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Centres of Excellence – an opportunity for SMEs?

DRAFT

Food for Thought Paper

Small and medium enterprises are the key players on the European Industrial Map - they are bearers of flexibility, new and emerging technologies, and guarantees of progress; they are able to fill the niche gaps and to deliver required services and products on time. Due to their size, they are also vulnerable to the market turbulences and competition pressure; it is difficult for them to obtain access to the market, and to be provided with sufficient funding. These facts and reality have been widely recognised and therefore the European Commission has issued the Small Business Act aiming at supporting SMEs of all sectors. The Act, however, does not fully respond to the needs of those SMEs producing goods and services for the defence and security market.

The defence market is specific by its nature, its actors and goods and services produced and traded. It's also still fragmented. The governments play double roles – the customers and the regulators. They possess the means to influence the market. The support provided by the governments should be equally distributed to all stakeholders, in practical terms to the major prime contractors as well as to the SMEs, which possess the technology but lack resources needed to penetrate the market. Big companies - national leaders play a main role in the market, competing for big defence contracts and allocating the work-share within established supply chain, thus making it difficult for SMEs to access the market.

Clustering of the SMEs seems to be the need for survival in the current world-wide consolidation process of the defence industry. The benefits of clustering relate to the cluster ability to cover a larger part of the market and leveraging the SMEs competitiveness. A cluster can increase the member companies' visibility in the market and creates higher brand value while facilitating the participation in larger projects and to bid for Prime and sub-contract work that otherwise would be inaccessible for individual SME. It also provides innovation of the supply chain and significantly reduces time and cost to the market.

Furthermore a cluster approach can help solve common problems and attract additional funding.

Clustering should go hand by hand with the overall transformation and consolidation of the defence industry, especially in the eastern part of Europe, where the companies are oriented on support and modernization of the heritage equipment and they seek specialisation in niche capabilities. Most of those companies also possess limited research capacity and are dependent largely on government contracts.

Clustering may lead to creation of Centres of Excellence (CoE). Although the Centres of Excellence are not completely a new term in defence, there is no common view and understanding of this term – CoEs could be expertise providers (e.g. NATO-accredited CoEs), research entities, and clusters of regional subcontractors in primes' supply chains.

To facilitate the discussion, a following definition of CoE is proposed: **the industrial Centre of Excellence could be seen as an international cluster of companies and institutions, co-operating under specific and clearly defined arrangements, in a certain area of expertise in order to satisfy specific needs of the customer, and capable to deliver products in all phases of the life cycle of the required capability – research, development, design, production, support, and disposal. Whereas cluster is seen as an umbrella organisation for its independent members, CoE is a next step, binding companies in a more organised way.**

The lack of legal framework and clustering rules are often a crucial obstacle to clustering mentioned by the industry. There are no national rules or guidelines related to clustering and it's mostly developed on ad hoc basis, some lessons learned. Is there a possibility to model a creation of the industrial cluster/CoE? Various issues have to be taken into account here – admission procedures, Intellectual Property Rights, licences needed, quality performance, ensuring Security of Information and Security of Supply. What role can governments play in this process? Also, one needs to raise the issue of overcapacity – in case where participating companies have the same/or similar capabilities - and threats of counter – productivity (in cases of internal competition).

Moreover, a possible status of such CoE should be discussed. Will it be recognised as a separate, integral entity, able to bid for the contract?

Centres of Excellence may be seen as a cure for market distortions, e.g. offsets. The evolving use of offsets, as stated in the EDA's Code of Conduct on Offsets, should lead to development of industrial capabilities that are capability driven, world class competent and globally competitive. As a result, offsets should help shape the aspired EDTIB, notably by facilitating the development of globally competitive Centres of Excellence, developing depth and diversity including Small- and Medium-sized companies and avoiding unnecessary duplication.

In identifying existing hurdles and possible instruments and measures which could be of benefit for SMEs as important players in this field of defence business, one cannot ignore the financial issue. SMEs certainly face the problem to finance their operations, marketing and development. At this point the consideration should be given to the interest of banking sector in financing SMEs, and how their clustering would impact their capability to reach for loans. The attractiveness of the loans to the CoEs in the light of current "credit crunch" situation and stabilization of the sector should be considered. Impact of the government policies and co-financing capability is certainly a factor.

These questions and considerations should trigger the panel discussion during the conference.