

**Private equity as a key contributor to the
financing of companies in the defence sector**

To meet the capability needs of both national and European armed forces, companies operating in the defence sector must rise to the challenge of significantly ramping up production. However, this effort extends beyond defence - **it is fundamentally about safeguarding industrial and technological sovereignty.**

Financing the defence sector calls for a collective strategy, coordinated at both the European and national levels, and encompassing the full spectrum of corporate financing - from bank lending to equity investment.

Private equity, including venture capital, infrastructure, and private debt, plays a crucial role in supporting high-growth sectors experiencing profound transformation. In this context, **France Invest reaffirms its members' dedication to being key contributors** in this momentum, working closely with manufacturers, public authorities, and their investors, and actively engaging in industry dialogue, with the aim of reinforcing European sovereignty and global competitiveness, while fostering the emergence of a more robust and resilient defence industrial base.

Four categories of companies should be addressed as a priority to meet their financing needs: (i) venture, up to late stage, to target new technologies, (ii) companies eligible for private equity, with strong growth or a hybrid model enabling them to benefit from equity and/or debt, or with prospects of consolidating their ecosystem (iii) companies stable but with no organic growth, which need non-dilutive long-term financing, for example in the form of bonds, and (iv) infrastructure.

Key figures on the support of French private equity players to businesses in the defence sector

With **€4 billion invested in equity between 2020 and 2024**, French private equity already plays a key role in supporting strategic sectors, notably the defence sector. Today, it is estimated that **20% of companies in the sector which are members of various defence associations benefit from financing through members of France Invest**, involving a total of 124 active funds.

- Among 828 companies in the defence sector, **181 are backed by at least one private equity player** as at end 2024
- **124 French private equity players** support these companies
- 70% of them operate in the industrial goods and services sector
- 30% are startups, **70% are SMEs and midcaps**

- Regional diversity: 56 are in Ile de France, 23 in Occitanie, 23 in Auvergne Rhone Alpes and 17 in Nouvelle Aquitaine
- **EUR 9.4 bn has been invested since 2003 and EUR 4.1 bn has been committed since 2023**

1°) Private equity is a decisive asset for strengthening the equity capital of strategic companies

Rising geopolitical tensions and the accelerating capability requirements of national and European armed forces are creating a dynamic that offers significant growth prospects for companies in the defence sector, especially the startups, SMEs and mid-caps which underpin the architecture of this vital industrial ecosystem.

In this context, private equity funds can play a key role. **By providing resources tailored to the particularities of this crucial sector, and supporting companies as they grow, private equity enables defence companies to innovate, structure themselves and guarantee their independence and sustainability** in the face of increasing competition.

A study by the European Commission (January 2024), in fact, estimates that significant needs remain to be covered: 40% of European SMEs in the defence sector find access to any type of financing difficult or very difficult, and the equity financing gap is estimated at between 2 and 5 billion euros, a figure we believe to be underestimated. Added to this is a significant gap with the United States, where financing for the sector is much more structured and where private equity and venture capital funds dedicated to defence are more numerous, encouraging innovation and industrial consolidation.

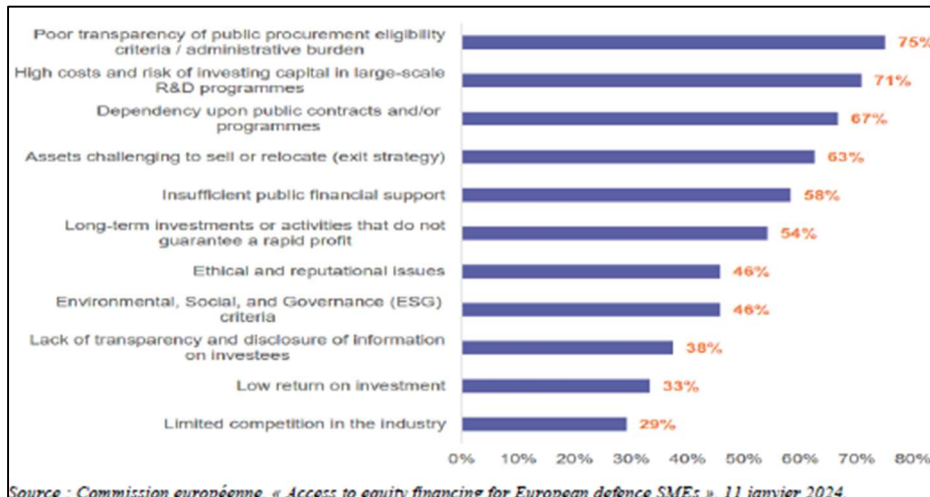
2°) France Invest's beliefs

- **Private equity has a key role to play in strengthening the Defence Industrial and Technological Base** as it offers solutions that are suited to long industrial cycles and the specific characteristics of the sector, in a context of accelerating expenditures, the development of our innovation capabilities, and increased demands on industrial tools.
- **The stronger integration of defence into responsible investment strategies is possible**, taking into account its role in sovereignty and economic stability.
- **A deeper dialogue between finance and industry should be structured**, to improve understanding of needs and to develop appropriate financing solutions.

3°) Challenges to address

- a. **Obstacles to investment in the defence sector need to be tackled.**

The Commission identified the following barriers to investment in the defence sector:



We identified the following main obstacles to investment in the defence sector which need to be tackled:

- **Regarding institutional investors:**
 - The image of the defence sector can sometimes be misunderstood, notably due to restrictive ESG policies.
 - Policies of foreign institutional investors that exclude defence from their investment funds (e.g.: some US institutional investors request the exclusion of defence companies from their investments outside their own country).
 - Recent developments, such as the easing of European Investment Bank (EIB) rules in May 2024, are taking time to trickle down the entire investment chain.
- **Regarding retail investors:**
 - Interest in defence financing exists, but incentive tools remain limited.
- **Regarding asset management companies:**
 - A complex market, with few procuring customers, sometimes lengthy exit strategies, and a lack of liquidity in certain segments.
 - Limited supply in mid-caps and large-caps, with investments concentrated on start-up opportunities.
- **Regarding businesses:**
 - Poor understanding of private equity financing mechanisms.
 - SMEs backed by VC/PE may not benefit from the same public support as other SMEs due to an inadequate definition of SMEs.
 - Difficulties in structuring fund-raising, particularly in the context of business transfers.

b. A deeper, more structured financing ecosystem at national and European level needs to be built.

Financing the defence sector requires a tailored approach, taking into account the central role played by funds in supporting company growth, investing in industrial facilities and consolidating the sector.

- **Supporting company growth:** private equity funds play a key role in helping innovative companies to scale up, by providing them with the capital they need to accelerate their development.
- **Investing in industrial facilities:** as in other strategic sectors, private equity funds help to modernise infrastructures and optimise production.
- **Promoting consolidation:** the defence sector in Europe still suffers from considerable fragmentation. Private equity funds have a structuring role to play in supporting mergers and creating critical players capable of competing internationally. The ecosystem needs to be strengthened at European level.

These challenges are comparable to those in other industries where private equity already support transformations (energy, healthcare, aeronautics). This dynamic should now be reinforced in the defence sector.

4°) France Invest proposals and actions

France Invest launched in France a “Defence Financing” Working Group counting over 150 members: private equity players are ready to take up the challenge, mobilise and stimulate the ecosystem. This work articulates around 4 main proposals:

a. Remove regulatory obstacles to investing in the defence sector

- Redefine a **clear and transparent investment framework** to support companies in the defence sector. This could be accompanied by the introduction of a “defence pact”, offering a counterpoint to institutional investors imposing systematic or excessively vague exclusion clauses in the sector. Encourage **promotional banks** to adopt a policy not to invest in funds with such clauses, such as what is done in some Member States.
- Introduce “**capital accounts**” in Member States where they are currently unavailable, to allow investment funds to offer their foreign institutional investors the possibility to opt out of investments in the defence sector would they wish to do so.
- Revise the **definition of SMEs** so that SMEs backed by VC/PE can benefit from the same public support as other SMEs. Conditions to access State aid are particularly important for EU start-ups and scale-ups. Attention should be paid to the discriminatory regulatory treatment of start-ups and scale-ups which are backed by venture capital in order to ensure that they can benefit from the same advantages as other SMEs with regards to public subsidies. This is particularly critical with respect to SMEs in the defence sector, which should not be forced to choose between State aid and private financing instruments to the exclusion of the other.

b. Encourage more private and institutional savings to be channeled into the defence sector

- **Review investors' investment doctrines** and remove the investment constraints which, to date, are perceived as the main obstacle to financing the defence sector.
- Develop an **automatic and flexible “sovereignty” label** enabling individual investors to channel some of their savings in life insurance or pension schemes into investment funds which support the financing of defence companies and/or companies contributing to our sovereignty.
- Encourage the **emergence of sector-specific funds**. It is necessary, but not sufficient, to support a few specialized defence funds (including for typical sectors or cyber /deeptech).

c. Develop a deeper, better structured financing framework

- Encourage the creation of **“sovereignty” strategies** beyond defence. The development of more funds committed to defence is essential, but it can also be part of a broader approach to investing in economic sovereignty. Encouraging the emergence of a sovereignty strategy within generalist and specialized funds would help attract investors with a variety of sensibilities, reinforce the rationale of economic and technological resilience, and facilitate exits. A complementary approach made up of specialized players and generalist funds capable of intervening in these areas is necessary to create a critical mass of European investors.
- Create **local vehicles** (funds of funds, secondary funds...) or **launch a Tibi-like initiative** in the sovereignty sector to leverage existing financing or develop new opportunities (non-dilutive financing, etc.).
- Structure a **more dynamic exit ecosystem**. The limited number of strategic investors in a position to consolidate their ecosystems makes it difficult to sell supported companies, limiting the liquidity of the investments made. Indeed, the - legitimate - control of foreign investment by Member States, or in the future via coordination at European level, the particular context of the sector, with a low number of principals and limited number of customers (States) as well as a low number of stock market listings, further hamper divestments. Intra-European acquisitions and initial public offerings (IPOs) of companies in the defence sector should be facilitated.

d. Strengthen the dialogue between finance and industry

- **Bring defence companies and investors together**, and inform companies about the challenges of equity financing, to better prepare them to structure their fundraising (equity or quasi-equity).
- Set up a **defence investment observatory**, to monitor financing trends and identify priority segments.

Conclusion

Private equity players are committed to supporting the growth of the defence sector and strengthen France's and Europe's industrial and technological sovereignty by assisting companies at every stage of their development, while responding favorably to the increased mobilisation of their institutional investors.

The investment ecosystem will have to be deepened, financial tools adapted and synergies between finance and industry strengthened.

Private equity funds have a key role to play in this dynamic, supporting growth, investing in industrial facilities and consolidating the sector, as they are already doing in other strategic industries.

With a better structured framework and collective mobilisation, France and Europe will make the defence sector more robust, innovative and competitive on a global scale.