



**EUROPEAN COMMISSION**

Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs

**European Commission**  
**Advisory expert group on cross-border access for SMEs to**  
**defence and security contracts**

**FINAL REPORT AND RECOMMENDATIONS**

**November 2016**

## **Legal Notice**

The Expert Group was appointed by the European Commission and consisted of representatives nominated by national authorities of Member States and individual experts from European defence businesses or business associations invited by the Commission.

Although the work was carried out under the guidance of Commission officials and in part by experts appointed by national governments, the views expressed in this document do not necessarily represent the official position of the European Commission nor the participating countries or entities.

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## 1. INTRODUCTION

In its Conclusions of December 2013, the European Council underlined “*the importance of cross-border market access for SMEs*”, stressing that “*full use should be made of the possibilities that EU law offers on subcontracting*”, and invited “*the Commission to investigate the possibilities for additional measures to open up supply chains to SMEs from all Member States*”.

As also noted by the European Council, “*SMEs are an important element in the defence supply chain, a source of innovation and key enablers for competitiveness*”. Moreover, opportunities for cross-border access are a key element of a functioning defence market.

Improving cross-border market access to defence contracts and supply chains, especially for SMEs, therefore, contributes to the ultimate objective of “*a more integrated, sustainable, innovative and competitive defence technological and industrial base (EDTIB)*”, which is needed to “*develop and sustain defence capabilities*” and “*enhance Europe’s strategic autonomy and its ability to act with partners*”<sup>1</sup>.

In February 2014 the Commission organised a first workshop with Member States and stakeholders to discuss the issue of cross-border market access for SMEs and non-distortive alternatives to offsets. In the Implementation Roadmap of June 2014<sup>2</sup>, the Commission announced its intention to set up an ad hoc Advisory Group with Member States and industry to receive expert advice in this area and to explore options for promoting cross-border supply chains.

The Commission selected the members of the “Advisory group on cross-border access for SMEs to defence and security contracts” (hereinafter the Group) on the basis of their profiles and technical competence, while ensuring a balance of geographical and representational interests. The European Defence Agency (EDA) has participated in the meetings of the Group. The first meeting of the Group took place in April 2015.

The objectives of the Group were to:

- a) assess possible obstacles that may hinder SMEs participation in defence contracts and cross-border market access and provide an overview thereof;
- b) explore options for improving the practical application of the subcontracting provisions of the Defence Procurement Directive and to promote the use of these provisions by Member States’ contracting authorities;
- c) analyse possible ways to support cross-border integration of supply chains; and
- d) investigate the possibilities for additional measures in this area<sup>3</sup>.

Besides the issue of cross-border market access to contracts and supply chains, which is the focus of the Group, the Commission has intensively been working, together with EDA, to support defence-related SMEs<sup>4</sup>. EDA has also developed several activities in

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<sup>1</sup> European Council Conclusions, 19/20 December 2013, points 16 and 20.

<sup>2</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014DC0387>

<sup>3</sup> Progress Report of May 2015: [http://ec.europa.eu/growth/sectors/defence/files/communication-implementation-report\\_en.pdf](http://ec.europa.eu/growth/sectors/defence/files/communication-implementation-report_en.pdf)

<sup>4</sup> Particular efforts have been undertaken to guide defence-related SMEs to use funding dual opportunities under the European Structural and Investment Funds, Horizon 2020 and COSME through various workshops and conferences and the publication of a Dual Use Support Guide. More

this area<sup>5</sup> in close coordination with Member States, Commission and industry. The Group has taken into account these activities and built upon all this previous work and existing tools. Any follow-up to the recommendations of this report, including possible measures and instruments, will be determined taking into account, in particular, the on-going and planned work within EDA.

## 2. BACKGROUND

### 2.1. EDTIB and supply chains: a brief overview

At the top of the supply chains are the prime contractors (the system integrators in case of the most complex systems). These are usually large companies, and in many cases national champions (although there are also multinational companies, e.g. Airbus, MBDA, Leonardo FNM), which interact with Member States' defence procurement authorities, or procuring bodies such as Organisation for Joint Armament Cooperation (*L'organisation conjointe de coopération en matière d'armement - OCCAR*) and NATO agencies. These companies work together with lower-tier suppliers in complex supply chains to produce and deliver defence systems<sup>6</sup> often distributed across and outside the EU.

A recent study commissioned by the EDA identified about 9 000 companies supplying various capabilities across the European defence industry supply chain. Tier 1 companies (prime contractors – companies having direct contracts with clients for delivery of complete products, system integrators) constitute numerically only 2% of the overall industry supply chain, but earn the dominant share of the defence expenditure revenues. Tier 2 companies (direct sub-suppliers of prime contractors) account for around 15% of the supply chain. Tier 3 to Tier 5 companies are mostly suppliers catering to end-user and industry prime contractors needs for components and associated support services<sup>7</sup>.

SMEs are active in the defence sector either as subcontractors to larger companies or as direct contractors for defence procurement authorities. They are often specialised product suppliers or service providers operating in niche markets. Many SMEs which are active in the defence sector do their business primarily on civil markets.

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information is available at: [http://ec.europa.eu/growth/sectors/defence/industrial-policy/smes/index\\_en.htm](http://ec.europa.eu/growth/sectors/defence/industrial-policy/smes/index_en.htm)

<sup>5</sup> EDA's "Guidelines for facilitating SME's access to the defence market", last revision in May 2015; EDA's SMEs Action Plan (2013); Document on National Defence Industry Associations' Best Practices (2012); Handbook for defence-related SMEs (2016); Pilot Case - Modelling and Simulation SME Platform (2016); Defence Procurement Gateway (<http://www.eda.europa.eu/procurement-gateway>); Studies: R&D/R&T contracting policies in support of SMEs, 2009, ([http://www.eda.europa.eu/docs/documents/R\\_D\\_R\\_T\\_contracting\\_policies\\_in\\_support\\_of\\_SMEs\\_1](http://www.eda.europa.eu/docs/documents/R_D_R_T_contracting_policies_in_support_of_SMEs_1)); Enhancing support to SMEs-Through better understanding of dual-use aspects of the EDTIB supply chain, 2014; Study on Eligibility of Suppliers in Defence Procurement, 2011; other related studies/activities on defence-related clusters, defence supply chain and EU funding (ESIF, COSME).

<sup>6</sup> Towards a more competitive and efficient defence and security sector - Commission Staff Working Document accompanying the Communication on the European Defence and Security Sector, 24 July 2013 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013SC0279&from=EN>

<sup>7</sup> Study on "Support to the implementation of the Supply Chain Action Plan" by IHS Global Limited for the EDA. The executive summary has been published at: [https://www.eda.europa.eu/docs/default-source/procurement-library/15-esi-op-029\\_eda-support-for-implementation-of-scap-executive-summarye39d983fa4d264cfa776ff000087ef0f.pdf](https://www.eda.europa.eu/docs/default-source/procurement-library/15-esi-op-029_eda-support-for-implementation-of-scap-executive-summarye39d983fa4d264cfa776ff000087ef0f.pdf).

Prime contractors and system integrators for complex systems are mostly concentrated in the so called LoI<sup>8</sup> countries (France, Germany, Italy, Spain, Sweden and the UK); in these countries, there is also a broad base of intermediate companies and SMEs. The defence related industrial base in several other Member States consists mostly of sub-suppliers (intermediate companies and SMEs), which have to compete with sub-suppliers in LoI countries to be integrated in system integrators/prime contractors' supply chains. While this represents a fair but summary description, it should be noted that the structure of the defence industrial base in Europe is more complex. For instance, subsidiaries, whether European or not, of companies based in third countries (e.g. US and Israel) also play a role. However, it is not the purpose of this report to provide a detailed and exhaustive analysis of the EDTIB<sup>9</sup>.

According to the recent EDA's study, a degree of cross-European consolidation and collaboration exists at the level of system integrators/prime contractors, while below this level, the EDTIB is more aligned on a national basis and with less evidence of EU-wide integration<sup>10</sup>. The structure of the supply chain may differ depending on the sector. Aerospace and defence related electronics industries tend to have more globalised supply chains, while the naval and land industries are defined to a greater extent along national boundaries. This corresponds to the differences in size and technological complexity of the programmes<sup>11</sup>.

## 2.2. Cross-border market access

The issues discussed within the Group encompass both the cross-border award of government contracts and cross-border access to supply chains. On the former issue, data on cross-border penetration in defence procurement show that around 10% of the value of contracts awarded under Directive 2009/81/EC has been won directly by foreign companies<sup>12</sup>. These data refer exclusively to "direct cross-border procurement", which occurs when a company operating from its home country bids and wins contracts for tenders launched in another country. It does not reflect awards to subsidiaries of foreign companies established in the country of the procurement authority. In addition, these data do not give account of the share in the implementation of the contract that can go to foreign sub-suppliers in the supply chain of the prime contractor. This would be an additional element of cross-border trade, but there is no available data to estimate the volume of cross-border subcontracting.

In fact, no specific information and data seem to be available to provide an accurate picture of the way defence supply chains are organised and the degree of cross-border participation in them. It would be extremely difficult to obtain such information beyond Tier 2<sup>13</sup>.

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<sup>8</sup> Letter of Intent on restructuring the European defence industry.

<sup>9</sup> European Defence Technological and Industrial Base.

<sup>10</sup> EDA study on "Support to the implementation of the Supply Chain Action Plan".

<sup>11</sup> Towards a more competitive and efficient defence and security sector - Commission Staff Working Document accompanying the Communication on the European Defence and Security Sector, 24 July 2013 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013SC0279&from=EN>.

<sup>12</sup> The proportion of "direct cross-border procurement" under the civil procurement Directives is 3.5% in terms of value.

<sup>13</sup> Prime contractors (Tier 1 companies) are unlikely to have specific information about their suppliers' suppliers and even less about lower tiers in the supply chain. Obtaining such information, for example through an ad hoc study, would require asking prime contractors to provide information about their

A number of challenges exist in relation to the issue of cross-border market access, especially (but not exclusively) for SMEs. Several of these challenges are not specific to the defence market, but also exist in civil markets. This can be a lack of information, administrative burden, language barriers, cultural, legal and administrative differences between particular Member States, and costs related to distance/shipment. Moreover, there are challenges that are specific to defence procurement such as nationally classified information and data, security of supply requirements, standardisation and certification, and national export control regulations. All these challenges and obstacles may discourage companies from bidding cross-border. For example, UK MoD data show that, in 2014, only 5 % of requests to participate came from suppliers outside the UK.

These issues affect not only cross-border bidding in public procurement, but also the possibility for sub-suppliers to get into supply chains of larger (higher tier) companies located in another country. Long-standing relations between prime contractors and sub-suppliers, often due to the need for stability in the manufacturing process of the most advanced defence systems, is another factor hindering new companies from entering supply chains.

Developments in relations between higher and lower tier companies can also constitute a relevant factor. For example, it seems that subcontracting activities are increasingly based on the so-called “risk-sharing partner” concept, whereby the development costs of new systems or equipment is distributed across the prime contractor and its partners. This trend may be explained by governments’ budgetary constraints. Under this concept, prime contractors delegate the responsibility for conceptualising, designing, developing and producing a new system to lower-tier companies. This may entail a potential for increased risks and costs to be borne by smaller and less financially resilient companies<sup>14</sup>. It may on the other hand open up additional sales opportunities for both parties due to, for example, shared IP-rights.

### **3. THE WORK OF THE GROUP**

The Group met eight times between April 2015 and October 2016<sup>15</sup>. Attendance at the meetings varied. Different categories of interests have been represented along all the work of the Group<sup>16</sup>, even though some members did not participate in last meetings.

The Group initially had a general discussion on the situation of SMEs (and sub-suppliers/intermediate companies) in the defence sector and on the issue of cross-border market access. It took stock, on the basis of a paper prepared by the Commission

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suppliers (their business partners), and then pass this question further down two or more levels. Given the investment in time and resources that would be needed for companies to reply, and taking into account the confidentiality of sensitive commercial information, such a survey would most likely not lead to meaningful results due to low response rates.

<sup>14</sup> Towards a more competitive and efficient defence and security sector - Commission Staff Working Document accompanying the Communication on the European Defence and Security Sector, 24 July 2013 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013SC0279&from=EN>

<sup>15</sup> Meetings of the Group have taken place on: 29 April, 22 June, 9 October, 10 December 2015 and 17 February, 26 April, 20 June, 12 October 2016.

<sup>16</sup> A summary of the Members participation is presented in the table at the page: <http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=3274&NewSearch=1&NewSearch=1>.

departments, of the existing activities and measures already identified at EU and national level.

Industry experts from both prime contractors and SMEs gave presentations to share their experiences and provided important and substantial inputs to the discussion on supply chains and market access. External experts, who were invited on the request of members of the Group, also provided presentations.

The Group discussed the challenges to SMEs participation and cross-border market access and started examining possible ways to improve the situation. The Group then continued its work on the basis of an overview of possible measures and recommendations compiled by the Commission departments in the light of the previous meetings.

The present document reflects the outcome of these discussions within the Group. The initial draft prepared by the Commission departments has been subject to written exchanges among the participants of the Group, then revised and discussed in detail at two meetings of the Group.

#### **4. KEY FINDINGS AND RECOMMENDATIONS**

The issue of cross-border market access and open supply chains is considered particularly important for a functioning European Defence Equipment Market (EDEM)<sup>17</sup>. Sub-suppliers should also benefit from a functioning EDEM, in particular by having a fair chance of gaining access to the supply chains of big system integrators located in other Member States. Since this widens the opportunities to develop new and more profitable industrial relationships, it should be beneficial to the companies concerned and to EDEM as a whole.

Cross-border market access to contracts and supply chains should contribute to the overall objective of strengthening Europe's defence industry. The competitiveness of prime contractors is a key element of this. Healthy and competitive prime contractors in Europe are also essential for SMEs and sub-suppliers to have opportunities to integrate into their supply chains.

When looking at the overall situation of Europe's defence industry and at prime contractors' competitiveness, the global perspective needs to be taken into account. Export markets, which are essential for European industry, are becoming increasingly competitive. The effects that the demanding offsets/industrial return requirements imposed by third countries have on European industry are also an important factor.

The recommendations below have been developed bearing in mind that prime contractors should always be able to work with the best (most competitive) possible sub-suppliers and SMEs irrespective of their location. These recommendations have been designed while taking into account the need to avoid any negative impact on prime contractors' competitiveness.

It is in the context of this balancing exercise that the recommendations below include voluntary instruments (possibly incentive-based), 'soft law' measures, and practical

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<sup>17</sup> European Council Conclusions, 19/20 December 2013, points 16 and 20. See also Recitals 2 and 40 of Directive 2009/81/EC.

actions. When implementing these recommendations and developing instruments such as the Code of Conduct, Memorandum of Understanding or covenants (see below points 11-16), the inclusion of monitoring and reporting mechanisms may be needed. It may also be useful to envisage reverting to the issues covered by these instruments after a reasonable period, and, while keeping in mind the priority objective of safeguarding EDTIB competitiveness on global markets, consider possible additional measures.

The Group considers that the recommendations below should, in any case, be discussed more widely with Member States and industry in order to see whether and how to take them forward.

#### **4.1. Government procurement**

Public procurement procedures based on competition, transparency and equal treatment are the corner-stone of a functioning European Defence Equipment Market (EDEM). Such procedures can offer direct business opportunities, including across the border, to prime contractors and system integrators, as well as to intermediate companies<sup>18</sup> and SMEs (e.g.: in specific niche capabilities, in the area of services, etc.).

In addition to complying with the legal obligations under EU law (Directive 2009/81/EC), it is important that Member States endeavour to facilitate cross-border and SMEs participation in their public procurement procedures. In this area, the Group has identified the following possible measures/recommendations.

##### **(1) Providing early information about long-term plans and priorities**

The publication of procurement notices takes place at a stage where it is often too late for prime contractors/system integrators to make changes to their supply chains and integrate new sub-suppliers from other Member States. It is also too late for sub-suppliers to offer innovative solutions to prime contractors/system integrators in order to access their supply chains. It is therefore important to provide appropriate information to the market at the earliest possible stage. This entails providing, whenever possible and considered appropriate by the competent authorities, early information about future long-term armaments plans (capability and R&T requirements and priorities). This can be done, for example, through: publication of planning documents; targeted events open to businesses (prime contractors and sub-suppliers) from different Member States; supplying information to National Defence Industry Associations (NDIAs), other defence and security business organisations (e.g. clusters) and via ASD to ensure EU-wide distribution of information.

##### **(2) Using pre-procurement advertising**

Using, to the greatest possible extent, pre-procurement advertising tools such as: Prior Information Notices (PIN), targeted events on advance procurements plans and specific projects which are open to businesses (prime contractors and sub-suppliers) from different Member States, and information supplied to NDIAs and other defence and security businesses organisations (e.g. clusters)<sup>19</sup>. When using

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<sup>18</sup> These could be defined as companies which, due to the type of their products rather than their size, play a role of sub-supplier for particular categories of defence contracts (e.g. producers or electronic equipment or engines).

<sup>19</sup> With the notion of pre-procurement advertising, reference is made to advertising occurring before the publication of a contract notice launching a formal procurement procedure. Obviously, any kind of



these tools, procurement authorities should clarify the provisional nature of the procurement plans at stake.

### **(3) Advertising procurement opportunities as widely as possible**

Whenever possible, advertise procurement opportunities for contracts under the threshold established by Articles 8 and 9 through voluntary publications on relevant portals and websites (not necessarily in TED) and send requests for information or requests for quotation to potentially interested businesses across Member States.

### **(4) Improve the quality of the information**

Provide the market with meaningful and accurate short information (e.g. description of the procurement in contract notices published in Tenders Electronic Daily (TED)) that can enable businesses to screen and identify opportunities, as well as to make informed decisions on their possible interest to bid. Whenever possible, provide a courtesy translation in English or other languages commonly used in defence trade (short extracts without legal effects) either on the website of the procurement authority or for publication in TED (see also point 8 below).

### **(5) Design public procurement procedures to facilitate cross-border and SMEs participation**

Whenever the contracting authority considers it possible, appropriate and beneficial for the quality of the purchase: use the option of sub-dividing contracts into lots<sup>20</sup>, keep selection criteria proportionate, alleviate the administrative burden (certificates, numerous negotiations meetings etc.), extend the time for submission of offers, shorten the award time, use e-procurement and competitive dialogue procedure to explore and benefit from the innovation and development capacities of businesses (naturally in big part SMEs).

### **(6) Improve procurers' skills**

Organise training for procurement officers, create opportunities for exchange of experience and for self-education. Provide dedicated training and guidance materials highlighting the specificities of SMEs and their inherent operational constraints (financial flows, human resources, IPR management etc.).

### **(7) Training and awareness raising for suppliers/providers**

Organise training and prepare information materials for the supply, service and works providers. The materials should be generally accessible (or generally accessible for all businesses declaring themselves as interested in defence public contracts), especially for SMEs and intermediate companies.

<p><u>Possible instruments:</u> measures 1 to 7 could constitute the content of a voluntary Code of Conduct to be subscribed by Member States. The Commission/EDA could</p>
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early advertising has to be carried out in an open and impartial matter, i.e. in a way that no group of potentially interested providers is privileged.

<sup>20</sup> Sub-dividing contracts into lots may sometimes interfere in the definition of the systems interfaces or limit flexibility and room for development. In some cases, it can also lead to both non-efficient technical solution and additional costs for the customer.

facilitate the process/broker the conclusion of this document. As an alternative, such measures could, after further and wider discussions with Member States and stakeholders, be set out in a Commission's Recommendation to Member States.

#### **(8) Improve the Tenders Electronic Daily (TED) website**

The TED website contains all contract opportunities published at EU level under the public procurement directives. It is, however, sub-optimal as a tool for companies (and especially SMEs) to easily and efficiently identify suitable business opportunities. It could be improved especially through certain aspects in the operation and user-friendliness of the website: e.g.: voluntarily adding electronic flags to the contract notices that are potentially suitable for SMEs and incorporating handy, web-displayed automatic translation functionalities.

Possible instruments: the Commission departments (DG GROW and Publication Office) will analyse all possible improvements that may be introduced thanks to the electronic automation and harmonisation of forms, and will assess the possible revision of the standard forms for notices in the field of defence and security, in consultations with stakeholders, including SMEs.

#### **(9) Revise the Commission's guidance on subcontracting**

There was broad consensus among experts in the Group on the fact that the specific subcontracting provisions of the Directive are ineffective and have not been used<sup>21</sup>. Some experts also pointed out that the existing Commission's guidance note on subcontracting prevents contracting authorities from organising subcontracting competition in ways not explicitly foreseen in the Directive, for instance to drive competition into the supply chain in case of single source procurement (award on the basis of negotiated procedure without publication due to a monopoly situation). This is arguably due to an unnecessarily restrictive interpretation of certain aspects of the subcontracting provisions. This guidance could be revised to open up (or reinstate) such possibilities for contracting authorities, in full compliance with the Directive and the internal market principles.

Possible instruments: it would be for the Commission, in close cooperation with Member States' experts in the Expert Group on Defence and Security Procurement and in consultation with stakeholders, to possibly revise the existing guidance note on subcontracting. If this action is pursued, the new guidance could take the form of a Commission Notice.

#### **(10) Use cooperative procurement much more extensively**

The importance of cooperative defence procurement is widely recognised. Although it was recognised that this topic goes well beyond the issue of SMEs participation and cross-border market access for sub-suppliers, the Group broadly agreed that cooperative defence procurement may be an important factor to foster the cross-border integration of Europe's defence industry and supply chains. In this context, it

<sup>21</sup> The subcontracting provisions are in practice not used (only in individual cases: 32 subcontracting notices published until the end of 2015). An overview of the problems related to these provisions is contained in EDA's document "Challenges for Member States contracting authorities and defence industry in using/implementing Directive 2009/81/EC subcontracting provisions".

would be beneficial in the medium-long term to organise, as far as possible, more cooperative armaments programmes involving several Member States (with work share arrangements in programmes for the development of new products based on research and development<sup>22</sup>) and more coordinated purchases or joint procurement.

Possible instruments:

Decisions on the establishment of cooperative programmes and the use of joint procurement are exclusively a responsibility of Member States. The EDA and the Commission should (continue to) explore ways to facilitate and encourage such decisions.

The Commission could prepare guidance on cooperative procurement in order to explain conditions and possibilities of organising cooperative procurement in accordance with the Directive. This could include assessing possibilities for promoting multi-suppliers (including SMEs) and multi-national participation.

#### **4.2. Prime contractors procurement (supply chains)**

As commercial businesses, prime contractors are free to organise and manage their supply chains within the requirements of national and EU law. They should not be subject to the same obligations and standards that are imposed on public procurement authorities. It is important to avoid interfering with the principle of commercial freedom to contract and adding unnecessary regulatory burden. This is also important due to the responsibility of prime contractors (vis-à-vis their customers) to guarantee reliability of suppliers, and risk management.

At the same time, the objective of a well-functioning EDEM is shared by all stakeholders. This means creating a level-playing field, preventing market distortions and discriminatory measures, and offering business opportunities to companies across Member States irrespective of their size and location. In this context, sub-suppliers should benefit from the opening-up of national defence markets by having a fair chance of gaining access to the supply chains of big system integrators located in other Member States.

As a consequence, prime contractors should maintain an open, fair and impartial approach in organising and managing their supply chains. In particular, prime contractors should give fair opportunities to sub-suppliers and SMEs from all Member States to prove their potential, capacity and usefulness for the defence contract/production that is implemented/carried out. In this area, the Group has identified the following possible measures. The Group also found that incentives would be important in order to maximise prime contractors' interest to follow these measures.

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<sup>22</sup> Exclusion from the Directive in case of programmes based on R&D and notified to the Commission (art. 13(c) of the Directive).

### **(11) Strategic long-term plans**

As early as possible, make potentially interested suppliers aware of future requirements and technology priorities, e.g. through B2B meetings, information to NDIAs, and publication where possible. The extent to which information can be shared is obviously limited by the need to protect commercially sensitive information.

### **(12) Pre-procurement and subcontracting advertising**

Think longer term and provide advance information on upcoming business opportunities in specific projects through meetings, information to NDIAs, and publication where possible. Consider advertising sub-contract opportunities on the company's website, especially above a certain value of contracts.

### **(13) EU-wide market search and scouting**

Carry out systematic and extensive EU-wide market search and scouting activities to identify potential suppliers across Member States, especially in case of development of new products, elements or functionalities. Use databases of EU defence suppliers and output/functional specifications in searches for subcontracting.

### **(14) Look for, accept and support civil–defence transitions and orientation of sub-suppliers**

As far as operationally possible and rational, look for possibilities of resorting to civil oriented sub-suppliers. Support them, if needed, in entering the defence market (e.g. in terms of obtaining the necessary certificates). In any case, prime contractors (system integrators) should not be expected to integrate civil oriented companies into their supply chains when this can make it more difficult for them to meet delivery schedule. In addition, sub-suppliers entering the defence market should not be pressed to leave the civil market.

### **(15) Enable and promote unsolicited proposals**

Indicate in a clear and transparent manner, on the company's website, how potentially interested suppliers can make contact and general proposals for collaboration.

As far as possible, use transparent and objective pre-qualification systems for suppliers' selection.

### **(16) Showcase existing cross-border suppliers in your supply chains**

Suppliers/SMEs can consider that it is not worth trying to get access to the supply chain of a large prime contractor in another Member State, based on the assumption that non-national suppliers are unlikely to be selected. It would, therefore, be important for prime contractors to be, as far as possible, transparent about the organisation and the cross-border elements of their supply chains. This would mean, for instance, showcasing examples in which prime contractors have integrated suppliers from other Member States (especially when it was not due to a particular requirement of the signed contract), or presenting in general terms their footprint in

different Member States. This would raise awareness and enhance confidence of other potential suppliers.

Possible instruments:

A voluntary Memorandum of Understanding or equivalent instrument (covenant, agreement, etc.) to be signed by prime contractors, business associations, and all relevant stakeholders. The content of this instrument would consist of commitments by the subscribing parties and could include in particular measures 11 to 16.

The Commission/EDA, with the close involvement of ASD, could support and facilitate the process for the conclusion of this instrument. In the process of preparing this instrument, the conditions under which stakeholders would be prepared to apply it, including options for incentives (e.g. fiscal, financial, administrative or procurement-related incentives), will need to be analysed.

**(17) Promote the use of accreditation systems by prime contractors**

Voluntary accreditation systems to be used by prime contractors are commercial sub-contracting support tools with third party control, which help suppliers to demonstrate they are “fit for business”<sup>23</sup>. Such systems could give prime contractors confidence to rely on suppliers that are accredited. A more widespread use of these systems could facilitate the integration of new suppliers and SMEs into prime contractors’ supply chains, including those from other Member States. In the use of such accreditation systems, care should be given to avoid or limit costs for SMEs.

**4.3. Intra-community transfer of defence related products**

A limited uptake and incomplete implementation of the Defence Transfers Directive (Directive 2009/43/EC), persisting differences across Member States and insufficient simplification of the system constitute significant hurdles to cross-border trade, especially for SMEs. Under these circumstances, prime contractors have to face the risk that deliveries from cross-border sub-suppliers are delayed or blocked due to issues related with transfer licences. This risk may be an additional factor deterring prime contractors from looking for sub-suppliers and SMEs across the border.

**(18) Improving implementation of the Defence Transfer Directive**

Support of effective implementation of, and compliance with, the Directive, including, for instance, the promotion of more uniform general transfer licenses, may reduce the burden for industry to supply across borders and increase procurement authorities confidence to purchase from companies established in other Member States. Making certification for companies under the Directive more attractive would also have a positive impact on cross-border opportunities for SMEs and sub-suppliers, as it would increase the number of companies (prime contractors – system integrators) that are certified.

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<sup>23</sup> Two significant examples are Nadcap (<http://p-r-i.org/nadcap/about-nadcap/>) and Joscar (<http://www.hellios.com/services/joscar-defence-industry-community.html>).

Possible instruments:

The Commission should: i) work to improve the application and compliance with the Directive through a dialogue with Member States, possibly including looking into the issue of transit licenses; ii) continue and further develop work, in close cooperation with Member States, to harmonise general transfer licenses through a common set of conditions and minimum content, as well as to improve the certification scheme under the Directive and incentivise its use; iii) intensify awareness raising and information exchange activities towards Member States and stakeholders, especially SMEs.

#### **4.4. Security of Supply**

Concerns related to Security of Supply can be a contributing factor limiting cross-border market access, both at the prime contractors' level and further down in the supply chains. Although this is a much broader and more complex topic, strengthening Security of Supply among Member States is important for the functioning of the internal market in the defence sector, and can be beneficial for cross-border trade, including for SMEs and sub-suppliers. Improving the application of Directive 2009/43/EC (see point 4.3 above) is key for strengthening Security of Supply. In addition, some work addressing various aspects of Security of Supply has been done and is still ongoing at EU level by the EDA and the Commission. This includes EDA Framework Arrangement for Security of Supply and the related Code of Conduct on Prioritisation, as well as the possible development of a political commitment or declaration that could help foster mutual trust. This report, however, focuses on two issues more directly related to procurement and supply chains.

##### **(19) Improving Security of Supply in defence procurement**

Guidance/good practices on ways Member States can increase Security of Supply while remaining in compliance with EU public procurement law could be highly useful. Requirements like being able to carry out maintenance within reachable distance from the place of storing or using an equipment may lead to achieving a better balance between Security of Supply and the need to carry out competitive procurement.

Possible instruments: it would be for the Commission, in close consultation with Member States' experts in the Commission's Expert Group on Defence and Security Procurement, to possibly revise the guidance on Security of Supply in relation to the Defence Procurement Directive. If this action is pursued, the revised guidance could take the form of a Commission Notice.

##### **(20) Security of Supply in supply chains**

Issues related to Security of Supply can have an impact on prime contractors' supply chain management. In order to avoid risks and respond to Security of Supply concerns from their clients (Member States), prime contractors may naturally rely on established supply chains of national suppliers. It could be useful to identify and disseminate good practices of contracting authorities and prime contractors on how to mitigate Security of Supply risks without unnecessarily restricting the openness and competitiveness of supply chains.

Possible instruments: Commission/EDA could develop, in close consultation with Member States and prime contractors experts, good practices documents and disseminate their content.

#### **4.5. Research and Technology (R&T) and innovation**

The capacity to innovate is an important strength of SMEs. R&T is one of the areas where SMEs can succeed in direct competition. Taking part in research projects can lead to significant opportunities for SMEs. On the other hand, it needs to be remembered that one of the difficulties in entering into established defence businesses for new SMEs is the R&T investment costs that are difficult to bear for SMEs.

R&T in the defence sector is almost entirely funded by national governments, with funding typically disbursed to government-owned or supported defence research institutes and national industry. The share of European collaborative defence R&T is still limited. There are also a number of initiatives by the Commission and EDA to increase collaborative spending. This would also have the effect of increasing cross-border opportunities for sub-suppliers and SMEs across different Member States.

In any case, possible decisions on national R&T investments lie solely with Member States.

##### **(21) More investments in R&T**

Investing more extensively in R&T may create additional business opportunities and enable supply chains to expand more easily and be more flexible.

Possible instruments: increase in Member States' investments budgets (which are in any case an exclusive decision of Member States), EU supporting policies and actions, prime contractors/big companies' investments.

With all possible limitations (limited budgets, established ways of operating), the defence research institutes of EU Member States may examine to what extent it is possible to involve SMEs in their projects.

##### **(22) EU R&T projects**

Initiating common cross-border EU R&T projects would create additional business opportunities and lead to creation of supply chains that are less dependent from existing closed solutions.<sup>24</sup>

Possible instruments:

The Preparatory Action for Defence Research and the future European Defence Research Programme will be key tools for launching multi-national (European) research projects. This will provide opportunities for companies across the EU, including sub-suppliers and SMEs.

By incentivising more European cooperation on new, future defence programmes and by ensuring the Member States' market uptake, these tools (PA and EDRP) will

<sup>24</sup> The Pilot Project on defence research, launched in 2016, required cross-border cooperation and each project had to involve at least 3 independent legal entities from 3 different Member States.

also pave the way for cross-border opportunities in the follow-on development and procurement programmes.

Dedicated National Contact Point Network can not only supply information on the rules, but also organise brokerage events/services<sup>25</sup>.

#### **4.6. SMEs and sub-suppliers' capacity**

A number of actions can be taken to enhance the capacity of SMEs and sub-suppliers so that they can increase participation in cross-border tenders and supply chains.

##### **(23) Improve or establish databases of EU companies (including SMEs) and their capabilities**

Establishing a new database would be labour and cost intensive. It could also be exposed to risks of limited use. Thus, this action should as much as possible build on combining forces of already existing projects. An agreement between keepers of national databases (linking-up existing NDIAs directories and other existing relevant sources, e.g. lists of members of big clusters) and mechanism of (conditioned) cross-access (a dispersed database mechanism) could assure a critical mass of information and necessary update (possibly building on EDA's experience and contacts and with its on-going coordination or initial facilitation). Such a tool could also include information on companies' technological capabilities and possess particular features (e.g. the possibility to search companies by capabilities).

At further stage and as a higher level of development, (and in case of a big success) the database could provide a possibility of linking descriptions of SMEs/intermediate companies with Members States information about future programmes or e.g. TED notices. In this way, prime contractors could immediately associate a description of SME they found with a particular type of project or a business opportunity.

Possible instruments: work by NDIAs and EDA in this area is ongoing and should continue. The main point is convincing prime contractors of the comprehensiveness and practical usefulness of these databases.

##### **(24) Promotion of cross-border bidding by SMEs**

Disseminating information about cross-border success stories can encourage SMEs and sub-suppliers to bid cross-border.

Organising cross-border suppliers' conferences to improve their understanding of the prime contractors' selection requirements, way of working and sought industrial competences and capabilities.

Possible instruments: organisation of B2B events and direct meetings with prime contractors. Provide platforms and opportunities for cross-border contacts between SMEs.

##### **(25) Support SMEs in combining forces to increase market power**

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<sup>25</sup> See, for example, the NMBP site for more information: <http://www.nmpteam.eu/welcome/>.



Various types of SMEs cooperation organisations, clusters, technological parks or project purpose groupings may ease and increase the chances of entering the supply chains of biggest system integrators, or of receiving a contract directly. It also decreases cost and increases chances of finding cross border business opportunities.

#### **(26) Providing support to defence SMEs and start-ups in their attempts to go international**

This can be done for example by providing grants to event organisers, proportionate to SMEs/start-ups participation and balanced for various defence sectors. This could help SMEs participation in international B2B meetings, business missions abroad, and other international events.

Possible instruments: EDA's Pilot Case on Modelling and Simulation SME Platform could constitute a good practice on enhancing the SMEs' networking.

In addition, the Commission will support European Strategic Cluster Partnerships in the area of dual use (call expected end 2016). The Commission is also promoting the use of the Enterprise Europe Network in support of defence-related SMEs. The Commission will facilitate the activities of the European Network of Defence-related Regions,<sup>26</sup> which should bring regional organisations and clusters together with the aim of networking and exchanging best practices in the area of dual use. The Commission should also promote the use of the European Cluster Collaboration Platform (ECCP)<sup>27</sup> to the benefit of defence clusters in Europe. The ECCP provides services to clusters, ranging from cluster mapping, matchmaking events and information on international cooperation.

#### **4.7. Standardisation and certification**

The use of divergent standards and burdensome procedures for the certification of military equipment, which vary greatly across Member States, makes defence procurement more difficult and more costly and creates barriers to cross-border trade.

As emphasised by the European Council in December 2013, "*developing standards and certification procedures for defence equipment reduces costs, harmonises demand and enhances interoperability*".

Through the EDA Materiel Standardisation Group (MSG), a system is in place for Member States to discuss the further evolution of standardisation of defence materiel in Europe, and in particular to identify the need for new defence standards and the most appropriate mechanism to develop them. The Commission has been working on the issue of hybrid standards for dual-use products to support security-related research.

With respect to certification, the EDA is currently taking forward a programme on certification for airworthiness of military products.

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<sup>26</sup> Just established service: [www.endr.eu](http://www.endr.eu)

<sup>27</sup> [www.clustercollaboration.eu](http://www.clustercollaboration.eu)

## **(27) Simplification and convergence of certification procedures**

The identification or development of common standards, as well as the simplification and convergence of military equipment certification procedures, could reduce costs and lower barriers to market entry. As one of the final effects, it could ease cross-border trade. This may also bring significant benefits in the context of fostering cooperative procurement.

Possible instruments: continue and, to the extent possible, further develop ongoing Commission and EDA work on standardisation and certification.

## **5. NEXT STEPS**

The Group considers that the Commission, in cooperation with EDA, should swiftly initiate wider discussions with all Member States and all relevant industry stakeholders (prime contractors, business associations, representatives of sub-suppliers and SMEs), on the basis of this report and its recommendations.

The objectives of these discussions should be: i) identifying the recommendations that can be supported and make concrete progress towards their implementation; ii) finding a broad agreement on the way forward in respect of any remaining recommendation; iii) in case additional proposals to facilitate cross-border market access for sub-suppliers and SMEs emerge during the discussions, assess them and explore the possible way forward for their implementation; iv) finding the appropriate means to monitor the implementation of the recommendations and to report thereon.