



**16.ESI.NP1.106:  
“Analysis of defence-related SMEs’ composition in EU”**

**Executive Summary**

**Prepared for:** The European Defence Agency (EDA)



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## Executive Summary

### Context

Engaging SMEs and optimising their participation in the defence-related supply chain is identified as a key enabler for competitiveness by the 2013 December European Council. The role of SMEs in the defence supply chain is also acknowledged by the European Commission Communication COM (2013) 542 entitled: “Towards a more competitive and efficient defence and security sector” and its related Implementation Roadmap. The increasing challenge for military planners is the speed with which requirements are changing. The struggle to keep pace with evolving requirements is creating a greater need for better future planning. However, this operational excellence must be delivered under increasing resource constraints. Harnessing the defence-related supply chain, horizontally and vertically, will be quintessential in ensuring sustainability and prowess in responding to such challenges, a task in which the SMEs play a pivotal role.

IHS understands that the EDA-led strategy for the EDTIB is a policy response to the shrinkage in defence spending among the EU Member States (MS) that aims to improve industrial collaboration to maximise military capability development in Europe. To aid the resilience of the EDTIB – and promote the European Defence Equipment Market (EDEM) – the EDA has developed a Supply Chain Action Plan. The core of the plan is to address supply chain related issues in a comprehensive manner through:

- Establishing a common understanding of the key elements surrounding the European Defence Supply Chain;
- Improving information sharing within the European Defence Supply Chain;
- Developing measures supporting the depth and diversity of European Defence Supply Chain;
- Developing measures enhancing the effectiveness of the European Defence Supply Chain; and
- Evaluating and monitoring the evolution of the European Defence Supply Chain.

As such, this project aimed to achieve following objectives from the recent study commissioned by EDA, 15.ESI.OP.029 ‘Support to the implementation of the supply chain action plan:

**Common understanding:** IHS supported the EDA to establish a common understanding of the European Defence Supply Chain and its key elements;

**Incentives to cooperation:** IHS identified and analysed potential incentives and measures for suppliers to open defence supply chains. IHS provided appropriate models for such measures, including efficient subcontracting.

### Study Approach and Deliverables

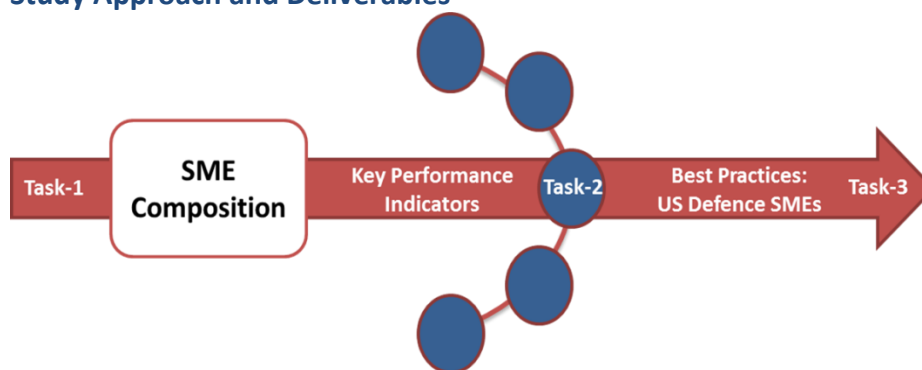


Figure 1: Study Deliverables. Source: IHS analysis

The study included three main tasks designed to enhance the visibility of SMEs participating in the defence-related supply chains across pMS); establish key performance indicators to measure SME

participation, and identify best practices in optimising SME participation across the US DoD. The three tasks are segmented as follows:

- **Task-1 SME Composition:** Achieve a better insight into and understanding of the SME composition in defence sector in the pMS
- **Task-2 Key Performance Indicators:** Define and establish a set of Key Performance Indicators (KPIs) against which the impacts of actions on defence-related SMEs can be measured
- **Task-3 Best Practices:** Identify key best practices on defence-related SMEs in the US.

### Applied Approach

IHS Jane's leveraged its vast market intelligence on defence related supply chains across the pMS, and further enhanced this with targeted secondary research. Specific interviews were conducted with industry participants and end-users to gather perceptions and validate analysis across the three tasks- ensuring the robustness of the research and analysis. Applied approach is summarised below:

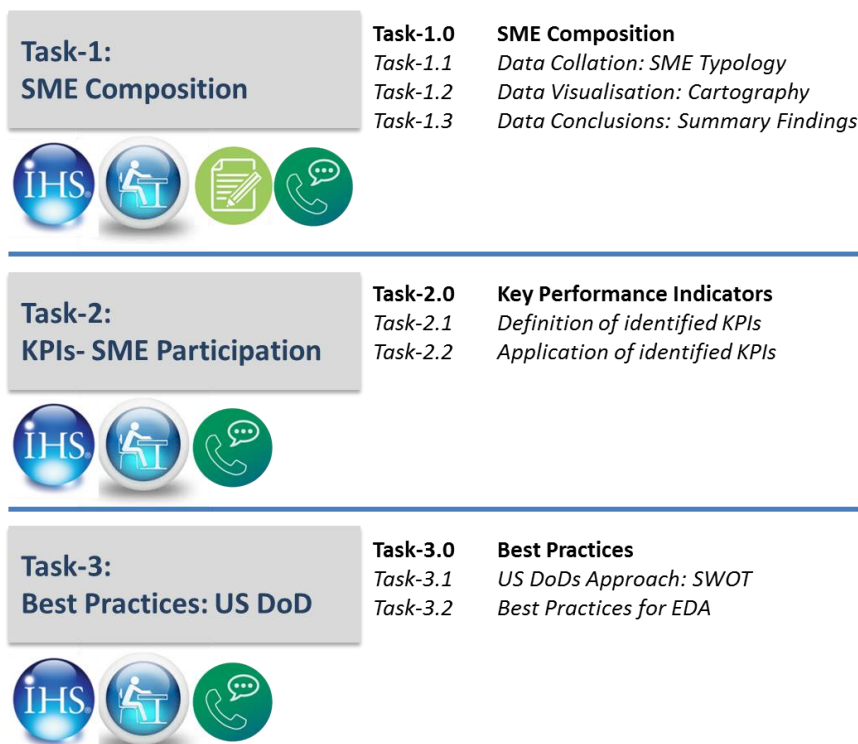


Figure 2: Study Approach. Source: IHS analysis

### Findings and Conclusions

The conclusions from the extensive research and analysis conducted by IHS Jane's experts across the three tasks are summarised in this section.

## Task-1: SME Composition

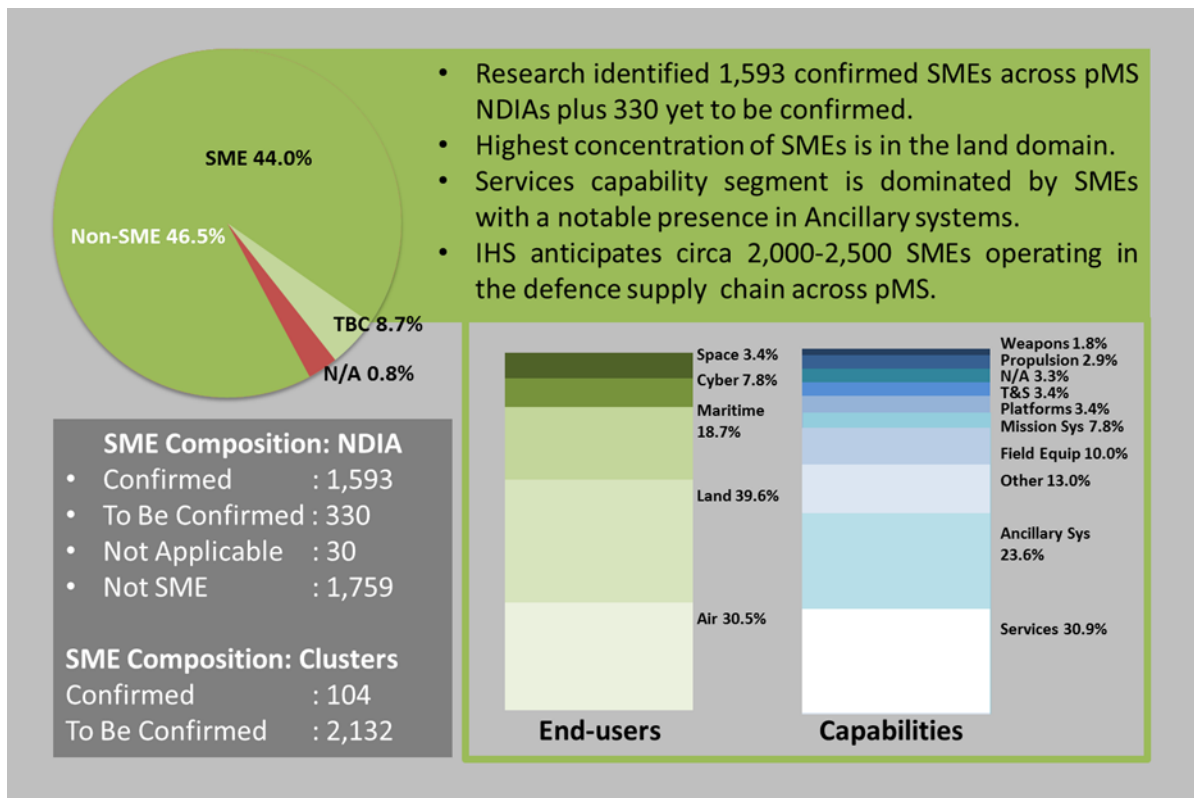


Figure 3: SME Composition Summary Overview. Source: IHS Analysis

In 2009, the European Commission published 'Study on the Competitiveness of European Small, and Medium-sized Enterprises (SMEs) in the Defence Sector', which identified 1,320 estimated number of SME members of aerospace and defence industry trade associations<sup>ii</sup>. This study identified, across NDIA alone, a fifth more SMEs than the 2009 European Commission study. Also, IHS research identified another hundred plus SMEs across the defence-related clusters, with a significant number of organisations as 'tentative' (to be confirmed).

Even though IHS Jane's has conducted a thorough research of NDIA members, and identified about 1700 SMEs across the NDIA and Clusters, there are more than 2,000 organisations that are yet to be confirmed. IHS Jane's understands that the true SME numbers operating in the EU defence supply chain is notably higher, circa 2,000-2,500.

SME engagement, in the long term, is expected to dictate the competitiveness of the defence sector-injecting a faster pace of technology uptake and obsolescence at an affordable price.

SMEs, unlike larger enterprises, are flexible, for commercial reasons need to, in pursuing and delivering business in multiple sectors. As such, SME count in a particular sector may tend to variate year on year.

### Recommendations (Task-1)

- IHS recommends that the typology is maintained as an ongoing process- updating SME information across NDIA and clusters.
- The Defence Procurement Gateway (Industry Directory) could potentially be tailored to capture this data.
- EDA and pMS are recommended to institute targeted campaigns towards attracting defence-related clusters. This will not only improve awareness of the supply chain but also diversify the supply chain with non-traditional suppliers from adjacent sectors.

- SME influx from across adjacent markets is now a necessity rather than a unique attribute- the digital battlefields of today (and future) need a more responsive and fast evolving supply base to match the rate of technological obsolescence [at an affordable price].
- EDA (and pMS) should introduce initiatives to attract SMEs from across these adjacent markets.

## Task-2: Key Performance Indicators

IHS research identified 10 KPIs for measuring SME participation across the pMS.

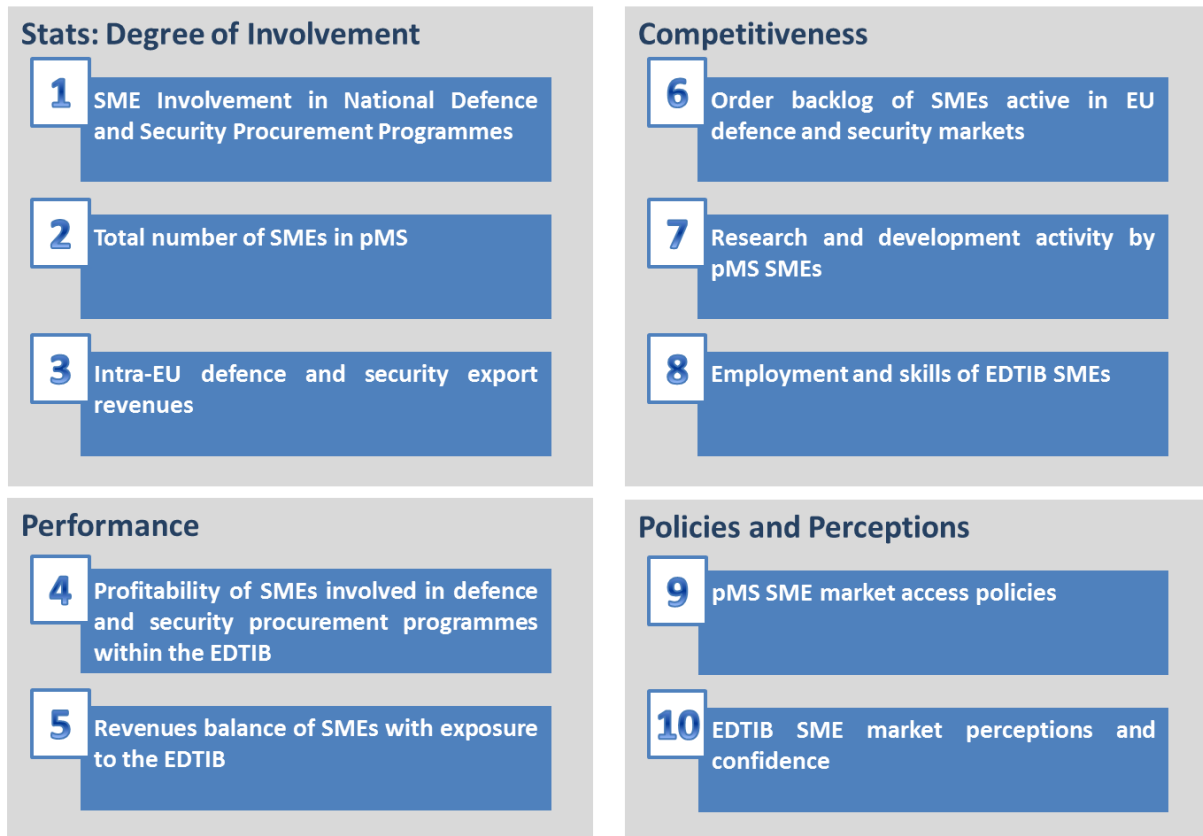


Figure 4: SME Participation KPIs. Source: IHS analysis

Key Performance Indicators (KPIs) are dependent on ability and access to collecting relevant data across a minimum required response threshold (which will be dependent on the audience size). pMS are crucial in defining and implementing such KPIs- provisioning base data collation in contractual terms are a possible example of instituting this in the process.

The response rate to surveys is expected to be low- a challenge that can be overcome through defined policies and processes to an extent, and more effectively through communications and incentives. As such, anonymous and impartial data collation and KPI analysis are a must-have. As such the process should be transparent, with regular updates without compromising or singling out data points (or organisations).

Benchmarking SME KPIs to adjacent markets/geographies helps benchmark performance and identifies avenues of improvement.

### Recommendations (Task-2)

- IHS recommends that pMS, to begin with, conduct an audit of the existing tools and mechanisms to measure SME participation. The assessed measures should be mapped across the identified KPIs.

- EDA should form a central node for creating a common picture of SME participation tools and mechanisms across the pMS.
- The concluded common picture should become the baseline for KPIs to collate and measure as a first step.
- Moving forward EDA, in consultation with pMS (and NDIAs and Clusters), should work towards a common KPI roadmap- with inbuilt incentives for industry participants.

### Task-3: Best Practices

The US does not have a single, fixed definition of a small business. Instead, business is defined as a small business regarding the number of employees over the prior year or average annual revenues over the past three years, and thresholds vary by industry. There are approximately 600 business classifications under the North American Industry Classification System. The US defence industry, similarly, is a vast and complex supply chain to navigate.

Even though direct migration of best practices from the US DoD to the European Union is assessed to be limited, IHS Jane's analysis has identified best practices for EDA/pMS to consider in enhancing SME participation across the defence supply chain.

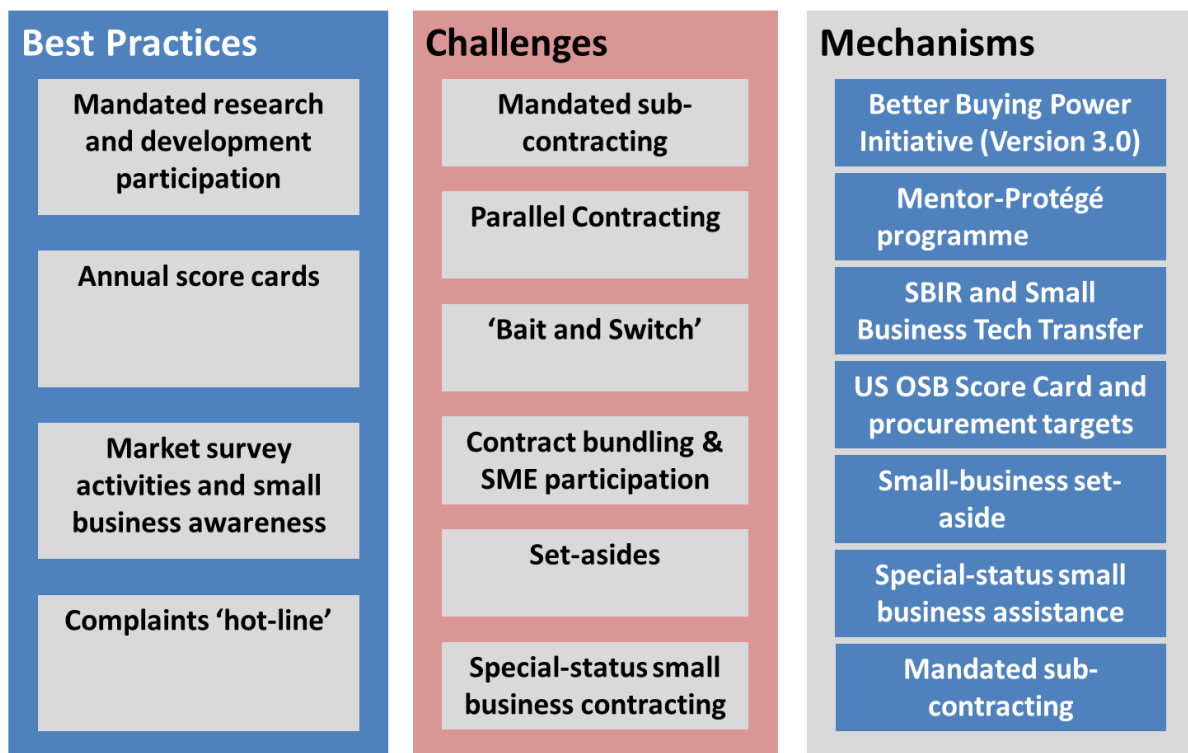


Figure 5: US DoD- Best Practices, Challenges and Mechanisms. Source: IHS analysis

### Recommendations (Task-3)

IHS Jane's identifies following recommendations for EDA and pMS to consider:

#### Recommendations for EDA

- EDA should encourage pMS to implement tools for monitoring and oversight of SME participation, ensuring that SME engagement processes (and targets) involving contracting plans are followed. However, specific approaches such as the HUBZone for defence programmes would be problematic within the EU given that national interest could override any approval of the regional development.

- EDA (and pMS) should consider the establishment of transparent complaints handling procedures to provide a faster and less formal tier below the procedures outlined in Directive 2009/81/EC to give SMEs a voice and formal (or broad-brush) grievance procedure on contract awards process.

#### **Recommendations for pMS**

- Declared SME participation targets (process defined, to begin with, but preferably legislated for continuity and effective implementation).
- Mandated subcontracting is a means of encouraging SME integration across the supply chain.
- Reward and recognition mechanisms: pMS (and EDA) should consider instituting a rewards and recognition program for contracts and contractors achieving SME targets.
- Auditing: pMS should institute measurable performance indicators in contract and supplier audits to overcome the challenges of parallel contracting.
- Communication: pMS should engage with and via NDIA's and Clusters to communicate SME participation initiatives, tools, and opportunities.
- Ease of Use: Processes and mechanisms put in place should consider ease of use (low bureaucracy and low costs), be accessible, be measurable, be secure and allow anonymity.
- Dynamic: IHS recommends a peer network that actively exchanges best practices and lessons learnt with interested pMS.



## End Note

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<sup>i</sup> <https://www.techuk.org/insights/news/item/7562-european-defence-agency-sme-advisors#sthash.cPzbGOal.dpuf>

<sup>ii</sup>

[https://www.google.co.uk/search?q=EC+SME+study+1450&rlz=1C1QJDB\\_enGB639GB639&oq=EC+SME+study+1450&aqs=chrome..69i57.5784j0j7&sourceid=chrome&ie=UTF-8#](https://www.google.co.uk/search?q=EC+SME+study+1450&rlz=1C1QJDB_enGB639GB639&oq=EC+SME+study+1450&aqs=chrome..69i57.5784j0j7&sourceid=chrome&ie=UTF-8#)