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Defense: The story for next boom

How Indian Defense can be a goldmine for fund managers

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Abstract: The study looks into long term factors that reasons why Indian defense industry is about to boom and factors as to why navigating through defense can be an easier task relative to other industries and how this is an untapped resource by many fund managers as of now.

I. INTRODUCTION

The Indian defense forces have had several changes in its policies over the years that will put a lot of cash on the hands of India's key defense personals to invest in equipment's platforms and logistics. This includes the fundamental changes in its recruitment policy and physical structure, a less hostile approach towards private sector and a general push by the current dispensations to ride the startup boom by providing a helping hand to young startups to meet the need of Indian forces. This combined with the fact that the number of players in this industry are limited, the barrier of entry on big equipment's are very high and the sector being one of national importance disclosures and transparency from the sellers 'The manufacturers 'and the buyers 'The Government' is very high. These factors make this industry on a whole one which is about to experience a big boom and Indian retail investors can be a part of this.

II. Factors which is increasing Cash on the balance sheet for spenders.

1. Changes in Recruitment policy - In September 2022 the Indian government applied the new Agnipath scheme, this scheme was majorly brought in to reduce the pension burden on India's defense budget. What many people didn't realize was that this scheme will also lead to a reduction in significant size of the forces. The number of soldiers recruited from these schemes will be capped at 40,000 soldiers at max and the number of troops who will retire out of forces is around 60,000 this will lead to a reduction in size of the forces amongst whom 3 out every 4 soldiers will not demand pensions in the long term. This will save a lot of liquidity on the balance sheet of the Ministry of Defense. This money will be available to utilize for the buying modern equipment in the armed forces.

2. Push by the Government for modernization - The Government has made sure that when it comes to modernization the pen meets the paper and the allocations increase have been significant over the years across dispensations. The Defense Budget is worth of 75 billion dollars in 2023 and is estimated to have a CAGR of 4% till 2028.

Modernisation Budget of Indian Armed Forces

	2019-20	2020-21	Increase in 2020- 21 over 2019-20%
Army	23517	25999	13.3
Navy	25155	25620	15.9
Air Force	41722	39031	7.3
Total	90394	90649	11.3

Modernisation Budget of Indian Army

Modernisation Head	2019-20 (Rs in Crore)	2020-21 (Rs in Crore)	Increase in 2020-21 over 2019-20 %
Aircraft & Aero-Engine	3237	4000	89.1
Heavy & Medium Vehicles	1466	1589	25.3
Other Equipment	18717	20209	8.9
Rolling Stock	3	100	100.0
Rashtriya Rifles	95	100	5.3
Total	23517	25999	13.3

Modernisation Budget of Indian Navy

Modernisation Head	2019-20 (Rs in Crore)	2020-21 (Rs in Crore)	Increase in 2020-21 over 2019-20 %
Aircraft & Aero-Engine	1150	4640	93.3
Heavy & Medium Vehicles	25	30	33.3
Other Equipment	3600	3000	-14.3
Joint Staff	929	1022	10.0
Naval Fleet	15434	12746	4.6
Naval Dockyard/Projects	4017	4182	37.1
Total	25155	25620	15.9

Modernisation Budget of Indian Air Force

Modernisation Head	2019-20 (Rs in Crore)	2020-21 (Rs in Crore)	Increase in 2020-21 over 2019-20 %
Aircraft & Aero-Engine	21736	26910	8.5
Heavy & Medium Vehicles	110	120	9.1
Other Equipment	19876	12001	4.8
Total	41722	39031	7.3

These allocations combined with the push of MoD on manufacturing projects the growth in defense production is projected to jump to 22 billion USD from 12 billion USD by 2025.

III. Demands for domestic goods in international Markets – India has achieved highest ever defence exports in Financial Year 2022-23. The exports have reached an all-time high of approx. Rs 16,000 crore, almost Rs 3,000 crore more than the previous financial year. It a rise of over 10 times since 2016-17.

India is now exporting to over 85 countries. Indian industry has shown its capability of design and development to the world, with 100 firms exporting defense products at present. The rising defense exports and participation of 104 countries in Aero India 2023 are proof of India's growing defense manufacturing capabilities.

India, exports major platforms like Dornier-228, 155 mm Advanced Towed Artillery Guns (ATAGs), Brahmos Missile's, Akash Missile System, Radar's, Simulator's, Mine Protected Vehicles, Armoured Vehicles, PINAKA Rockets & Launchers, Ammunitions, Thermal Imagers, Body Armours, besides Systems, Line Replaceable Units and Parts & components of Avionics and Small Arms. There is growing global demand of LCA-Tejas, Light Combat Helicopters etc.

On a policy level, Export procedures have been simplified and made industry friendly with end-to-end online export authorisation curtailing delays and bringing Ease of Doing Business. Government has notified three Open General Export License (OGEL) for

Financial Year	Total Export Value (Rs in Crores)
2016-17	1,521
2017-18	4,682
2018-19	10,745
2019-20	9,115
2020-21	8,434
2021-22	12,814
2022-23	15,920

export of Parts and Components/Transfer of Technology/Major Platforms and Equipment. OGEL is one-time export license, which permits the industry to export specified items to specified destinations, enumerated in the OGEL, without seeking export authorisation during the validity of the OGEL.

IV. Why Navigating Defence Might be an easier task – Defence as an industry is one with very high barriers for entry due to the amount of capital involved and the intricacy of engineering required to fit the standards. As a result core players in each industry are very few and considering that the contracts on big equipment's can stretch from months to years this brings a stable stream of cashflow over long terms This along with the involvement of private players in the fields like shipbuilding makes it a huge opportunity.

V. Including Startups to this industry – The current dispensation has shown a surprisingly inclusive attitude towards new age startups as well as private sector for Development and Research to meet the requirement of the Forces. The introduction of iDEX has been something new that none of us could have imagined. The idea of a portal where the government posts its requirement and anyone is allowed to contribute to it as an individual, business or an institution opens new avenues for Indian startups as well as investors willing ride this curve from AIF side and from Formal Funds if and when business becomes a listed entity.

VI. Conclusion – To Conclude in 3 points what makes this sector one that requires dedicated fund managers in the coming years.

- 1) The Domestic costumers i.e., The MoD today has spending capacity and political will to increase spending in the domain.
- 2) Policy changes by regime to ease exports and the demand that for the equipment's that have shown up.
- 3) As the cost of capital in the industry falls down the innovation has started picking up along with the size of production.
- 4) Being a sector largely isolated from market cycles the defence also becomes ideal to store a certain portion of our portfolio.

VII. Reference –

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