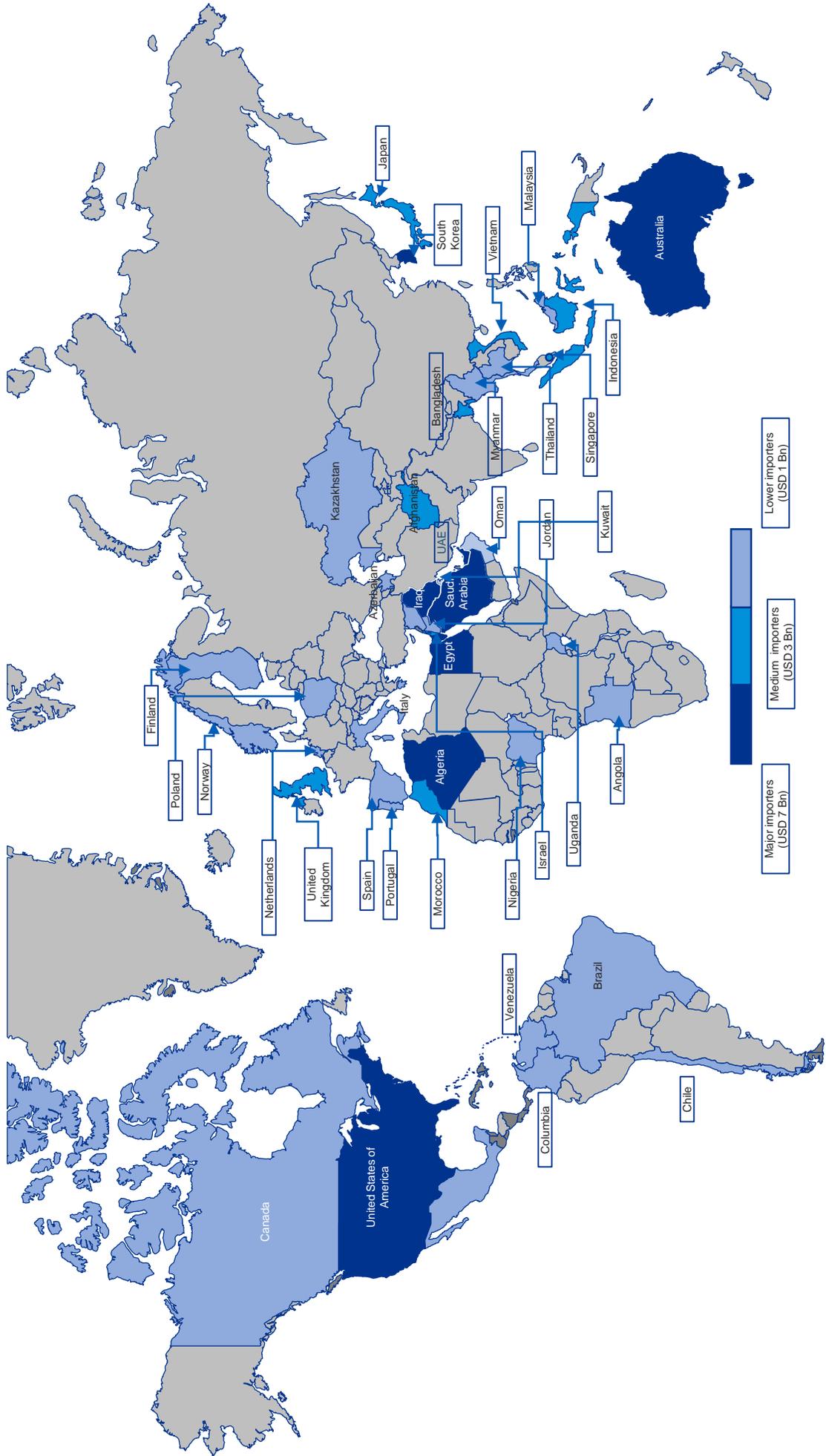
7. DDP dashboard/Government of India/Ministry of Defence/April 2020

8. KPMF analysis, DDP dashboard/Government of India/Ministry of Defence/April 2020

9. Press Information Bureau/Government of India/Ministry of defence/June 2019



Figure 1-1. Key region/geographies for defence exports



The map shows the key import hubs of the world. It also highlights the key regions/geographies where India can focus to boost defence exports:

- Middle East and South Asian regions are the key import hub of the world
- Opportunities for sub-system/component level exports exist in Western Europe and USA
- Africa and Latin America are the two upcoming import centres with substantial increase in imports over the last five years

02

Replicating success

Israel

Israel, with a much lower annual defence spend compared to India, has emerged as one of the key defence export hubs of the world and as per the SIPRI report of 2019, it ranks 8 in terms of defence exports. A major reason for its emergence as a defence manufacturing and export hub has been the establishment of SIBAT, a dedicated directorate under the Israeli Ministry of Defence (IMoD), that looks after promotion of defence exports and participates in the formulation of Israel's defence export policy.

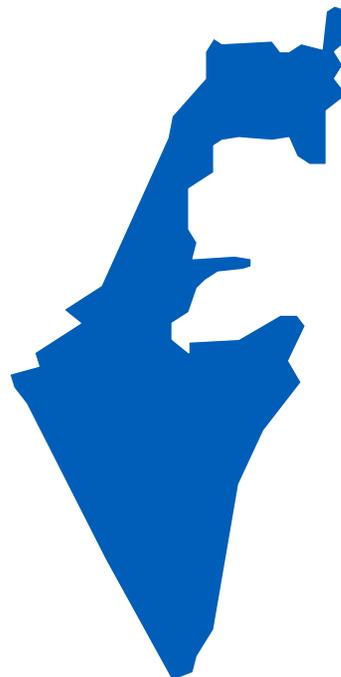
SIBAT acts as a one stop shop for all the Israeli defence manufacturing firms and the directorate continuously tracks export opportunities within the sector. It is also very well connected with the domestic manufacturers and has updated information regarding the wide variety of technologies and solutions being developed by Israeli defence companies. The directorate does not just act as a facilitator for marketing Israeli products and companies but works through diplomatic and government-to-government (G2G) channels to promote Israeli defence exports.

The understanding that it has of the technology and solution landscape coupled with the Israeli Defence Force's operational requirements not only allows it to play a critical role in the development of export policy but also to be a point of coordination for all export related activities. Key services offered by the directorate are: -

- Generating Government-to-Government agreements
- Initiating visits of official foreign delegations

- Identifying cooperation opportunities with the Israeli defence industry
- Locating relevant technological solutions for specific requirements
- Establishing joint ventures
- Managing the marketing and sales of IDF inventory
- Providing in-depth information on Israel's defence industry through a biennial directory and by organizing the Israel national pavilions at international defence exhibitions.

It accomplishes the aforementioned tasks through the professionals and defence attachés positioned with various Israeli embassies around the world along with its presence in Israel.





United States of America (USA)

The U.S., being the world leader and the largest exporter of defence equipment by far, has a separate department – Bureau of Political-Military affairs, that oversees most of the defence exports and commercial licensing of U.S. origin defence technologies and equipment.

The department has set up well-defined mechanisms for export from the domestic defence companies, which includes a generic Direct Commercial Sales (DCS) route (where contractor directly contracts with the end-user) and a government backed Foreign Military Sales (FMS) route.

Under the FMS route, the Department of Defence (DoD), charges a mark-up on the final price for its guarantees, thereby providing an additional revenue stream to the department. In 2018, it released a revised Conventional Arms Transfer (CAT) policy which asserts its objective to “strengthen the manufacturing and defence industrial base”.

The policy aims to expedite the deal approval process and to increase the role of senior officials, including the President, in closing foreign deals and given a greater weight to business interest.



Also, the Department of Commerce, has a separate website export.gov that allows U.S. companies to derive competitive advantage by expanding their business in the global market. The website provides granular information required for any entity foraying into a new market(s) for its products and extensively covers the defence sector.

It includes information on foreign market research, buyers and partners, source of financing, logistics, compliance with U.S. and foreign regulations, operational due diligence reports, etc. Assistance is provided to both private and public organisations especially smaller firms and MSMEs, that can ill afford to expend capital on identification of opportunities to understand the requirements/demand for their products and services in the global market.

Export policies of the country strike the right balance between maintaining the superiority of its own armed forces and commercial benefits. As most of the systems used by the U.S. armed forces are of a different version vis-à-vis platforms that have export permissions from the DoD.





Measures to replicate success

Continuous monitoring of existing/upcoming opportunities in countries/regions of interest

- A mapping of the existing and upcoming opportunities in countries/regions of interest so as to build a pipeline for exports



A well connected domestic ecosystem with clarity on recent developments and detailed offering from the domestic defence manufacturers

- Continuous sharing of information on capabilities/competencies in defence manufacturing from the industry to the MoD



Detailed analysis for identification of import substitution opportunities basis requirement of each geography/country

- A mapping of import substitution opportunities in target countries after charting capabilities of domestic manufacturers



Identifying collaboration opportunities with foreign countries and assist in establishing partnerships/joint ventures

- Addresses the primary concern of global OEMs on IP protection and develop opportunities for establishment of JVs/other partnerships



Increase export horizon and identify best route of engagement

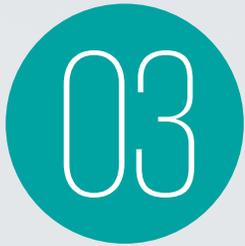
- Increase the horizon in terms of products as well as countries. Focus on promoting export demand for newly developed systems through diplomatic channels/defence attaché's in countries of interest



Handholding and supporting domestic industry for enhancing exports

- Establishment of a permanent help desk to assist in the conduct of regular seminars for education of domestic manufacturers, especially MSMEs about export opportunities.





Way forward



Targeted strategy for defence exports

1

Platform/system level exports to developing countries



Developing countries have limited domestic defence manufacturing capabilities and are primarily dependent on imports for meeting their defence forces' requirements. Rather than going for highly advanced systems, they focus on medium technology platforms and systems and hence should be a focus area for defence exports from India.

Countries from the African continent, South Eastern Asia and LATAM region are some of the markets for export of complete defence systems/platforms by Indian OEMs especially DPSUs. To promote exports to such nations there may be a requirement to provide/ increase the line of credit – a financing mechanism from the EXIM bank to promote exports to such countries.

2

Forging long-term partnerships with upcoming defence hubs



These are countries that have shown a strong growth in their defence industry over the past few decades and now are focusing on developing indigenous capabilities, such as Australia, UAE, Saudi Arabia, South Korea, Turkey, Norway, Brazil, Poland, Netherlands and Portugal.

These countries are focusing on developing their own systems and platforms and for that are ready to collaborate. MoD in conjunction with domestic defence industry should identify such opportunities in these countries and assist the Indian companies to forge partnerships for joint manufacturing. Similar collaboration in past, such as joint development of BrahMos missile, has yielded fruitful results.





3 Enlarge the export horizon



Though India exports defence related equipment to 42 countries, the major public sector exports is limited to a few countries only namely Myanmar (46 per cent), Sri Lanka (25 per cent) and Mauritius (14 per cent).¹⁰ The other countries where defence equipment is being exported to at platform/system level are Azerbaijan, Seychelles, Estonia, Indonesia, and Guinea. The MoD has introduced a new scheme to promote defence exports through defence attachés (DAs) and funds have been allocated for export promotion to 34 countries.¹¹ However, the horizon needs to be increased to at least 70 countries with optimum funding for promotion. The OEMs/DPSUs may also be required to expand their presence through foreign offices in key countries thereby increasing the Indian footprint

4 Public sector to target large system/platform level exports



In the last two financial years, i.e., FY19 and FY20, the public sector accounted for only ~10 per cent of the overall exports, reflecting limited exports from state-owned organizations including both the DPSUs and OFB. Out of the nine DPSUs, only Bharat Earth Movers Limited (BEML), Hindustan Aeronautics Limited (HAL), Bharat Electronics Limited (BEL) along with Mishra Dhatu Nigam Limited (MIDHANI) exported their products. In FY19, HAL and BEL accounting for 95 per cent of the total exports from DPSUs. The DPSUs and OFB have been given a target of exporting 25 per cent of the overall revenue by FY 2022-23, and in order to achieve the target there is an urgent need to focus on platform/system level exports. Each public sector organisation needs to set up a specialised task force for identification of export opportunities, develop market intelligence and long-term strategies for defence exports.





5

Focus on supplying components/sub-systems to defence manufacturing hubs



The advanced defence equipment manufacturing nations such as the U.S., Russia, France, Germany, Spain, Japan, etc. have limited requirement for major platforms and systems. However, to reduce rudimentary manufacturing processes and to benefit from the cost-arbitrage they establish their supply chains in countries with lower costs of manufacturing. They outsource portions of the less complicated manufacturing (labour-intensive) work to such geographies. Another key demand driver for MSMEs and Tier 1/2/3 companies is the offset obligations of major OEMs and smaller manufacturers should therefore need to focus on enhancing their capabilities with the aim of becoming part of the global supply chains as a natural extension of the offset discharge process.

7

Handholding and support to the MSMEs



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6

Focus on newly developed systems



Over the last decade, Indian defence manufacturers have produced technologically advanced defence equipment/systems/sub-systems with reasonable demand from friendly countries. They have significant export potential in the near future and therefore there is a need to examine the export potential of systems like Tejas, Akash, Dhanush, Pinaka Multi Barrel Rocket Launcher (MBRL), etc. Currently, the primary defence items exported include Dornier 228 aircraft, Chetak helicopter, Cheetak helicopter, Dhruv helicopter, Offshore Patrol Vessels (OPVs), fast interceptor boats, Light Weight Torpedoes (LWT) and coastal surveillance systems.





In conclusion, the way ahead for India in order to maintain and further enhance its defence export trend is to merge the methodology developed by major defence exporting nations by adopting the best practices with the competencies that provide a competitive advantage to India and Indian companies within the sector. India needs to create a collaborative mechanism that enables the identification of business opportunities so that it can be married with capabilities and competencies of Indian companies. This will enable both private and public sector to pitch for existing and future opportunities more effectively. The MoD needs to ensure end-to-end handholding for domestic industry in terms of providing them with information on market trends, certification requirements and process, regulatory framework, export guidelines, steps to participate in global tenders, list of active global tenders, etc. on an ongoing basis.

It is imperative for MoD to establish an exclusive organisation/ department focusing only on defence exports. The department needs to identify existing opportunities, create new horizons, facilitate G2G deals, establish lineages with domestic industry, handhold potential suppliers and establish partnerships. The proposed department shall also ensure greater transparency in terms equipment allowed for exports. A good starting point for such mission may be the establishment of an exclusive defence export help desk.

On the basis of inputs from the help-desk, Indian companies need to develop a focused matrix for realising the identified export opportunities and work in conjunction with the government machinery towards realising the opportunity. A broad framework for the same basis the defence manufacturing value chain is depicted below:

Table 4-1. Export opportunity matrix

	OEMs/PSUs	Tier- 1s	Tier- 2 & 3/MSMEs
Defence hubs	Low opportunity	Medium opportunity	Large opportunity
Upcoming centers	Medium opportunity	Large opportunity	Low opportunity
Developing countries	Large opportunity	Medium opportunity	Low opportunity

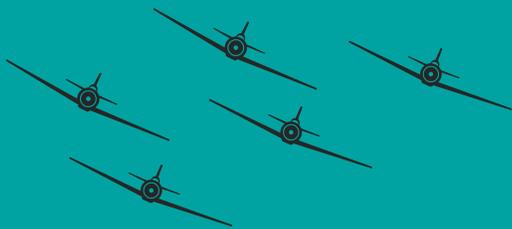
With the impetus and focus that has been given to the defence manufacturing sector by the industry and the government, India is poised to transform itself from being the world's largest importer of defence equipment to becoming a key defence export centre over the next years.





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