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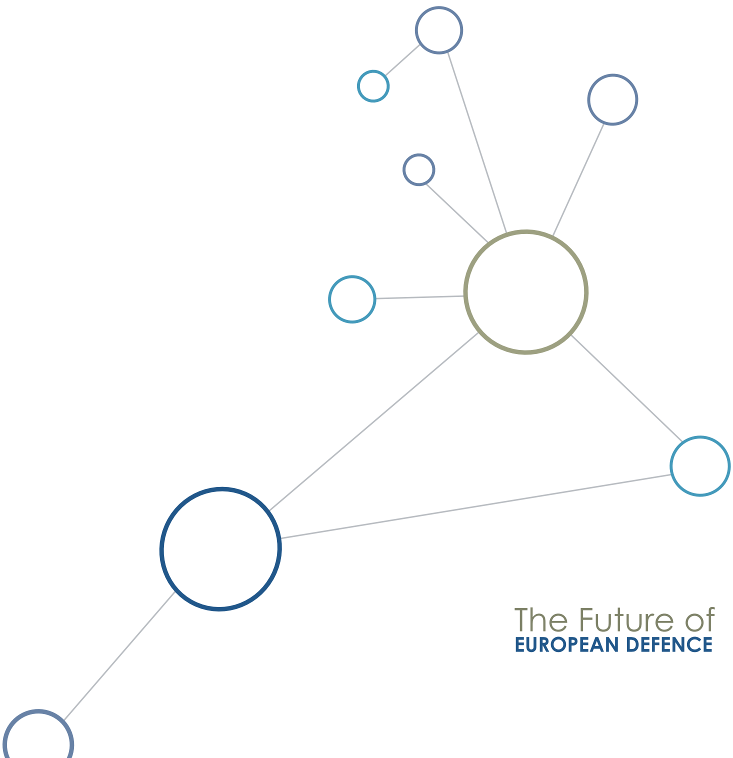
Aerospace & Defence

The Future of European Defence: Tackling the Productivity Challenge



The Future of
EUROPEAN DEFENCE

Executive summary

European defence faces an austerity challenge

A productivity imperative is arising from the widening gap between Europe's defence capability needs and its weakened finances. Efficiency gains must compensate for the financially mandated reduction of resources if governments are to achieve their stated level of ambition.

Pooling and sharing can help to secure level of ambition …

Some rather limited pooling of Europe's aggregate procurement spend is already done, but much more is possible. We estimate the long-term productivity potential at about 30 percent of total procurement, or about 7 percent of all military spending. In 2012, the potential annual savings would have been EUR 13 billion.

Sharing, or the joint use of a capability, offers further opportunities for productivity gains, in maintenance and other functions. For example, sharing the deep depot-level maintenance of 12 major aircraft platforms would yield an estimated savings potential of about EUR 500 - 600 million annually.

Pooling and sharing would also promote standardisation of Europe's highly varied equipment and platforms inventory; the resulting enhanced interoperability promises also to yield efficiency and effectiveness gains.

To realise this potential, issues of national sovereignty need to be addressed. Smart sharing models can avoid these sensitive questions. For example, shared equipment that is deployed with national rather than multinational forces can help maximise the potential whilst minimising loss of autonomy.

To be fully effective, pooling and sharing requires three major prerequisites: first, a process for joint capability planning has to be actively embraced. Second, transparency on procurement pipelines is required among partners. And third, an alignment of replacement cycles across collaboration partners has to be achieved. Possibly a European defence review could promote this process. This will take time to implement, with full gains only materialising over the medium to long term.

… but has to be complemented by national productivity levers

The benefits of pooling and sharing will take time to realise. To accelerate savings, national governments will need to optimise their discretionary spend in the short term. This is not about doing less (cutting), but about achieving a better ratio. A broad array of levers is available, including:

- Design-to-value approaches, lowering costs by optimising the definition of requirements in equipment design

- Improved contracting, for example by striking new deals in which equipment providers retain ownership of assets, and instead provide the customer with availability

- Improving basic procurement and maintenance through risk-adjusted approaches, possibly through public-private partnerships.

The industrial base also faces structural challenges

Europe's industrial base remains fragmented and in certain areas sub-scale.

- Europe deploys six times the number of different weapon systems as the US – even though it spends only 40 percent as much

- In 40 percent of defence sub-sectors, Europe has twice as many competitors as in the US.

Industry is likely to see further privatisation and consolidation as European Union directives increase the pressure to liberalise the industry. However, the path to consolidation is not straightforward:

- Notably, and in contrast to the US, around a quarter of Europe's top 30 defence companies have large government shareholdings

- Recent consolidation has focused on smaller players, with few mega-mergers

- The interplay of European and national legislation will shape the extent of future consolidation; several scenarios are possible and require industry to prepare appropriate contingent strategies.

Decisions on consolidation of both the supply and demand sides need to actively consider the implications on Europe's industrial competences. The uncertain outlook has led to a drain of defence specialists towards other areas. To the extent that Europe will require the sustainment of current skills (e.g. fighter jet skills required for developing UAVs), such a drain can only be stopped through large "structuring programmes".

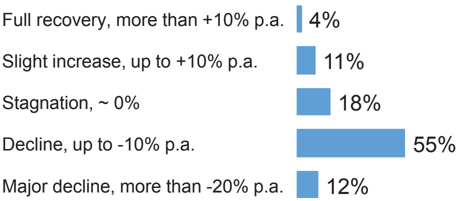
What leaders expect for the future of European defence*

At present there is a high degree of uncertainty about the future trajectory of European defence. A survey conducted during the Future of European Defence Summit, which took place in Berlin, 25 - 26 April, shows the perception of around 100 leading decision-makers from politics, the military and industry on five key aspects of the future of European defence.

How will the demand for European defence capabilities change in the medium to long term?

While a majority sees the demand for European capabilities increasing …

What are your expectations for the development of European defence budgets in the medium term in aggregate – compared to today's level?

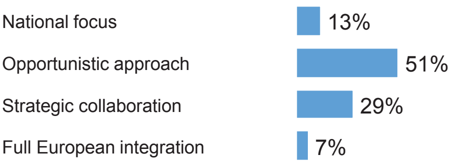


… two-thirds expect that defence budgets will decline significantly.

What is the main driver of pooling and sharing activities?

~ 75% see budgets and efficiency as the key drivers of pooling and sharing.

Which of the described scenarios do you believe best describes the future of European defence integration?



Despite this gap, 80% expect that defence integration will range from opportunistic to strategic cooperation – not full European integration.

To what extent do you believe that governments are willing to transfer sovereignty to multinational command structures?

Yet, more than 60% do think that a transfer of sovereignty is feasible for non-core capabilities – some 20% even imagine this for core capabilities.

* Q1 - 106, Q2 - 83, Q3 - 82, Q4 - 72 and Q5 - 82 answers

SOURCE: Survey at the Future of European Defence Summit, Berlin, 25 - 26 April (organised by the Munich Security Conference with McKinsey as knowledge partner)