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Indian Offset Contracts: An Evaluation

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Ever since the offset policy was promulgated as part of the Defence Procurement Procedure (DPP) – 2005, more than 19 defence offset contracts have been signed, with the first contract for Medium Power Radars signed in 2007. Former Minister of State for Defence, Mr. MM Pallam Raju highlighted that Indian Air Force procurements have generated about 80 per cent of the total amount of offsets. The remaining 20 per cent has come from naval procurements, while the Army procurements have not led to any offsets till now, since the value of most of the Army programmes was less than INR 300 crore. According to media reports, the total amount of these offsets is to

the tune of roughly \$5 billion. With the emphasis on modernisation of the defence forces, the scope and value of offset contracts are expected to rise exponentially. The new DPP guidelines are likely to be issued in early 2013 which would further refine and streamline the offset processes. Different stakeholders have differing opinions on the level of achievement of offset goals. The November 2012 Comptroller and Auditor General (CAG) report is the latest review on offsets throwing light on the performance of offset projects.

The offset contracts of Indian Air Force (IAF) and Indian Navy (IN) sealed till the third quarter of 2012 are tabulated below:

S. No	Procurement Programme	Offset Value (Approx)	Signed in	Status/ Offset Avenues*
	Medium Power Radars for IAF	\$5 million	October 2007	Manufacturing contract to IOPs
	Fleet tankers for IN	\$55 million	April 2008	Manufacturing contract to IOPs
	MiG 29 Upgrade for IAF	\$308 million	May 2008	Simulator centre
	Mi-17 V-5 Helicopters (MLH) for IAF	\$405 million	December 2008	Training simulator
	P-8I Long Range Maritime Reconnaissance (LRMR) aircraft for IN	\$641 million	January 2009	Metallurgy and hydraulic lab facility Composite manufacturing tooling Friction stir welding Aero structures tools and processes Training
	Medium Altitude EO/IR Recce System for Jaguar aircraft for IAF	\$21 million	February 2009	Not known
	P-IV (HAROP) System for IAF	\$44 million	February 2009	Not known

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S. No	Procurement Programme	Offset Value (Approx)	Signed in	Status/ Offset Avenues*
	C-130 J-30 aircraft (Foreign Military Sales) for IAF	\$219 million	February 2009	Training simulator Manufacturing contract to IOPs
	Fleet tanker under option clause for IN	\$55 million	March 2009	Not known
	Low Level Transportable Radar (LLTR) for IAF	\$34 million	July 2009	Manufacturing contract to IOPs
	Air Route Surveillance Radar (ARSR) for IN	\$11 million	November 2009	Not known
	AW 101 VVIP Helicopters for IAF	\$224 million	February 2010	Not known
	Unmanned Aerial Vehicles (UAVs) for IN	\$80 million	March 2010	Manufacturing contract to IOPs
	Sensor Fused Weapons for IAF	\$102 million	November 2010	Manufacturing contract to IOPs
	C-17 Globemaster aircraft (Foreign Military Sales) for IAF	\$1.09 billion	June 2011	High Altitude Engine Test Facility Transonic Wind Tunnel (TWT) Facility Training and maintenance Defence strategic communication systems
	Mirage 2000 upgrade for IAF	\$592 million	July 2011	Manufacturing contract to IOPs
	MICA IR and RF missiles for IAF	\$386 million	January 2012	Overhaul, upgrade and training
	Rafale Medium Multi Role Transport Aircraft (MMRCA) for IAF	\$5 billion	January 2012	Manufacturing contract to IOPs Training simulator
	Pilatus PC-7 trainer aircraft for IAF	\$150 million	May 2012	Maintenance ToT (Transfer of Technology) to HAL Manufacturing contract to IOPs

* These are some of the avenues offered by the vendors for discharge of offset obligations. The complete details are not known.

The details of the status of offset contracts and the names of Indian companies which are benefitting from offsets are not clearly known. It may be better that the Ministry of Defence (MoD) provides the information on the technology/capability received from each offset contract so that the stakeholders can carry out a clear assessment of the benefits that will accrue. This will help them to apply mid-course corrections to ensure that the gaps between the stated and achieved objectives are minimised. The recent CAG report (audit scope – October 2011 to February 2012) that was tabled in Parliament in November 2012 indicated certain shortcomings in the offset contracts signed till mid-2012.

The report highlighted that most of the offset contracts have not adhered completely to the DPP guidelines. The report also questioned the waivers given by the ministry to foreign vendors in fulfilling their offset obligations.

As per DPP-2011, foreign Original Equipment Manufacturers (OEMs) can discharge their offset obligations only in the form of Foreign Direct Investment (FDI) in Indian Offset Partners (IOPs). Direct Foreign Investments (DFIs) in kind were not eligible offsets in the previous offset policies. The CAG team observed that in five offset contracts, equipment involving Rs. 3,410.49 crore was being directly provided by the foreign vendor as DFI in kind without any value addition through IOPs. The offset

contract with Boeing for C-17 Globemaster aircraft catered for the establishment of the TWT test facility at DRDO in the form of DFI. As the TWT test facility was a DFI in kind, the offset was allowed by the Defence Acquisition Council (DAC) even though it was not an eligible offset as per the prevailing offset policy. Similarly, against the offset contract with Boeing for procurement of P-8(I) aircraft for the Indian Navy, the OEM agreed to provide \$153.90 million in the form of safety, reliability, composite manufacturing and hydraulic lab facilities, composite manufacturing assembly/tooling, mobile broadband, friction stir welding and aero structures tools and processes. The DFI proposals relating to safety, reliability and airworthiness seminars and establishment of fire finder class rooms were not valid offsets as there was no value addition through the IOP. The remaining metallurgy/hydraulic lab facilities, composite manufacturing assembly/tooling, etc. were also a kind of direct import without any value addition through the IOP. Since offsets have been evolving gradually, the MoD did not realise the likely pitfalls during the implementation process. However, they tried to rectify most of the anomalies of the policy in the revised offset policy of April 2012. The revised policy makes the DFI in kind eligible to discharge offset obligations.

The DAC had clarified in 2010 and 2011 that only purchases of simulator services by the vendor from the IOP would be eligible to the extent of value addition in India and investment in the simulator itself would not be recognised for offset credits. As per the CAG report, however, Boeing (C-17 Globemaster aircraft), Lockheed Martin (C-130J Hercules aircraft), Rosoboronexport (medium lift helicopters) and RAC MiG (upgrade of MiG 29 aircraft) are still claiming the supply of training simulators to IOPs towards discharge of their respective offset obligations. Since, the offset contracts have been signed between the MoD and the OEMs, the MoD needs to justify their rationale for taking such decisions. OEMs are likely to wash their hands off since they have signed an offset contract with them. Hence, the onus of providing clarifications on the observations of CAG lies with the MoD.

The government has allowed 100 per cent participation of the private sector in defence, with FDI permissible up to 26 per cent. It has been noticed that some companies having more than 26 per cent of foreign holding were also accepted by the ministry as IOPs. For instance, for the contract of the MiG 29 upgrade, Prescient Systems and Technologies Private Limited was approved as IOP despite the fact that it is a foreign company. For the procurement of the Low Level Transportable Radar (LLTR), Thales International India (TII) was approved as the IOP, despite it being a 100 per cent subsidiary of Thales Singapore and Thales Hong Kong. In the offset contract for procurement of fleet tankers for the Indian Navy, Wartsila India Limited and Johnson Pumps Limited were approved as IOPs despite being ineligible. The MoD should pay adequate attention while signing the offset contracts with the OEMs to ensure that the existing guidelines are applied correctly. Lack of professionalism is clearly visible in the offset evaluation committee members since most of the offset contracts have not been implemented so far. Perhaps the MoD needs to think of creating a special task force of professionals/experts who could evaluate the offset proposals as per the policy before signing the offset contracts.

A penalty of 5 per cent of the value of unfulfilled annual offset obligation is to be levied on the vendor according to the DPP guidelines. It was observed that in two contracts, penalty charges of Rs. 3.06 crore on account of unfulfilled offset obligations had not been recovered from the defaulting vendors – Israel Aerospace Industries (IAI) for Harop Systems (Rs.2.04 crore) and Lockheed Martin for C-130J Hercules aircraft (Rs. 1.02 crore). The findings of CAG might have come as a shock to the OEMs because they believed that they were in sync with the MoD to fulfill the offset obligations.

The lackadaisical attitude towards evaluation of offset proposals, lack of professionalism in contract formulation and inadequate experience in monitoring the projects have been the main causes of inefficient implementation of offset projects. The insufficient staff, lack of trained

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professionals and frequent changeover of the responsible staff generally creates such an environment in the MoD. Offsets is a specialised field that requires in-depth knowledge of industry, technology, international practices and manufacturing processes. Therefore, the evaluation and monitoring committees should consist of trained professionals who know about the intricacies of the offset process and can take decisions congruent to the spirit of the offset policy. Most of the officers responsible for evaluation, contract formulation and monitoring of offset projects seem to lack the required expertise on the prevalent offset practices in the international arena. This has resulted

in varied interpretations of the same clauses of the contracts by different stakeholders. The industry sources express their apprehensions that some of the OEMs might have manipulated the weak offset clauses for their benefit, thus, causing further delays in the contract implementation. Monitoring of offsets needs to be strengthened as the Defence Offset Facilitation Agency (DOFA) has not been able to monitor it effectively in the past. As a consequence of poor management of offsets by the MoD, most of the objectives laid down in the policy have still not been realised. "It has remained only a paper exercise", CAG pointed out. The foreign OEMs cannot be blamed completely for non-adherence to the DPP guidelines. The ministry should have been more careful and attentive before signing the contracts. The companies which are in line for becoming IOPs should be checked for

eligibility before the offset contract is signed. The CAG has asked the ministry to leave little room for ambiguity in its interpretation.

When the offset policy was conceived, the Indian industry was very hopeful of getting good business opportunities in defence manufacturing. Many Indian private companies ventured into the defence sector by investing money and resources with the hope of getting manufacturing contracts. However, even after waiting for 6-7 years, most of these companies have not been able to get the desired business opportunities for a viable investment proposition. The slow pace of defence programmes coupled with inadequate manufacturing orders from the OEMs has increased the level of frustration of the Indian defence industry. With Transfer of Technology (ToT) now being entitled to be an eligible form of discharging offsets, India could utilise offsets to acquire cutting edge technologies that it has not been able to develop on its own. The armed forces, being the end users, could specify the specific technologies that need to be obtained to build state-of-the-art capability. A detailed review of the current policy procedures and the implementation processes needs to be carried out with a view to take corrective measures and align it with the vision of the policy. The industry is hoping that the reorganised Defence Offset Management Wing (DOMW) and the Acquisition Wing would draw appropriate lessons from earlier experiences and take the requisite measures to make the offset story a success.



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