

SEPTEMBER 2023



**RESTRUCTURING THE
EUROPEAN DEFENCE INDUSTRY:
CONSOLIDATION AND
INTERNATIONALISATION**

WRITTEN BY: FRANCESCO BARONIO



WRITTEN BY

FRANCESCO BARONIO

EDITED BY

STEF CLEMENT

SUPERVISED BY

GINEVRA BERTAMINI

Introduction

Defence constitutes a rather atypical industrial sector. Due to the sensitive nature of its products, it has long been strictly protected by states and 'placed outside the bounds of free-market economy' (Bitzinger, 1994, p. 172). Countries with a relevant industrial base have traditionally sought self-sufficiency in arms production for national security (Bitzinger, 1994). States' control over their domestic industry has frequently slowed or even hindered attempts at cross-border European cooperation (Alvarez-Couceiro, 2023). This has ultimately resulted in a significant fragmentation of the European defence industry (Alvarez-Couceiro, 2023).

Nevertheless, the European defence industry has been restructuring since the 1990s. Processes of consolidation and internationalisation have established European defence giants, such as Airbus, BAE Systems and Thales, capable of competing with their American counterparts (Kurc & Oktay, 2018). What is striking about this process is the driving role played by the industry itself (Bitzinger, 1994).

Accordingly, this Info Flash addresses the restructuring of the European defence industry by discussing its drivers, as well as the processes of consolidation and internationalisation that have increased inter-firm ties through mergers, acquisitions and joint ventures. To some extent, this piece constitutes a follow-up to a recent Info Flash written by François Barbieux about the fragmentation of the European defence industry. While this latter is mainly concerned with the political dimension at the national and European level, this Info Flash focuses on the industrial component.

Drivers to the Restructuring

Some driving factors that emerged after the end of the Cold War have sparked the restructuring of the European defence industry. First, in the 1990s, most European states had reduced their defence budget and purchase of defence products (Schmitt, 2000). Hence, Consolidating the defence market was identified as a possible way to address the shrinking demand (Kenny, 1999). Second, the seek for technological superiority provoked a rise in research & development (R&D) costs of weapons systems, causing also a drop in the number of programmes carried out (Schmitt, 2000). Hence, incentives emerged for industrial cooperation among firms to pool R&D costs and create economies of scale capable of reducing unit production costs (Schmitt, 2000).

The Revolution in Military Affairs (RMA) is strictly related to the former. It refers to integrating modern information and communication technology into warfare by developing weapons systems with cutting-edge electronics, information and telecommunications capabilities (Meijer, 2010). These technologies had further increased R&D costs and, therefore, created even more incentives for inter-firm cooperation. Moreover, these technologies' civil origin had given some non-defence companies an increasingly strategic role in defence (Schmitt, 2000). The growing role played by the civil industry in turn had progressively diminished the state's control over the defence industry (Schmitt, 2000). Consequently, the defence sector became increasingly subjected to the logic of the free market economy (Schmitt, 2000).

Lastly, defence giants from the United States (US), consolidated through a wave of mergers and acquisitions in the 1990s, had progressively outmatched European firms in terms of turnover (Meijer, 2010). Considering the impact of the other elements just outlined, European defence companies were 'too small to compete in technology or price with their US counterparts' (Steinberg, 1992). This required the European defence industry to restructure and increase its competitiveness (Steinberg, 1992). While these factors alone cannot account for the restructuring, they have played an important driving role for consolidation and internationalisation processes.

Consolidation at the National Level

Over time, the factors outlined in the former section have driven the European defence industry to restructure and increasingly subscribe to the logic of the free market economy (Schmitt, 2000). The role played by states has declined relative to the industry (Bitzinger, 1994). Moreover, transnational industrial cooperation became more widespread and structured (Bitzinger, 1994). Ultimately, this restructuring has resulted in processes that have enhanced inter-firm ties at the national and European levels.

The first process is national consolidation. Some firms progressively consolidated their control of a specific sector through mergers and acquisitions of other companies, ultimately creating "national champions" (Bitzinger, 1994). Consolidation is essential to reduce duplication, pool resources devoted to R&D and increase market shares (Schmitt, 2000). Nevertheless, depending on the country and sector, it has progressed at different speeds (Schmitt, 2000).

In Germany, Krauss-Maffei Wegmann (KMW) and Rheinmetall have concentrated the land sector. Rheinmetall has managed to do so by acquiring a range of German and European firms (Crunchbase, n.d.; Rheinmetall, n.d.). KMW was established through the merger between Krauss und Comp. and J.A. Maffei (Krauss-Maffei, n.d.) and the later acquisition of this new entity by Wegmann & Co. (KNDS, n.d.). Moreover, domestic acquisitions have allowed Daimler-Benz to create DASA and consolidate the German military aerospace and electronics industry (Steinberg, 1992; Dunne & Surry, 2006).

In France, the state-owned Nexter Systems, formerly GIAT Industries, has consolidated the land and ammunition sectors through domestic acquisitions (Steinberg, 1992; Schmitt, 2000). Instead, the 1990s restructuring has resulted in the duopoly of Aerospatiale-Matra and Dassault Aviation in the aerospace sector (Schmitt, 2000). Aerospatiale was privatised by the French government in 1998 and merged with the private Matra Hautes Technologies (Schmitt, 2000). However, since Aerospatiale-Matra's integration into Airbus, Dassault Aviation has concentrated the French aerospace sector. Moreover, the semi-private Thomson-CSF has consolidated the electronics sector by acquiring Dassault Electronique, Alcatel's space and electronics businesses and Aerospatiale's satellite business (Guay & Callum, 2002).

BAE Systems has concentrated large parts of the British defence industry through domestic acquisitions (Guay & Callum, 2002). First, British Aerospace brought together several firms in the aerospace sector in the 1970s (Dunne & Surry, 2006). By acquiring Marconi Electronic Systems, British Aerospace became BAE Systems in 1999 and unified the electronics sector (Schmitt, 2000). Moreover, BAE Systems consolidated the British land sector by acquiring the prominent tank manufacturer Alvis Vickers in 2004 (BBC, 2004).

The former Finmeccanica has largely consolidated the Italian defence sector (Schmitt, 2000). Its crucial position has resulted from its acquisition of the EFIM defence units (Leonardo, n.d.), part of Elettronica and part of Aermacchi (Steinberg, 1992). A corporate restructuring then renamed Finmeccanica as Leonardo in 2016, shifting the company's focus to developing aerospace and military capabilities (Fleurant et al., 2017).

Consolidation at the European Level

After undergoing national consolidation, defence companies have increasingly strengthened their cross-border ties, moving consolidation strategies to the European level (Meijer, 2010). European consolidation entails similar benefits to national consolidation, resulting in transnational acquisitions, mergers and joint ventures driven by the industry (Schmitt, 2000). It has also progressed differently from sector to sector (Schmitt, 2000). Unlike the aerospace and electronics sectors, in fact, European consolidation in the land sector is recent.

The most significant example of European consolidation is perhaps Airbus. National champions established through consolidation forged this transnational venture through a “merger of mergers” (Guay & Callum, 2002). In 1999, the German DASA merged with the French Aerospatiale-Matra establishing the European, Aeronautic, Defence and Space Company (EADS), which then integrated the Spanish Casa (Schmitt, 2000). Until 2006, the Airbus consortium was 80 per cent owned by EADS and 20 per cent by BAE Systems (Guay & Callum, 2002). Eventually, EADS purchased BAE Systems' shares (Gow, 2006) and changed its name to Airbus in 2014 (Parker, 2014). Therefore, without considering the UK, Airbus has largely consolidated the European aerospace defence sector.

Another relevant example is the missile manufacturer MBDA. The former Matra BAe Dynamics (MBD) was established as a 50-50 subsidiary of Matra and BAE Systems (Schmitt, 2000). It then integrated the missile businesses of Alenia Marconi Systems (AMS), a joint venture between Finmeccanica and GEC-Marconi (Schmitt, 2000). A merger of the main French, British and Italian missile systems companies established MBDA in 2001 (MBDA, n.d.-a). Due to Matra's integration into Airbus and Marconi's incorporation into BAE Systems, MBDA represents a joint venture between BAE Systems, Airbus and Leonardo (MBDA, n.d.-b). Eventually, MBDA also acquired LFK, the German missile subsidiary of Airbus (MBDA, n.d.-a). Hence, MBDA has successfully consolidated the missile sector at the European level, including the UK.

European consolidation in the land sector constitutes a more recent trend (Schmitt, 2000). The creation of KMW+Nexter Defense Systems (KNDS) proves that. After national consolidation led to the emergence of Nexter Systems in France and KMW in Germany, the two companies merged into KNDS in 2015 (KNDS, n.d.), creating the first trans-European defence company in the land sector. A further example is the establishment of Rheinmetall BAE Systems Land (RBSL). It represents a joint-venture that emerged as Rheinmetall purchased a 55 per cent stake in BAE Systems' combat vehicles business unit in 2019 (RBSL, n.d.). While European consolidation in the land sector has not resulted in a single player, transnational industrial cooperation has grown more structured and permanent throughout the last decade.

Internationalisation

Internationalisation occurs as companies attempt to expand into foreign markets (Bitzinger, 1994). While first limited to trans-border cooperation on specific programmes, it has gradually evolved in the establishment of more permanent structures through joint ventures, alliances and acquisitions of foreign firms (Schmitt, 2000). Like consolidation, internationalisation has progressed differently from country to country and sector to sector (Schmitt, 2000). The economic benefits of pursuing internationalisation include sharing costs and risks, gaining access to innovative foreign technologies, achieving economies of scale and penetrating foreign markets (Bitzinger, 1994).

Of particular interest is the internationalisation of European defence firms towards the US. Since the American defence market is bigger than the European one, acquiring American defence firms constitutes a way for European companies to gain access to a broader market and a higher demand (Perlo-Freeman & Sköns, 2008). Furthermore, the American defence sector is technologically more advanced, providing European defence firms access to innovative technologies without needing to develop them internally (Bitzinger, 1994).

BAE Systems has been particularly active in pursuing internationalisation through foreign acquisitions in the US. BAE Systems purchased two Lockheed Martin military electronics units in 2000 (Kopac, 2006). The decision to purchase Marconi itself was also related to Marconi's ownership of the American Tracor (Schmitt, 2000). Then, BAE Systems completed the strategic purchase of the American United Defense in 2005 (Dunne & Surry, 2006) and the American Armor Holdings in 2007 (Perlo-Freeman & Sköns, 2008). These last acquisitions, in particular, have made BAE System a global defence giant in the land sector.

Finmeccanica, now Leonardo, had also demonstrated an inclination towards internationalisation. In 2004, Finmeccanica purchased GKN's shares in AgustaWestland, a joint venture between the two companies (Aerocorner, nd.). Finmeccanica then purchased Selex, a joint venture between its Alenia and Marconi Systems, absorbing part of the British radar industry (Kluth, 2017). Furthermore, its 2008 purchase of the defence electronics firm DRS marked the first non-UK European major acquisition of an American company (Neuman, 2010).

After partially privatising and acquiring the Dutch Signaal in 1990, the French Thomson-CSF was renamed Thales (Kluth, 2017). It then purchased a range of British companies, most notably Racal (Kluth, 2017). More recently, Thales' purchase of Moog navigation aids business and Advanced Acoustic Concepts has further strengthened its presence in the US defence market (Thales Group, 2021, 2022). Therefore, Thales has successfully established itself as a global defence electronics provider.

Concluding Remarks

The wave of national consolidations throughout the 1990s and the more recent dynamics of European consolidation have contributed to reducing the fragmentation of the European defence industry (Schmitt, 2000). Nevertheless, a more integrated European defence industry does not directly address the lack of joint planning and procurement of defence capabilities among European countries. To comprehensively address fragmentation, the industrial dimension is not enough. Barbieux (2023) has effectively outlined how the political dimension at the national level still lags behind. However, Kluth (2017) finds that a more integrated defence industry has effectively reduced European governments' inclination to purchase national products vis-à-vis those developed elsewhere in Europe.

Ultimately, a more unified European defence industry is instrumental in achieving a more integrated Common Defence and Security Policy (CSDP). Integrating the European defence industry means standardising and reducing the number of systems and platforms procured by states and thus deployed by armed forces (Schmitt, 2000). This directly addresses the technical dimension of interoperability (Moon et al., 2008) and creates favourable conditions for national armed forces to operate jointly under the CSDP framework.

Furthermore, a more integrated European defence industry is better suited to compete globally (Schmitt, 2000). While the need to restructure emerged in the first place to face American firms' competition, European companies now face a wider array of industrial competitors. Therefore, establishing and strengthening European industrial ventures remains of utmost relevance.

References

- Aerocorner (n.d.). AgustaWestland. <https://aerocorner.com/manufacturers/agustawestland/>
- Alvarez-Couceiro, P. (2023, April 18). Europe At a Strategic Disadvantage: a Fragmented Defense Industry. Texas National Security Review. <https://warontherocks.com/2023/04/europe-at-a-strategic-disadvantage-a-fragmented-defense-industry/>
- Barbieux, F. (2023, September 1). Tackling the Issue of Fragmentation in the European Defence Industry. Finabel, European Army Interoperability Centre. <https://finabel.org/tackling-the-issue-of-fragmentation-in-the-european-defence-industry/>
- BBC (2004, June 4). BAE triumphs in tank firm battle. <http://news.bbc.co.uk/2/hi/business/3775713.stm>
- Bitzinger, R. A. (1994). The Globalization of the Arms Industry: The Next Proliferation Challenge. *International Security*, 19(2), 170-198. <https://doi.org/10.2307/2539199>
- Crunchbase (n.d.). List of Rheinmetall's 4 Acquisitions. https://www.crunchbase.com/search/acquisitions/field/organizations/num_acquisitions/rheinmetall
- Dunne, P. & E. Surry (2006). Arms production. In SIPRI (ed.), *SIPRI Yearbook 2006: Armaments, Disarmament and International Security*. <https://www.sipri.org/yearbook/2006>
- Fleurant, A., Kuimova, A., Tian, N., Wezeman, P. D. & Wezeman, S. T. (2017, December). The SIPRI Top 100 Arms-producing and Military Services Companies, 2016. SIPRI. <https://doi.org/10.55163/MXIP5627>
- Gow, D. (2006, September 7). BAE agrees sale of stake in ailing Airbus. *The Guardian*. <https://www.theguardian.com/business/2006/sep/07/theairlineindustry.travelnews1>
- Guay, T. & Callum, R. (2002). The transformation and future prospects of Europe's defence industry. *International Affairs*, 78(4), 757-776. <https://doi.org/10.1111/1468-2346.00278>
- Kenny, B. (1999). Change and cross-border activity in the European defence industry. *European Business Review*, 99(2), 115-124. <https://doi.org/10.1108/09555349910256854>
- Kluth, M. (2017). European defence industry consolidation and domestic procurement bias. *Defense & Security Analysis*, 33(2), 158-173. <https://doi.org/10.1080/14751798.2017.1302576>
- KNDS (n.d.). History. <https://www.knds.de/en/about-us/history/>
- Kopac, E. (2006). Defense Industry Restructuring: Trends in European and US Defense Companies. *Transition Studies Review*, 13(2), 283-296. <https://doi.org/10.1007/s11300-006-0117-9>
- Krauss-Maffei (n.d.). History. <https://www.kraussmaffei.com/en/about-kraussmaffei/history>

References

Kurc, C. & Oktay, S. (2018). Taking production relations seriously: the role of defence firms in armaments cooperation. *European Security*, 27(4), 469-489. <https://doi.org/10.1080/09662839.2018.1520699>

Leonardo (n.d.). History. <https://www.leonardo.com/en/about/history>.

MBDA (n.d.-a). History. <https://www.mbda-systems.com/about-us/history/#:~:text=MBDA%20was%20created%20in%20December,of%20technological%20and%20operational%20success>.

MBDA (n.d.-b). About Us. [https://www.mbda-systems.com/about-us/#:~:text=A%20joint%20venture%20of%20the,%25\)%20and%20Leonardo%20\(25%25\)](https://www.mbda-systems.com/about-us/#:~:text=A%20joint%20venture%20of%20the,%25)%20and%20Leonardo%20(25%25)).

Meijer, H. L. E. (2010). Post-Cold War Trends in the European Defence Industry: Implications for Transatlantic Industrial Relations. *Journal of Contemporary European Studies*, 18(1), 63-77. <https://doi.org/10.1080/14782801003638745>

Moon, T., Fewell, S. & Reynolds, H. (2008). The what, why, when and how of interoperability. *Defense & Security Analysis*, 24(1), 5-17. <https://doi.org/10.1080/14751790801903178>

Neuman, S. G. (2010). Power, Influence, and Hierarchy: Defense Industries in a Unipolar World. *Defence and Peace Economics*, 21(1), 105-134. <https://doi.org/10.1080/10242690903105398>

Parker, A. (2014, January 2). EADS changes name to Airbus. *Financial Times*. <https://www.ft.com/content/9e29cfb0-73be-11e3-a0c0-00144feabdc0>

Perlo-Freeman, S. & Sköns, E. (2008). Arms Production. In SIPRI (ed.), *SIPRI Yearbook 2008*. <https://www.sipri.org/yearbook/2008/06>

RBSL (n.d.). About Us. <https://rbsl.com/about/about-us>

Rheinmetall (n.d.). History. <https://www.rheinmetall.com/en/company/history/1981-1990>

Steinberg, J. (1992). The Transformation of the European Defense Industry: Emerging Trends and Prospects for Future U.S.-European Competition. *RAND Report*. <https://www.rand.org/pubs/reports/R4141.html>

Schmitt, B. (2000, July). From cooperation to integration: defence and aerospace industries in Europe. *EUISS, Chaillot Paper 40*. <https://www.iss.europa.eu/content/cooperation-integration-defence-and-aerospace-industries-europe>

References

Thales Group (2021, December 6). Thales completes acquisition of Moog navigation aid business. https://www.thalesgroup.com/en/worldwide/aerospace/press_release/thales-completes-acquisition-moog-navigation-aids-business

Thales Group (2022, July 27). Thales acquires full ownership of Advanced Acoustic Concepts (AAC). https://www.thalesgroup.com/en/worldwide/defence/press_release/thales-acquires-full-ownership-advanced-acoustic-concepts-aac