



## Defence & Aerospace Update:

### Framework for placing Long Term Orders for Indigenization by Defence PSUs and OFB

Nov 25, 2019

Dear Readers,

Further to the previously notified 'Policy for indigenization of components and spares used in defence platforms for DPSUs/ OFBs', the Department of Defence Production (DDP) has now approved a '**Framework for placing Long Term Orders for indigenization by Defence PSUs and OFB**'. The notification is attached for your ready reference.

While the former laid down strategies to give preference to the indigenization of components or sub-assemblies, the latter now addresses the challenge faced by the industry - the fact that the number of such items required at any given point of time are too small and it does not make economic sense for the industry to then invest in its development/indigenization. In order to address such barriers to growth, the Government has now laid down a framework by which a procuring organization may aggregate demand of an item (components, materials, spares, sub-systems, or equipment) for a long-term period of a maximum of 10 years.

Some of the key features of this framework include:

- **Identifying the items/materials for long term orders** – The indigenization committee of each DPSU/ OFB will be responsible for identifying the imported items which can benefit from a long term order of up to 10 years. The end users (Army, Navy, Air Force, Coast Guard etc.) may be consulted in the process of identifying such items.
- **Visibility of long term demand** – This does not necessarily mean availability of firm order from the user, but an expectation that the equipment/platform or its upgraded version for which the items are required, is going to be in use for the coming 5 to 10 years, therefore indicating, that the indigenization of such items would also be required in the coming years.
- **80% estimated quantity to be considered** – In order to safeguard the DPSUs/ OFB against any downward trend in demands, the framework provides that only 80% of the said demand should be considered for inclusion in the long term orders. Appropriate price variation clauses must be incorporated in the agreements to take care of any price variations over a period of time.
- **Approval of Competent Authority** – The indigenization committee of each DPSU/OFB shall obtain approval from the Competent Financial Authority with regard to the items/material identified for long term orders, estimated quantities for the long term orders, and time frame for such orders.
- **Appropriate Safeguards** – The framework also provides safeguards for the DPSUs/OFB against any delinquent long term vendor. It recommends that the procuring authority should consider keeping an inventory of 12 months to 24 months of the material/item that is placed on a long term order (considering shelf life and financial implications). Thus, in case the vendor fails to supply the product on schedule, the procuring authority has time to develop new vendors by using the stock available to it. Additionally, it is recommended that the procuring entity include a clause in its contract whereby it reserves the right to foreclose the long term order at the risk and cost of the vendor in case the vendor fails to comply with the terms of the contract or if the indigenization does not proceed at the approved rate or on account of any other reason.

## ELP Comments

With this notification, the DDP seeks to remedy the inherent challenges faced by companies looking to indigenize India's spares and components market. In the current state of affairs, Public Sector Undertakings/Ordnance Factories (**PSUs/OFs**) procure large quantities of spares and components, however they only order those quantities of defence items (components, materials, spares, sub-systems etc.) that they require at that given point of time. These quantities are usually extremely low from a business case perspective and as such have resulted in the absence of any established domestic vendors. Though the Government released a notification earlier this year addressing the need to indigenize the spares market, it was practically not enforceable due to the low quantities that these PSUs and OFs tend to demand. Thus, recognizing the roadblocks present for Indian companies trying to enter this market, the Government has now provided this Framework for its Defence PSUs and OFs, which protect the interests of all the parties involved. The local vendors are able to invest in the development/indigenization of this industry on the reliance of such long term orders, and the DPSUs/OFB are able to avail considerable savings and will also have sufficient inventory at any given time.

While this notification is a step in the right direction, it must be noted that most defence platforms have a life cycle of ~20-40 years. Thus, the DDP may consider increasing the maximum time period of such long term orders from the current maximum of 10 years to up to 15-20 years. This would serve the dual purpose of making it easier for companies entering the spares market to recover their investments while also allowing the DPSUs/OFB to better plan their long term investments and activities.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at [insights@elp-in.com](mailto:insights@elp-in.com).

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