The future of European Defence industry: challenges for the supply chain and smaller countries

Jan Pie, ASD Secretary General

5-6th February, Hotel Crowne Plaza, Ørestaden, Copenhagen
Outlook – Main Messages

Introduction

- ASD in a nutshell

Defence Supply Chains So Far (in brief)

- The business models have changed dramatically
- Public policies to support the supply chains have come a long way, but...

Looking at the future

- “From offsets to sub-contracting” or better “the future of industrial collaboration”?  
- Focus on the supply chains means focus on the markets/customers, not just “Brussels”...  
- Revisiting Networking among Industry, Research Institutes, Academia?
ASD in a nutshell

Four pillars with different preconditions

Aeronautics  Defence  Security  Space

€186.8 billion  752,200 employees  2,000 companies  80,000 suppliers
ASD member associations are spread across 20 European countries, 17 of them in the EU.

Aerospace and Defence Industries Turnover: 186.8 Bn €

R&D expenditure - year 2012:
- 17.6 Bn € (16.3 in 2011)
- 8% average growth per year

Direct employment: 752,000 (average growth 3%)

Number of companies: 2,000

Number of suppliers: 80,000

Export outside EU (year 2011 aeronautical only): 38.6 Bn €
The Defence Supply Chains

- Several supply chains for different defence contractors on different projects and in different and fragmented national markets in Europe
  - 80% of procurement expenditure is spent nationally
- “Selling” (e.g. LoI) and “Net Importing” Nations
- In the past National Industry/Supply Chains/SMEs could survive thanks to:
  - National Programs
  - Offsets
- From “suppliers” to “risk-sharing partners”
  - OEMs “delegate” ~80% of volume of business across the supply chain
  - Hundreds or thousands suppliers per Program and/or Prime/OEM
  - However, opportunities come together with growing uncertainties and risks
Public policies in support of supply chains in Europe

- Promoting for years a more “integrated” European market through the motto: “to know and to be known”.
  - Through non-binding Code of Conducts (EDA) at first (no longer in use)
- …and then came the EU-wide Defence Procurement Directive (2009/81/EC)
- Modest results so far

"the total value of all defence procurement published EU-wide (2008-2010) amounted to only 3.3% of the total defence procurement expenditure"
Source: European Commission’s staff working paper, July 2013

  - Lots of work ahead...
European Council (Dec. 2013): Inputs and output

One of the many inputs

The Output

• “opening up the market for subcontractors from all over Europe”
• “A well-functioning defence market based on openness, equal treatment and opportunities, and transparency for all European suppliers is crucial”
• “The European Council underlines the importance of crossborder market access for SME”
• “Invites the Commission to investigate the possibilities for additional measures to open up supply chains to SME's from all Member States”.

“…all Member States should procure a minimum of 25% of their defence equipment from non-national sources by 2020”.

Dear President Van Rompuy,

In the view of the upcoming European Council December meeting, we went to draw your attention to the following:

Vis, the defence industrial associations of Belgium, Denmark, Estonia, Finland, Latvia, Norway, Sweden and The Netherlands strongly support an open European defence and security market. We represent industries that already operate in home markets that are widely open to crossborder defence trades, it is paramount that also defence industries in smaller member states, provided they are competitive, get framework conditions that facilitate less constrained access to the national European defence markets.

The total value of cross-border contracts awarded under directive 2001/87/EC so far is (announced) in the range of 0.03% of the total market value. The net importing nations awarded approximately 50% of the cross-border contract volume but represent less than 20% of the total market. The only way to achieve a level playing field is therefore to begin by implementing measures to increase cross-border trade in the (leading) nations that also count for approx. 40% of the overall European defence equipment market. This would also enable for more efficient and effective use of existing competitive, innovative companies across Europe, outside the current national supply chains.

We propose that the European Council at its December meeting set the goal that all Member states should procure a minimum of 25% of their defence equipment from non-national sources by 2020. Until this has been achieved, monitoring and corrective actions should be targeted at complying this objective. However, it is important to recognize, that a significant number of member states already are controlling a considerably higher percentage of their defence equipment from non-national sources.

Member states should, based on their assessment of essential security interests, clearly define their key national defence industrial and technological capabilities. All other defence capability requirements should be sourced in a transparent and non-discrediting manner, recognizing that acquisition of defence equipment in itself, for many European nations, also have significant strategic implications involving their relationship with third countries.

A particular attention should be directed towards retaining and developing cutting-edge technologies and market R&D efforts, which are guaranteeing the sovereign effectiveness of European military forces and the competitiveness of European defence industry.

Helsinki, 12 November 2013

Mr. Herman van Rompuy
President of the European Council
Rue de la Loi 272
B-1040 Brussels
Implementation of the EC Defence & Security Procurement Directive
  – The presumed “certainty” and the valid “uncertainties”
  – From offsets to sub-contracting?

The trends and patterns in the National Procurement policies (Europe and the world)

Revisiting Networking among Industry
The presumed “certainty”

“Offsets shall continue one way or the other” (?)

...and the valid “uncertainties”

– Will the Directive lead to strengthening of the European Defence Industrial base at most Member States?
– Will the Directive drive an open market throughout the industry in its entirety or mostly in the lower tiers of the supply chains?
– Will it drive more European Cooperative and Cross border initiatives?
– What is the incentive of the Contractor to move from current to new suppliers?
– ....???
From Offsets to Sub-contracting?

• “The future of offsets” vs “The future of industrial collaboration”
  – Offsets can be “implied” also!
  – Limited chances for a foreign bidder to win a contract abroad unless parts of the national/local industry in the importing nation are involved or unless significant parts of the development of a new program (e.g. systems design capabilities) are relocated to this buying Nation (the case of “significant” markets).
  – *How can one trust an interesting, yet unknown, possible partner/sub-contractor?*

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<tr>
<th>Supplier</th>
<th>Contractor</th>
<th>Both</th>
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| • Communicates  
  • Medium to long term  
  • capabilities  
  • capacities  
  • Investment plans  
  • Strategic objectives  
  • Current & Target “Niche position” | • Communicates  
  • Supply Chain  
  • Strategic aims  
  • Requirements  
  • Work  
  • Financial – Risk sharing etc.  
  • Seeks to identify within its requirements potentially suitable items for subcontracting | • Aim  
  • For mutually beneficial relationship  
  • Recognise  
  • That world market conditions prevail |
The European Council demonstrated “what Brussels can do for Industry”

- Dual-use R&T, EU roadmaps, implementation of legislation, certification/standardisation etc.

We need however to start analysing “what could the real customers do for industry”

- The future is not just in the efforts towards new, collaborative programs in Europe
- Customers are not just the Nations – Industry is also a customer (from a supply chain perspective)
- Which are these best practises and win-win cases for taxpayers, military capabilities and industries?
Looking at the markets/customers (while remaining at the pre-competitive level)

• (some) Areas to be analysed in the future:
  – the variances in the national models of turning R&T/R&D results into armaments/procurement stages, as well as best practices in involvement of industry into the national capability defence development processes,
  – Efficiency and effectiveness of national and European R&T&D programs
  – treatment of IPRs, security of supply and other aspects in defence procurement,
  – best practices in outsourcing of technical support/maintenance,
  – implementation of structural funds for R&D at the national level (quantitative & qualitative analysis).
  – the landscape in Europe in terms of declining supply chains in critical defence components/technologies (quantitative & qualitative analysis).
  – The evolution of offsets and other national measures promoting sub-contracting to local suppliers and “industrial cooperation”.

Would knowledge around these topics be helpful/attractive to the lower tiers of the supply chains? Should ASD embark into such analyses?
Networking revisited

- The world is full of exhibitions and conferences
  - Driven by short-to-medium term business development & marketing

- Is there room for massive B2B events with medium-to-long term focus on technologies/innovation?
  - “Designed in Brussels” (ASD) – Implemented regionally/locally/outside Europe (e.g. BRIC countries)
  - OEM/Primes identify the promising technology/business areas where future collaboration may be needed...
  - ...and all tiers in the supply chains, Research Institutes, Academia present their capabilities and potential
  - Procurement Authorities and military planners with active/passive role

Would such events be attractive to the supply chains? What “success” could look like from your point of view?
Conclusions

Evolution in business models
- Dramatic change; shift in exports and risk-sharing

Public policy in support of market openness
- Has come a long way, but we are not “there” yet

Markets, offsets, local industry in “small” Nations
- Growing uncertainties

Sub-contracting and collaboration
- Effective means will have to be identified/developed

Better focus for the future
- Look at the markets/customers (globally), not just at “Brussels”
- New analyses and possibly new approaches in networking among Industry
Thank You!