

Defence Committee

Foreign Involvement in the Defence Supply Chain

Fourth Report of Session 2019–21

HC 699



Defence Committee

Foreign Involvement in the Defence Supply Chain

Fourth Report of Session 2019–21

HC 699

Report, together with formal minutes
relating to the report

Ordered by the House of Commons
to be printed 9 February 2021

Published on 14 February 2021
by authority of the House of Commons

The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies.

Current membership

[Rt Hon Tobias Ellwood MP](#) (*Conservative, Bournemouth East*) (Chair)

[Stuart Anderson MP](#) (*Conservative, Wolverhampton South West*)

[Sarah Atherton MP](#) (*Conservative, Wrexham*)

[Martin Docherty-Hughes MP](#) (*Scottish National Party, West Dunbartonshire*)

[Richard Drax MP](#) (*Conservative, South Dorset*)

[Rt Hon Mr Mark Francois MP](#) (*Conservative, Rayleigh and Wickford*)

[Rt Hon Kevan Jones MP](#) (*Labour, North Durham*)

[Mrs Emma Lewell-Buck MP](#) (*Labour, South Shields*)

[Gavin Robinson MP](#) (*Democratic Unionist Party, Belfast East*)

[Rt Hon John Spellar MP](#) (*Labour, Warley*)

[Derek Twigg MP](#) (*Labour, Halton*)

Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.parliament.uk.

Publications

© Parliamentary Copyright House of Commons 2021. This publication may be reproduced under the terms of the Open Parliament Licence, which is published at www.parliament.uk/site-information/copyright-parliament/.

Committee reports are published on the Committee's website at <https://committees.parliament.uk/committee/24/defence-committee/> and in print by Order of the House.

Committee staff

Matthew Congreve (Second Clerk), Mark Etherton (Clerk), Dr Greg Hannah (Committee Specialist), Sascha Sajjad (Committee Operations Officer), Ian Thomson (Committee Specialist), Sarah Williams (Committee Operations Manager) and George Woodhams (Committee Specialist).

Contacts

All correspondence should be addressed to the Clerk of the Defence Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5745; the Committee's email address is defcom@parliament.uk. Media inquiries should be addressed to Joe Williams on 020 7219 8878 | 075 4651 7626 or Toni McAndrew-Noon on 075 6243 5286.

You can follow the Committee on Twitter using [@CommonsDefence](https://twitter.com/CommonsDefence).

Contents

Summary	3
Our Inquiry	5
The Extent of Foreign Involvement in the Defence Supply Chain	7
Defining a ‘Defence Supply Chain’ and ‘Foreign Involvement’	7
The Ministry of Defence’s current approach and the extent of foreign involvement in UK Defence	9
Differentiating between friendly and hostile foreign involvement	11
Legislation limiting Foreign Involvement	17
The Enterprise Act 2002	17
The National Security and Investment Bill	18
The role of the Ministry of Defence in the new system	20
Venture Capitalism	21
Impact on Foreign Direct Investment	22
The impact of COVID-19 on the Defence Supply Chain	24
The impact on finances	24
Assessing Ministry of Defence support to industry	26
The impact on global supply chains	28
Efforts to reform the supply chain	28
Conclusions and recommendations	30
Sub-Committee Formal minutes	33
Committee Formal Minutes	34
Witnesses	35
Published written evidence	38

Summary

This report details our inquiry into foreign involvement in the defence supply chain, launched following the early stages of the COVID-19 pandemic and intended to scrutinise the vulnerability of the UK's defence supply chain to undesirable foreign involvement.

We found that, no matter how defined, foreign involvement in defence is widespread, with the UK hosting a broad range of UK-based and international suppliers. This results from the Ministry of Defence's approach of encouraging inward investment as one of its primary means for delivering value for money, an approach that is matched across Government. We recognise that this approach has brought some benefits to the UK defence industry and the wider economy.

However, we felt it important to recognise that any foreign domiciled company, or subsidiary owned by a foreign domiciled company, will be subject to influence from outside the UK. Whilst the evidence suggested that most investments are from close allies and are to be welcomed, there were a number of investments which were concerning. The Ministry of Defence's open and country-agnostic approach has meant that the defence supply chain has been open to potentially hostile foreign involvement, with reports of companies being owned and influenced by foreign Governments whose values and behaviours are at odds with our own and who are known to engage in intellectual property theft. Our report lists seven companies operating within UK defence that have been acquired by Chinese companies in recent years. We recommend that the Minister of Defence publish a list of countries it considers friendly and from whom investment should continue. However, all those countries falling outside of this list should be barred from investing in the UK's defence supply chain, including China and Russia.

This report also explored a number of related issues. In particular, we express concerns following reports that the Ministry of Defence have purchased second-hand Chinese equipment and recommend that the purchase of equipment from China for use by the Armed Forces should not be considered as a viable option. We also express concerns at the relative indifference of the Ministry of Defence in 2018 and 2019 to the

possible relocation outside of the UK of General Electric's Rugby facility and recommend that the Ministry of Defence should prioritise the maintenance of sovereign capability within the UK defence industry.

During our inquiry we also examined the National Security and Investment Bill, concluding that it will offer greater protection to the UK's economy and therefore has our support. We were content that the 'Investment Security Unit' should sit within the Department for Business, Energy and Industrial Strategy and recommend that the Ministry of Defence, alongside other departments and agencies, should proactively feed into all relevant assessment processes. Should the regime be implemented efficiently, we were content that it will have little to no harmful impact on foreign direct investment to the UK defence supply chain, only preventing investment that is undesirable.

We also examined concerns that the COVID-19 pandemic could leave companies operating in the UK defence supply chain vulnerable to foreign bids and therefore assessed the support given by the Ministry of Defence to businesses at this time. We found that the defence industry has remained broadly resilient through this period and that the Ministry of Defence has provided substantial support. Unfortunately, we heard that this support has not always reached its intended beneficiaries or had the intended consequences and call on the Ministry of Defence to improve its communication with small and medium sized businesses. We also found that the commercial aerospace industry remains particularly vulnerable and that there are close links between this industry and the defence supply chain. We therefore recommend that the Ministry of Defence consider what more it can do to support businesses that operate here, particularly small and medium sized enterprises.

Finally, we examined the impact of COVID-19 on the global supply chain, recognising that the defence and security sectors are heavily reliant on global supply chains for raw materials and components. We conclude that global supply chains for defence represent a vulnerability, especially when these supply chains include countries not closely aligned with the UK. The Ministry of Defence should therefore set out how it is proactively supporting efforts from defence businesses to seek domestic alternatives for supply and to shorten supply chains.

Our Inquiry

1. On 30 July 2020 we launched an inquiry into foreign involvement in the defence supply chain.¹ Following the early stages of the COVID-19 pandemic, the inquiry was intended to scrutinise the vulnerabilities of the UK's defence supply chain to undesirable foreign involvement. Our initial call for evidence asked:
 - What is the current extent of foreign ownership of the UK's defence and security sectors?
 - What has been the impact of the COVID-19 pandemic on the defence and security supply chain, particularly the finances of SMEs?
 - Under what circumstance will the Government currently intervene to prevent foreign takeovers in these sectors and what changes does the planned National Security Investment Bill make?
 - Are additional measures required to protect UK Defence and Security technological advances?
 - How does the UK's regime compare internationally and what can the UK learn from its allies?²

We have published the written evidence received on our website and have engaged privately with a number of stakeholders.³ On 4 November 2020 the Committee agreed that the inquiry would be taken forward by its Sub-

1 Defence Committee, 30 July 2020, [Defence Committee launches inquiry into foreign involvement in the Defence supply chain](#)

2 Defence Committee, Foreign Involvement in the Defence Supply Chain, [Call for evidence](#)

3 Defence Committee, Foreign Involvement in the Defence Supply Chain, [Written Evidence](#)

Committee, to be chaired by Richard Drax MP.⁴ Evidence sessions took place on 9 November 2020, 23 November 2020 and 14 December 2020.⁵ We are grateful to all who contributed to the inquiry and shared their insights with us.

4 Defence Committee, 4 November 2020, [Defence Committee has launched its Sub-Committee on Foreign Involvement in the Defence Supply Chain](#)

5 Defence Committee, Foreign Involvement in the Defence Supply Chain, [Oral Evidence](#)

The Extent of Foreign Involvement in the Defence Supply Chain

Defining a ‘Defence Supply Chain’ and ‘Foreign Involvement’

- 2.** It is important to recognise, as the Ministry of Defence’s (MOD) written evidence points out, there is no single recognised definition of the ‘defence sector’ and that there is no ‘defence’ category in the Standard Industrial Classification used for national statistics purposes’. In addition, organisations contracted by the MOD are active in a wide range of different business sectors, including, for example, construction, facilities and estates management, and IT. Many of these organisations obtain only a minority of their revenue from defence customers.⁶ However for the purposes of this inquiry we consider a broad definition desirable, and define the defence supply chain as any companies contracted by the MOD or the Armed Forces to provide a service, with a particular focus on those providing materials to military equipment programmes.
- 3.** Defining foreign involvement is similarly difficult, as it can be complicated to determine an organisation’s status as foreign owned or not. The MOD told us that the majority of its top suppliers by spend are Public Limited

⁶ Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 1

Companies, with diverse international shareholder bases, and shares freely traded on the stock exchange. This means that companies of this type are predominantly privately owned by shareholders from the UK and across the rest of the world. Airbus' written evidence illustrated the point that private ownership of the defence supply chain is widespread: they argued that whilst several countries maintain ownership stakes in companies supplying their defence and security needs, private ownership usually exceeds the stake owned by states. Airbus is 74% privately owned, with French and German national investment funds owning 11% each and Spain having a 4% stake.⁷

4. In addition, many overseas domiciled suppliers to Defence have UK registered subsidiaries, which may be members of UK trade associations, and which contract directly with the MOD.⁸ The MOD's evidence further added that privately held companies are more common in the lower tiers of the defence supply chain and that information on their ownership is not so readily accessible, making it more difficult to clearly define whether they are subject to foreign involvement.⁹
5. Foreign involvement also extends beyond ownership into links between companies and Governments. During the course of our inquiry we heard evidence about links specifically between the Chinese state and Chinese companies, with Francis Tusa, Editor of Defence Analysis, explaining that China's commercial companies and its military (as a part of its Government) are "inextricably linked".¹⁰ Even amongst liberal democracies, such as the United Kingdom, there is close collaboration between the defence sector and the Government and military, for example through loaning of staff.¹¹
6. It is difficult to define what constitutes foreign involvement in the UK defence supply chain. However, regardless of the level of foreign ownership or the closeness of a company's relationship with another Government, any foreign domiciled company, or subsidiary owned by a foreign domiciled company, will be subject to influence from outside the United Kingdom.

7 Written evidence submitted by Airbus ([FSC0004](#)), 2 October 2020, paragraph 2.3

8 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 2

9 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 3

10 Francis Tusa, Editor, Defence Analysis ([Q49](#))

11 See, for example: Ministry of Defence, 3 April 2019, [Defence Minister and industry leaders commit to closer collaboration](#)

The Ministry of Defence's current approach and the extent of foreign involvement in UK Defence

- 7.** MOD doctrine appears to be that ownership, country of domicile, or links to foreign governments are not a concern or consideration in its approach to industry and contracting. Huw Walters, Director, Economic Security and Prosperity at the MOD, told us that the MOD “very much welcome foreign investment” and its evidence stated that its current approach continues to draw on definitions set out in the 2002 Defence Industrial Policy, which described the UK defence industry as:

“Embracing all defence suppliers that create value, employment, technology or intellectual assets in the UK. This includes both UK and foreign-owned companies.”

and:

“The UK defence industry should ... be defined in terms of where the technology is created, where the skills and the intellectual property reside, where jobs are created and sustained and where the investment is made.”¹²

- 8.** ADS Group, the trade organisation for companies operating in the UK Aerospace, Defence, Security and Space sectors, noted that the UK Government has pursued international competition as a primary means for delivering value for money.¹³ This is echoed by Jag Patel, a researcher focusing on procurement matters, who argued that the Government’s approach to foreign investment was motivated by a desire to enhance the competitiveness of the defence market and increase value for money.¹⁴
- 9.** This approach has meant that foreign involvement, no matter how defined, is widespread in the UK defence industry. The UK’s defence and security sectors host a broad range of UK-based and international suppliers, headquartered in a range of countries.¹⁵ Andrew Kinniburgh, Director General of NDI, told us that foreign ownership is relatively widespread in defence at 19%.¹⁶
- 10.** The MOD provided an overview of its most significant suppliers, outlining the country of domicile, key stakeholders, percentage of UK ownership of shares

12 Huw Walters, Director Economic Security and Prosperity, Ministry of Defence ([Q125](#)) and Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 2

13 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 2.1

14 Written evidence submitted by Jag Patel ([FSC0003](#)), 2 October 2020, paragraph 2

15 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 2.1

16 Andrew Kinniburgh, Director General, NDI ([Q4](#))

and the percentage of their total revenue which comes from the UK.¹⁷ This information showed that ten of the UK's top twenty-three defence suppliers by MOD spend are domiciled in the UK. Eight of the others are domiciled in the United States, with one each domiciled in the Netherlands, Italy, Spain, France and Japan. The average percentage UK ownership across these companies, where data was available, was 17.7%.

- 11.** We were told that this approach of encouraging inward investment has brought many benefits to UK defence and the wider economy. ADS Group's written evidence argued that most defence and security suppliers to the UK national security community invest in the UK on a long-term basis. ADS Group argued that these organisations contribute significantly to the UK's national prosperity by establishing UK businesses, investing in the local economy and creating jobs and fostering research and development activities.¹⁸ Their evidence additionally claimed that international involvement enables greater opportunities for trade and strengthening ties with the UK's allies.¹⁹ Andrew Kinniburgh told the Committee that the UK has "benefited hugely" from foreign direct investment.²⁰ Jeremy Quin MP, the Minister for Defence Procurement, echoed these comments arguing that foreign companies invest strongly in skills, research and development, apprenticeships and generate jobs in the UK.²¹ Huw Walters added that these companies generate intellectual property in the UK and are a positive for other companies in the UK supply chain as "it gives them a route to market and easier access to some of the primes".²²
- 12.** The Minister for Defence Procurement made the point that the MOD's approach to encouraging inward investment is reflected across Government:

"I think there has just been a general UK willingness to see foreign direct investment across our industries. That is something that we have obviously gained from as a country, and that is global Britain at work."²³

- 13.** As a result of the Ministry of Defence's approach of encouraging inward investment, foreign involvement in the UK defence supply chain is widespread, with the UK hosting a broad range of UK-based and international suppliers. This approach has brought many benefits to the UK defence industry and wider economy.

17 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, p12-13

18 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 2.2

19 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 2.3

20 Andrew Kinniburgh, Director General, NDI ([Q108](#))

21 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q125](#))

22 Huw Walters, Director Economic Security and Prosperity, Ministry of Defence ([Q125-129](#))

23 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q129](#))

Differentiating between friendly and hostile foreign involvement

- 14.** It is, however, necessary to distinguish between friendly foreign involvement, that from our closest allies, which brings benefits to the UK defence and to the economy more broadly, and hostile foreign involvement, which brings risks to the UK's national security.
- 15.** We heard concerns relating to disruption of the supply chain for sensitive technologies or capabilities. MOD evidence accepted that certain types of foreign investment in companies with sensitive technologies or capabilities or within the UK's Critical National Infrastructure can raise national security concerns.²⁴ Specific concerns have been articulated about the involvement of companies linked to states such as China, which could result in British high-technology and equipment featuring in foreign military technology. Elisabeth Braw, a defence industry analyst formerly at RUSI and now with the American Enterprise Institute, argued that cutting-edge tech takeovers are a strategic threat to the West.²⁵ She told us about two of China's strategies—Made in China 2025 and Military-Civil Fusion—which mean that it seeks to incorporate civilian innovation into the defence supply chain to improve its own defence industrial capabilities and, by extension, its own armed forces.²⁶ She explained that Chinese companies therefore started investing in Western companies to get access to their innovations. Francis Tusa added that commercial companies and the military are “inextricably linked” in China: “In everything China is doing ... it will end up in the defence sphere.”²⁷ ADS Group highlighted another national security concern, that hostile foreign ownership can pose a risk to the UK's international supply chains by disrupting industrial support to the UK's national security.²⁸
- 16.** Understanding and identifying which organisations are likely to pose these risks is a difficult task, as illustrated by the volume and depth of work conducted by the MOD. Huw Walters said that the MOD recognise that “there are some sorts of hostile foreign investment that come in”. He explained that the MOD has had a team in place since 2017 to look specifically at investment screening.²⁹ The Minister for Defence Procurement explained that the MOD operate a “risk-based approach”.³⁰ The MOD described the procedures that it has in place by explaining that companies with a direct contract with the MOD are mandated to provide advance notification of any change of control (either within the UK or to a foreign

24 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 12

25 Financial Times, Elisabeth Braw, 7 October 2019, [Cutting-edge tech takeovers are a strategic threat to the west](#)

26 Elisabeth Braw, Visiting Fellow, American Enterprise Institute ([Q48](#))

27 Elisabeth Braw, Visiting Fellow, American Enterprise Institute and Francis Tusa, Editor, Defence Analysis ([Q49](#))

28 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 2.4

29 Huw Walters, Director Economic Security and Prosperity, Ministry of Defence ([Q125](#))

30 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q139](#))

owner). The MOD explained that upon notification it will co-ordinate a due diligence exercise designed to establish whether the change creates concerns over security of supply, proximity risk, or other national security implications that need to be considered alongside any competition issues. In such cases, the Department can choose to transfer work to an alternative supplier.³¹ Huw Walters explained that the process followed by the MOD is “basically” the same regardless of the purchaser’s country of origin:

“So we will be doing a national security assessment and look at things like who the acquirer is and what their links are. We will look at the target company, what they do and what capabilities they have, and we will look at what programmes of ours they might be involved in. Then we will look at whether they could have an impact in providing insight to our potential adversaries about the capabilities we have and how those might be countered or whether they might give a capability uplift to our adversaries.”³²

- 17.** Unfortunately, this approach, whilst recognising that the vast majority of investment into UK defence has been friendly and is to be welcomed, has resulted in investments being permitted which risk UK national security. The Henry Jackson Society has created a database with examples of such investments.³³ This lists companies that have been acquired by Chinese-owned firms since 2010 and includes six which list defence as a key business area:

- [FDM Digital Solutions](#), acquired by Shaanxi Ligeance Mineral Resources in 2019, which specialises in thermoplastics for engineering applications and work in ‘Space and Defence’ industries.
- [Gardner Aerospace](#), acquired by Shaanxi Mineral Resources in 2017, is an international manufacturer of aerospace finished components and are included in military platforms for A400M’s and engine platforms for RTM322’s.
- [CAV Aerospace](#), acquired by Shaanxi Mineral Resources in 2018, a provider of ice protection and drag reduction technology, and states on their website that they provide such services to “general aviation, commercial aerospace and defence markets worldwide.”
- [The Sepura Group](#), acquired by Hytera Communications in 2017, design, manufacture and supply digital radio products, systems and applications and state on their website that they are “working on several projects with armed forces in Europe and America.”

31 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 5

32 Huw Walters, Director Economic Security and Prosperity, Ministry of Defence ([Q135](#))

33 Written evidence submitted by the Henry Jackson Society ([FSC0006](#)), 9 February 2021, paragraph 7; The Times, Lucy Fisher, 12 November 2020, [Chinese have swooped on 115 UK firms in a decade, Henry Jackson Society think tank finds](#);

- [eXception PCB](#), acquired by Fineline Global in 2016, a manufacturer of time critical and technology driven printed circuit boards, and produced circuit boards for F-35s.
 - [Specialist Machine Development \(SMD\)](#), acquired by CRRC Zhuzhou in 2015, a global designer and manufacturer of subsea remotely operated and autonomous power and control solutions. Their products include Defence remote operated vehicle systems, aimed at and designed for defence customers.
- 18.** In addition to these examples, a 2018 report claimed that British semiconductor technology ended up in a Chinese naval railgun. Reports suggested that the acquisition of Dynex Semiconductor by Chinese railway firm CRRC Zhouzhou in 2008 “could have helped the development” of the Chinese navy’s railguns with Dynex’s high-powered semiconductors being supplied to China’s military.³⁴
- 19.** Witnesses before the sub-committee specifically highlighted the risks posed by the acquisition of eXception PCB. The company was the subject of a 2019 report by Sky News which explained that the printed circuit board manufacturer, based in Gloucestershire, produced circuit boards that “control many of the F-35’s core capabilities” and were Chinese owned through its parent company Shenzhen Fastprint. Defence experts at the time expressed concerns that a Chinese owned company was producing any parts for a classified British and American programme.³⁵ Francis Tusa told us that the MOD did not know about the purchase for six years, until the 2019 report, and that the information that this company had access to about the F-35 included:
- “ ... what g-force that circuit board is due to take, and the voltages, power and temperature range. Quite frankly, if you gave an electrical engineer all that data, they would be able to start to reverse engineer the capabilities of the overall system.”³⁶
- The Minister for Defence Procurement disputed this claim, stating that “an approach was made to the MoD back in 2013 - six years before it appeared on Sky - where this was flagged up.” He argued that the components provided were “bare plastic boards” that were then supplied further up the supply chain for more advanced production stages.³⁷
- 20.** Involvement by companies with links to China could represent a risk throughout the defence supply chain. China is well known to engage in large

34 The Times, Mark Hookham and Richard Kerbaj, 4 March 2018, [Has China used British technology to build a railgun?](#); The Register, Gareth Corfield, 5 March 2018, [Brit semiconductor tech ended up in Chinese naval railgun - report](#)

35 Sky News, Deborah Haynes, 15 June 2019, [F-35 jets: Chinese-owned company making parts for top-secret UK-US fighters](#)

36 Francis Tusa, Editor, Defence Analysis ([Q53](#))

37 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q140](#))

scale intellectual property theft.³⁸ The Defence Committee heard about the extent of Chinese espionage and property theft during its recent inquiry into the Security of 5G.³⁹ This behaviour raises concerns that any company working alongside another company with links to China could be subject to theft of its intellectual property.

- 21.** It is possible that the MOD does not have full sight of the defence supply chain, as suggested by Francis Tusa, and was therefore unaware of the acquisitions listed above.⁴⁰ However, the Minister for Defence Procurement said that the MOD are:

“extremely mindful of the need to maintain a clear vision of our supply chain, and we are working through a Department-wide supply chain resilience and risk programme.”⁴¹

Air Marshal Richard Knighton, Deputy Chief of the Defence Staff (Financial and Military Capability) at the MOD, told us that the MOD recently launched this supply chain resilience and risk programme, which built on work undertaken in recent years to understand and map the supply chain of the MOD. The purpose of this exercise, he explained, was to have a better understanding of where vulnerability and risks might lie and therefore take action to mitigate them.⁴² The Minister for Defence Procurement built on the Air Marshall’s comments and explained that through a “risk-based approach” the MOD can go down through the entire supply chain and understand it with “some 37 projects going through that supply chain mapping”.⁴³

- 22.** This work therefore suggests that the MOD knew about the acquisitions and are relaxed about Chinese ownership of companies operating in defence. Indeed, when asked how the MOD would react to efforts from a Chinese company to purchase a company within the British defence sector, the Minister for Defence Procurement maintained that it is “agnostic in terms of particular states”.⁴⁴

- 23.** If the Ministry of Defence has the level of oversight of the defence supply chain that it claims, then it is clear that it was aware of purchases by Chinese companies into the UK defence supply chain and decided that such involvement was an acceptable risk. We do not agree.

38 The Guardian, 6 February 2020, [China theft of technology is biggest law enforcement threat to US, FBI says](#); and Dr Beyza Unal, Deputy Director, International Security Programme at Chatham House ([Q72](#))

39 See [Security of 5G](#) report for evidence of intellectual property theft, particularly comments from Mike Rogers, Chairman of 5G Action Now ([Q85](#))

40 Francis Tusa, Editor, Defence Analysis ([Q53](#))

41 Westminster Hall Debate, 1 December 2020, [Defence Procurement and Supply Chains](#), Volume 685, Column 130WH

42 Air Marshal Richard Knighton, Deputy Chief of the Defence Staff (Financial and Military Capability), Ministry of Defence ([Q132](#))

43 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q133-134](#))

44 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q135](#))

- 24.** *The Ministry of Defence should urgently assess the implications of Chinese ownership of the companies listed within this report.*
- 25.** The UK is involved in a number of military alliances with likeminded partners across the globe and these alliances could form the basis for distinguishing between friendly and hostile investment. The UK’s current primary military and intelligence alliances are those with NATO and Five Eyes partners.⁴⁵ The Minister for Defence Procurement told us that there is “without any doubt” a level of involvement from companies sourced outside of NATO and outside of Five eyes.⁴⁶ Indeed, according to data provided by the MOD, one of the top twenty-three defence suppliers in the UK is domiciled outside these alliances (Fujitsu Limited in Japan).⁴⁷ There is no evidence to suggest that investment from Japan poses the risks described above and it may be beneficial to expand the friendly grouping of investors to include those nations not in NATO or Five Eyes but featuring in the D-10 grouping, previously discussed in our report on the Security of 5G.⁴⁸
- 26.** But any country outside these groupings, or another formal alliance with the UK, may be considered as a potential adversary. Additionally, countries which consistently involve themselves in intellectual property theft, and regularly behave contrary to the UK’s values, such as China under the Chinese Communist Party, should be categorised as hostile.⁴⁹ Investments from countries, such as Russia, that regularly engage in espionage against the UK, or its allies, should also be classified as hostile.⁵⁰
- 27.** *The Ministry of Defence’s open and country-agnostic approach to foreign involvement means that the defence supply chain has been open to potentially hostile foreign involvement, with reports of companies being owned and influenced by foreign Governments whose values and behaviours are at odds with our own and who are known to engage in intellectual property theft. The Ministry of Defence should publish a list of countries it considers friendly and from whom investment should be encouraged. All those countries falling outside of this list should be barred from investing in the UK’s defence supply chain, including China and Russia.*

45 See NATO, 31 August 2020, [NATO Member Countries](#); UK Defence Journal, J. Vitor Tossini, 14 April 2020, [The Five Eyes – The Intelligence Alliance of the Anglosphere](#)

46 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q139](#))

47 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, p12–13

48 Defence Committee, Second Report of Session 2019–21, HC 201, [The Security of 5G](#); see also Foreign Policy, Erik Brattberg and Ben Judah, 10 June 2020, [Forget the G-7, Build the D-10](#)

49 See our recent inquiry into the [Security of 5G](#) for evidence of intellectual property theft, particularly comments from Mike Rogers, Chairman of 5G Action Now ([Q85](#))

50 Intelligence and Security Committee of Parliament, 21 July 2020, HC632, [Russia](#)

- 28.** This report has focused on the level of foreign involvement in the UK defence industry. Reports have highlighted a risk of another kind, the purchase of Chinese equipment for use within the UK military. The Government has recently purchased two second hand Chinese 737 airliners to convert into E-7 Wedgetail planes to deliver the UK's Airborne Early Warning and Control Capacity. Commentators have raised concerns as to the security of the equipment, which some suggest may have been defective or actively sabotaged before transfer. The Minister for Defence Procurement has defended the decision, insisting that the airframes will be stripped down and thoroughly checked to ensure that it meets security requirements.⁵¹
- 29.** Recent reports have highlighted the purchase of second-hand Chinese equipment by the Ministry of Defence. This is deeply concerning. *The purchase of equipment from China for use by the Armed Forces should not be considered a viable option by the Ministry of Defence.*
- 30.** In late 2018 and 2019 concerns were raised about the future of the General Electric site in Rugby responsible for manufacturing Type 26 frigate motors, which General Electric had previously said would be moved to Nancy in France. A previous Defence Committee, and the Unite trade union, raised concerns that this would have national security implications, with MOD classified work leaving the country, and that it represented a “hollowing out of the UK’s defence industrial capacity.”⁵²
- 31.** Commentators criticised the MOD’s relative indifference to the maintenance of the industrial capacity in the UK, with an MOD official at the time stating that the future of the facility was a decision for General Electric.⁵³ Following the intervention of a previous defence committee, a long-term agreement was reached between the MOD and General Electric, confirming the long-term future of the site.⁵⁴
- 32.** The relative indifference of the Ministry of Defence to the possible relocation of General Electric’s Rugby facility was concerning. We are pleased that this important industrial capacity ultimately remained in the UK. *The Ministry of Defence should prioritise the maintenance of sovereign capability within the UK defence industry.*

51 The Telegraph, Christopher Hope, 16 January 2021, [Beijing spying fears as it emerges airframes of new MoD spy planes were previously used by Chinese airlines](#)

52 UK Defence Journal, 14 February 2019, [Concern that Type 26 Frigate engine work could go to France](#); Financial Times, 5 November 2018, [GE under pressure over plan to move work from UK to France](#)

53 Rugby Observer, 4 April 2019, [Parliamentary inquiry launched over plan to close GE factory](#)

54 BBC News, 20 May 2019, [MoD order ‘secures future of General Electric factory’](#)

Legislation limiting Foreign Involvement

The Enterprise Act 2002

- 33.** Our inquiry assessed the Government’s ability to intervene in mergers and acquisitions. The current powers are set out in the Enterprise Act 2002, with the related competition regime overseen by the Competition and Markets Authority. Paul Everitt, Chief Executive of ADS Group, told us that this current regulatory regime is “very non-interventionist” and is “very lightly used”.⁵⁵
- 34.** We were told that, having reviewed these powers, the Government had concluded that they needed to change in order to address the evolving national security threats the UK faces, with the introduction of a new regime necessitated by technological, economic and geopolitical changes.⁵⁶ A staged approach was adopted by introducing short-term amendments to the Enterprise Act 2002 aimed at closing existing gaps, while preparing a new National Security and Investment Bill.⁵⁷ The MOD’s written evidence provides a comprehensive overview of powers within the Enterprise Act 2002.⁵⁸

55 Paul Everitt, Chief Executive, ADS Group ([Q12](#))

56 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 25

57 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 12

58 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 13–19

The National Security and Investment Bill

- 35.** The National Security and Investment Bill was introduced to the House of Commons on 11 November 2020.⁵⁹ The Bill passed its third reading in the House of Commons on 20 January 2021 and is currently under consideration by the House of Lords.⁶⁰ The responsible department for the Bill is the Department for Business, Energy & Industrial Strategy (BEIS). Nadhim Zahawi MP, the Minister for Business and Industry, is responsible for the Bill's progress. Minister Zahawi acknowledged that the Bill was a long time in the making, with a Green Paper in October 2017, a White Paper in July 2018, and a public consultation.⁶¹
- 36.** The Bill will introduce, for the first time in the UK, a distinct regime and standalone powers for the review of foreign direct investment in the UK and will replace the scrutiny of mergers which give rise to national security considerations under the Enterprise Act 2002.⁶² Commentators have argued that the Bill goes beyond earlier consultation drafts, such as the White Paper, and also goes beyond “a number of peer regimes” in other countries.⁶³ Analysis from Bryan Cave Leighton Paisner LLP stated that the Bill will:
- establish a mandatory filing and pre-approval regime to apply to all acquisitions of ownership or control (including minority acquisitions giving rise to shareholdings above 15%) over entities active in one or more of 17 Key Sectors in the UK (such as ‘Military and Dual Use’, ‘Defence’, ‘Civil Nuclear’, ‘Advanced Robotics’ and ‘Artificial Intelligence’). The filing obligation (to a new, specialist unit in BEIS) will apply irrespective of the value of the transaction or the country source of the investment;
 - create a voluntary notification system for a broad range of transactions in any sector of the UK economy that may raise national security concerns (outside of the 17 Key Sectors);
 - enable the BEIS Secretary of State to “call in” a broad range of transactions to undertake a national security assessment, whether or not they have been notified for five years post-closing; and

⁵⁹ [National Security and Investment Bill 2019–21](#)

⁶⁰ UK Parliament, [National Security and Investment Bill 2019–21](#)

⁶¹ Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q96](#))

⁶² Herbert Smith Freehills LLP, 12 November 2020, [National Security and Investment Bill: A new dawn for review of foreign investment in the tech and comms sectors in the UK](#)

⁶³ Slaughter and May, 12 November 2020, [National Security and Investment Bill - What you need to know now about the UK's proposed new M&A screening powers](#)

- give the BEIS Secretary of State the power to impose remedies to address national security concerns (including potentially requiring unwinding of transactions) and sanctions for non-compliance with the regime.⁶⁴
- 37.** The impact assessment for the Bill suggested that there could be 1,000 to 1,830 transactions notified under the new system each year, and that around 70 to 95 transactions of these would progress to full substantive review, with around 10 transactions being subject to remedial orders or prohibition.⁶⁵ The Bill provides for an annual report to Parliament detailing the number of transactions called in and the sectors they are in.⁶⁶
- 38.** The reaction from industry to the Government’s plans to strengthen its powers to scrutinise and intervene in business transactions has been positive. ADS Group Limited supported the plans.⁶⁷ Francis Tusa told us that the Bill was just “the UK catching other people up”.⁶⁸
- 39.** The UK is not alone in making changes to its foreign investment screening arrangements, with “like-minded partners” including the US, Australia, Japan and some European governments having strengthened their own investment screening regimes.⁶⁹ Dr Ashley Lenihan, a fellow at the Centre for International Studies at the London School of Economics, argued that the introduction of this Bill was in line with international trends surrounding strengthening of foreign investment screening legislation with seventeen countries having made changes to foreign investment screening in the past couple of years.⁷⁰ Minister Zahawi echoed these remarks telling us that the new approach brings the UK into line with “other open, free market economies” including the Five Eyes group.⁷¹
- 40.** The MOD told us that the development of the National Security and Investment Bill included scrutiny of the regimes applied by others and related experiences, with BEIS having engaged extensively with other countries, particularly within Five Eyes.⁷² The MOD provided an outline comparison of the current international investment screening regimes

64 Bryan Cave Leighton Paisner LLP, 13 November 2020, [Highly impactful - UK National Security & Investment Bill introduces mandatory Government review of a wide range of transactions](#); Herbert Smith Freehills LLP, 12 November 2020, [National Security and Investment Bill: A new dawn for review of foreign investment in the tech and comms sectors in the UK](#)

65 House of Commons Library, 16 November 2020, [National Security and Investment Bill 2019–21](#); Bryan Cave Leighton Paisner LLP, 13 November 2020, [Highly impactful - UK National Security & Investment Bill introduces mandatory Government review of a wide range of transactions](#)

66 National Security and Investment Bill ([Second Sitting](#)), 24 November 2020, Column 54

67 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 1.2; Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q112](#))

68 Francis Tusa, Editor, Defence Analysis ([Q64](#))

69 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 26

70 National Security and Investment Bill ([Second Sitting](#)), 24 November 2020, Column 33

71 Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q96](#))

72 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 28

by country.⁷³ The Minister for Business and Industry told us that the UK had indeed learnt from others, such as the US regime, and have talked to colleagues in other countries “to make sure that we try to take the best ideas that we think will work sensibly in the United Kingdom”.⁷⁴

- 41.** The UK previously lacked foreign direct investment screening legislation which left the defence supply chain, alongside other sectors of the UK’s economy, vulnerable to influence from hostile foreign investors. The National Security and Investment Bill, once law, will change this situation and offer greater protection to the UK’s economy. Alongside industry and many expert commentators, we support the introduction of this Bill and the planned regime.

The role of the Ministry of Defence in the new system

- 42.** The Bill places the ‘Investment Security Unit’ within BEIS, with no mention of the role that the MOD or the Defence Secretary would perform in the new system. Under the Enterprise Act 2002 the Defence Secretary could provide formal advice if any transactions raised national security concerns for the MOD.⁷⁵
- 43.** Some commentators have questioned the placement of this Unit, with Charles Parton, Senior Associate Fellow at RUSI, questioning the Bill “putting everything in the hands of the Department for Business, Energy and Industrial Strategy”, arguing that it “probably does not have the expertise on China—certainly not in the defence, security and surveillance realms”.⁷⁶ Dr Chris Mackmurdo, Director at Legatus and former Head of National Security Research at the Foreign Office, argued that the Foreign, Commonwealth and Development Office should instead be taking the lead in strategic assessments.⁷⁷
- 44.** However, both Francis Tusa and Elisabeth Braw agreed that BEIS was the most suitable department within the UK Government for the powers within the Bill.⁷⁸ They suggested that other government departments and agencies should instead “feed into” the unit. The “feed in” model is exactly what was described by the Minister for Business and Industry. He said:

73 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, Table 1

74 Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q104-105](#))

75 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), p4

76 National Security and Investment Bill ([First Sitting](#)), 24 November 2020, Column 7–8

77 Foreign Affairs Committee, 1 December 2020, The FCDO’s role in blocking foreign asset stripping in the UK ([Q262](#))

78 Elisabeth Braw, Visiting Fellow, American Enterprise Institute and Francis Tusa, Editor, Defence Analysis ([Q85](#))

“The unit will sit in BEIS, and it is obviously up to the perm sec at BEIS, working with the Treasury, to make sure it is resourced adequately. It is able to pull in any expertise from across Government and the agencies. It is a sort of hub and-spoke model.”⁷⁹

- 45.** The Minister for Defence Procurement confirmed to us that he was content with BEIS’ lead role under the regime.⁸⁰ Huw Walters said:

“The current arrangement gives us freedom to pull together a very robust national security assessment because we are advisers who do not have to balance all the other issues that BEIS must consider. We can give an unfettered national security perspective.”⁸¹

- 46.** Some commentators have questioned the placement of the ‘Investment Security Unit’ within the Department for Business, Energy and Industrial Strategy, suggesting that it does not have the necessary expertise and knowledge. We are content, however, that the unit will be able to draw on experience across Whitehall. *The Ministry of Defence, alongside other departments and agencies, should proactively feed into all relevant assessment processes.*

Venture Capitalism

- 47.** Innovation in defence and associated industries is often led by small start-ups, frequently within universities.⁸² These small start-ups are often subject to investment through venture capitalism (VC) in order to scale up. Andy Sellars, Strategic Development Director at Compound Semiconductor Catapult, told the Foreign Affairs Committee that:

“The UK has the second highest number of start-ups outside the US and attracts the second highest level of venture capital outside the US. There is a lot of evidence that a lot of these companies come out of universities. They attract VC, they scale up, they de-risk over a short period, and they then sell out.”⁸³

79 Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q111](#))

80 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q126](#))

81 Huw Walters, Director Economic Security and Prosperity, Ministry of Defence ([Q127](#))

82 Francis Tusa, Editor, Defence Analysis ([Q64](#)) and Elisabeth Braw, Visiting Fellow, American Enterprise Institute ([Q62](#))

83 Foreign Affairs Committee, 24 November 2020, The FCDO’s role in blocking foreign asset stripping in the UK ([Q237](#))

- 48.** There are concerns that VC funding represents an area of focus for foreign involvement in defence innovation. Elisabeth Braw told the Committee that VC funding is incredible hard to track or measure and that few countries have been able to address foreign involvement in VC in legislation.⁸⁴
- 49.** The Minister for Business and Industry told us that venture capitalism was covered by the Bill, explaining:
- “Where early funding or venture capital amounts to a trigger event, that will be absolutely covered by the Bill. I believe very strongly that it is only right to ensure that we can scrutinise acquisitions of control over national security-sensitive entities, some of which may happen at a very early stage.”⁸⁵
- 50.** Venture capitalism helps to drive innovation in defence and associated industries. However, we heard concerns that venture capitalist funding could represent an avenue for hostile foreign investors to gain entry into the UK defence supply chain. The Minister for Business and Industry told us that the National Security and Investment Bill legislates in this area to protect national security-sensitive entities.

Impact on Foreign Direct Investment

- 51.** It is unclear how the Bill’s provisions will impact on levels of foreign direct investment into the UK, particularly in sectors such as defence and security. Michael Formosa, a Partner at Renaissance Strategic Advisors, told us that the UK has been an “incredibly open FDI destination”, behind only the United States and Hong Kong in terms of levels of foreign direct investment.⁸⁶ This high level of foreign direct investment is illustrated in the defence supply chain by the volume of foreign involvement in top tier suppliers, as described in the MOD’s written evidence.⁸⁷
- 52.** Skadden, Arps, Slate, Meagher & Flom LLP stated that the new regime will be a significant factor for overseas investors to consider in planning investments in the UK and that “the Bill represents a very significant departure from the past as far as inward investment into the UK is concerned”.⁸⁸ Baker McKenzie suggested that “investors into the UK

⁸⁴ Elisabeth Braw, Visiting Fellow, American Enterprise Institute ([Q62](#); [Q93](#))

⁸⁵ Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q116](#))

⁸⁶ Michael Formosa, Managing Partner, Renaissance Strategic Advisors ([Q59](#))

⁸⁷ Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, pages 12–13

⁸⁸ Skadden, Arps, Slate, Meagher & Flom LLP, 11 November 2020, [UK Government Introduces New Regime for Screening Foreign Direct Investment](#)

should be prepared for additional regulatory burdens, more complex risk assessments and allocation as well as delays to anticipated deal timelines”.⁸⁹

- 53.** Roger Barker, Director of Policy and Corporate Governance at the Institute of Directors, told the Foreign Affairs Committee that the Bill could negatively or positively impact the ease of foreign investment in the UK depending on how it is implemented. He explained that if the process is “slick”, “efficient” and “transparent and predictable” it could provide a competitive advantage; however if it were not implemented correctly it “could become a bureaucratic nightmare for companies”.⁹⁰ Michael Formosa was more positive and predicted that foreign direct investment is likely to rise on the back of this Bill as it is a “significant commitment which makes the UK more attractive”.⁹¹
- 54.** When we asked about the impact of the new regime on the UK’s attractiveness for foreign direct investment, the Minister for Business and Industry said that the new regime will strike a balance between protecting national security and sending “a very clear message to the world that we are open to good, positive inward investment”.⁹² Specifically on the defence and security sectors the Minister said that the only investment that the new regime will lose the UK “is malign investment by hostile actors - that is business we probably would not want here anyway”.⁹³
- 55.** The new regime’s impact on foreign direct investment is, as yet, uncertain. If implemented efficiently the new regime should have little to no harmful impact on foreign direct investment to the UK defence supply chain, only preventing investment that is undesirable. This will require HMG to ensure rapid efficient turnaround of decisions.

89 Baker McKenzie, 14 November 2020, [UK introduces major overhaul of national security and foreign investment regime](#)

90 Foreign Affairs Committee, 24 November 2020, The FCDO’s role in blocking foreign asset stripping in the UK ([Q230](#))

91 Michael Formosa, Managing Partner, Renaissance Strategic Advisers ([Q91](#))

92 Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q108](#))

93 Nadhim Zahawi MP, Parliamentary Under-Secretary of State (Minister for Business and Industry) Department for Business, Energy and Industrial Strategy ([Q109](#))

The impact of COVID-19 on the Defence Supply Chain

The impact on finances

- 56.** Part of our motivation to launch this inquiry was to ensure that the financial consequences of the COVID-19 pandemic did not result in increased vulnerability of companies with the UK defence supply chain. Our inquiry launch came after comments by the European Commissioner for Competition, Margrethe Vestager, who warned that the pandemic had made companies vulnerable to foreign bids and suggested that European countries should buy stakes in companies to stave off the threat of Chinese takeovers.⁹⁴ This comment was matched by some of the evidence we received, which linked the financial consequences of COVID-19 to an increased risk of foreign involvement in defence industries. Airbus, for example, made the case that a failure to support the UK supply chain would leave innovative companies supplying defence programmes at greater risk of foreign takeover.⁹⁵ Mandy Ridyard, Finance Director of Produmax, told us that companies working in aerospace and defence are “bound to be at risk, from either disappearing or being taken over”.⁹⁶
- 57.** Paul Everitt and Andrew Kinniburgh told us that the defence industry has remained relatively resilient throughout the pandemic, and that a number of companies in related sectors have expressed their interest in developing

⁹⁴ Financial Times, Javier Espinoza, 12 April 2020, [Vestager urges stakebuilding to block Chinese takeovers](#)

⁹⁵ Written evidence submitted by Airbus ([FSC0004](#)), 2 October 2020, paragraph 3.2

⁹⁶ Mandy Ridyard, Finance Director, Produmax ([Q43](#))

their work in defence.⁹⁷ ADS Group also said that the UK's defence and security industries remained broadly resilient during the early stages of the COVID-19 pandemic.⁹⁸ However, the MOD noted that the COVID-19 pandemic created financial challenges across the defence and security sectors, and that liquidity and cash flow concerns continue, particularly for firms with exposure to the civilian aerospace sector or relatively high debt. The MOD reported that many defence and aerospace companies have had to introduce cash conserving strategies, for example suspending dividends, reducing executive pay and pension contributions and arranging additional credit facilities.⁹⁹ ADS Group stated that small and medium-sized enterprises continued to face severe challenges with significant impacts on adjacent industries such as civil aerospace.¹⁰⁰

58. Airbus' evidence also emphasised the impact on commercial aerospace, arguing that it was essential that the UK Government supports businesses operating in commercial aerospace through the crisis to ensure that they are able to continue delivering vital products and services to defence and to prime contractors.¹⁰¹ We heard about the impact of COVID-19 on civil aerospace during a panel with small and medium sized enterprises. Jayne Moorby, Marketing Manager of Oxley, alongside Mandy Ridyard, explained that their companies do a combination of defence and aerospace work and that aerospace has been heavily impacted with the cancellation of orders, delays and greater price pressures. Both witnesses described pressure on cash reserves and the restructuring that they had been forced to engage in, with Mandy Ridyard explaining that her business was 30% down against planned business.¹⁰²

59. The defence industry in the UK has remained broadly resilient in the face of financial pressures resulting from the COVID-19 pandemic. Unfortunately, the same cannot be said for all businesses within the defence supply chain, particularly those that also operate in commercial aerospace and are small and medium sized enterprises. The financial vulnerability of such businesses could increase the risk of hostile foreign involvement in the defence supply chain.

97 Paul Everitt, Chief Executive, ADS Group; and Andrew Kinniburgh, Director General, NDI ([Q18-19](#))

98 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 3.1

99 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 11

100 Written evidence submitted by ADS ([FSC0002](#)), 1 October 2020, paragraph 3.1

101 Written evidence submitted by Airbus ([FSC0004](#)), 2 October 2020, paragraph 3.1

102 Jayne Moorby, Marketing Manager, Oxley; and Mandy Ridyard, Finance Director, Produmax ([Q31](#))

Assessing Ministry of Defence support to industry

- 60.** In response to the financial impact of the COVID-19 pandemic the MOD said that it had undertaken targeted financial relief measures to support cash flow, maintain service delivery and retain staff within the defence supply chain. This included forward ordering, prepayment, interim payments and payment on order rather than receipt, accompanied by strong guidance around the MOD's expectation that suppliers continue to pay employees and flow down funding to their supply chains. The MOD stated that it had also made interim payments to prime contractors when required, meaning that primes received some payment early and in advance of delivery of services or products to the MOD, and that primes had actively supported their supply chain in a similar way, responding to requests for financial and other assistance, which had ensured continuing cash flow through supply chains.¹⁰³
- 61.** Some of the evidence we received was critical of the level of support provided by Government. William Hynett, Chief Executive of Britten-Norman, told us that “the amount of support that we have had from Government to date has been pretty limited”.¹⁰⁴ Regarding the MOD's pre-payment plans, forward ordering, interim payments and payments on order, three SME witnesses said that they had benefited from none, with William Hynett commenting that “They have not been communicated to me at all”.¹⁰⁵ Mandy Ridyard said that “most of the primes” do not seem to ensure that interim payments flowed down the supply chain.¹⁰⁶ Responding to this criticism, the Minister for Defence Procurement said that he was sorry if it was the case that some small and medium sized enterprises did not know about the support but that he was aware of “a lot” of examples where companies were very pleased.¹⁰⁷
- 62.** The support provided in the UK, particularly support for commercial aerospace, has also been compared negatively with that provided in other countries. Francis Tusa told the Committee earlier in the year that France had set up a committee “to look at the complete defence supply chain of SMEs across the piece”, which he explained “were in danger of going broke and also being bought out.”¹⁰⁸ He called for the MOD to consider doing the same, later adding:

“Looking at the approach with Covid effects, France very quickly set up an inter-ministerial team to look at the supply chain with industry

103 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 11

104 William Hynett, Chief Executive, Britten-Norman ([Q34](#))

105 William Hynett, Chief Executive, Britten-Norman; Jayne Moorby, Marketing Manager, Oxley; and Mandy Ridyard, Finance Director, Produmax ([Q41](#))

106 Mandy Ridyard, Finance Director, Produmax ([Q41](#))

107 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q155](#))

108 Francis Tusa, Editor, Defence Analysis ([Q41](#))

for defence and aerospace, to highlight which companies were at risk of collapse, especially if they had key roles in the defence supply chain, and, if so, what could be done to rescue them.”¹⁰⁹

63. Responding to this comparison, the Minister for Defence Procurement argued that the work on defence supply chain resilience had started before COVID-19 and that the MOD had had ongoing dialogue with industry via the Defence Supplier Forum.¹¹⁰ Lieutenant General Jim Hockenull, Chief of Defence Intelligence, also highlighted work conducted in 2016 through the “Defending Defence” programme which focused, in part, on supply chains.¹¹¹

64. Michael Formosa told us that France and Germany proactively supported their civil aerospace industries:

“Not only have their defence and interior ministries sped up acquisition, but, in the case of France, I believe it was about €15 billion in bail-out, which took the form of loan forgiveness and financing. About half of that went to Air France, but the balance was aimed at the OEMs like Safran, Airbus and Thales, where the Government invested in a fund with the proviso that the OEMs would follow suit and specifically help small businesses in the supply chain and invest in greener tech. The Germans did something similar with about a €10 billion bail-out. Their five-year plan for military procurement was pulled forward. A lot of 2024–25 money was pulled back into 2021–22.”¹¹²

65. When asked whether the UK had done enough to support civil aerospace, the Minister for Defence Procurement argued that it had, stating that there had been about £9 billion of COVID-19 corporate finance support, loan guarantees, export credits through the furlough scheme and business interruption loans.¹¹³

66. The Ministry of Defence and wider Government have provided substantial support to businesses in the defence supply chain. Unfortunately, we heard that this support has not always reached its intended beneficiaries or had the intended consequences. *The Ministry of Defence should improve its communication strategy with small and medium sized enterprises to ensure that they are aware of the support that they are eligible for at this difficult time.*

109 Francis Tusa, Editor, Defence Analysis ([Q74](#))

110 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q155](#))

111 Lieutenant General Jim Hockenull OBE, Chief of Defence Intelligence, Ministry of Defence ([Q157](#))

112 Michael Formosa, Managing Partner, Renaissance Strategic Advisers ([Q89](#))

113 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q160](#))

- 67.** The commercial aerospace industry remains financially fragile. *The Ministry of Defence should already be aware of the close links between this industry and the defence supply chain and should consider what more it can do to support businesses which operate here, particularly small and medium sized enterprises.*

The impact on global supply chains

- 68.** COVID-19 heavily disrupted global supply chains as countries introduced measures which included the disruption of manufacturing and restriction of exports and imports. The pandemic also resulted in workforce reductions and travel bans.¹¹⁴ The MOD's evidence recognised the impact this could have on the defence supply chain as the defence and security sectors are heavily reliant on global supply chains for raw materials and components.¹¹⁵
- 69.** UK defence companies therefore have significant global supply chains and, according to material provided to the MOD by the Security and Resilience Industry Supplier Community, some companies are reviewing their supply chains and seeking domestic alternatives for supply, potentially resulting in shortened supply chains and improved transparency. The MOD also noted that the international trend appears to be movement towards increasingly local supply chains, accompanied by the risk of protectionism, motivated by security, surety of supply and economic stimulus. The impact of such measures, the MOD explained, is likely to be exacerbated by pandemic-induced changes to many bilateral and multilateral relationships, including those relating to trade.¹¹⁶

Efforts to reform the supply chain

- 70.** The Minister for Defence Procurement told us that the MOD has “broadened the intensity of the screening” of its suppliers and has had a “very active dialogue” through the Defence Supplier Forum and other forums.¹¹⁷ Despite some efforts to explore alternative and shortened supply chains, the Minister for Defence Procurement explained that it would be difficult to source entirely from the UK as:

114 Deloitte, 2020, [COVID-19: Managing supply chain risk and disruption](#)

115 Written evidence submitted by the Ministry of Defence (FSC0001), 30 September 2020, paragraph 8

116 Written evidence submitted by the Ministry of Defence (FSC0001), 30 September 2020, paragraph 9

117 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q142](#))

“... that will rack up enormous costs, and our ability to provide all the capabilities that we wished to would be compromised by spending money perhaps unnecessarily on getting something from a particular source.”¹¹⁸

- 71.** He concluded that there was a balance to be struck and that the MOD were conscious of the need to strike a balance, particularly with regards to materials such as rare earths.¹¹⁹ Air Marshal Knighton explained that about a third of the world’s reserves of rare earth elements were in China, as well as two thirds of the production capability, but that only about 5% of rare earth imports from China were relevant to defence.¹²⁰
- 72.** The COVID-19 pandemic impacted the supply chains of defence businesses as well as their finances. Global supply chains for defence represent a vulnerability, especially when these supply chains include materials from countries not closely aligned with the UK. *The Ministry of Defence should set out how it is proactively supporting efforts from defence businesses to seek domestic alternatives for supply and to shorten supply chains.*

118 Written evidence submitted by the Ministry of Defence ([FSC0001](#)), 30 September 2020, paragraph 9; Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q142](#))

119 Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence ([Q142](#))

120 Air Marshal Richard Knighton, Deputy Chief of the Defence Staff (Financial and Military Capability), Ministry of Defence ([Q152](#))

Conclusions and recommendations

- 1.** It is difficult to define what constitutes foreign involvement in the UK defence supply chain. However, regardless of the level of foreign ownership or the closeness of a company's relationship with another Government, any foreign domiciled company, or subsidiary owned by a foreign domiciled company, will be subject to influence from outside the United Kingdom. (Paragraph 6)
- 2.** As a result of the Ministry of Defence's approach of encouraging inward investment, foreign involvement in the UK defence supply chain is widespread, with the UK hosting a broad range of UK-based and international suppliers. This approach has brought many benefits to the UK defence industry and wider economy. (Paragraph 13)
- 3.** If the Ministry of Defence has the level of oversight of the defence supply chain that it claims, then it is clear that it was aware of purchases by Chinese companies into the UK defence supply chain and decided that such involvement was an acceptable risk. We do not agree. (Paragraph 23)
- 4.** The Ministry of Defence should assess the implications of Chinese ownership of the companies listed within this report. (Paragraph 24)
- 5.** The Ministry of Defence's open and country-agnostic approach to foreign involvement means that the defence supply chain has been open to potentially hostile foreign involvement, with reports of companies being owned and influenced by foreign Governments whose values and behaviours are at odds with our own and who are known to engage in intellectual property theft. *The Ministry of Defence should publish a list of countries it*

considers friendly and from whom investment should be encouraged. All those countries falling outside of this list should be barred from investing in the UK's defence supply chain, including China and Russia. (Paragraph 27)

- 6.** Recent reports have highlighted the purchase of second-hand Chinese equipment by the Ministry of Defence. This is deeply concerning. *The purchase of equipment from China for use by the Armed Forces should not be considered a viable option by the Ministry of Defence. (Paragraph 29)*
- 7.** The relative indifference of the Ministry of Defence to the possible relocation of General Electric's Rugby facility was concerning. We are pleased that this important industrial capacity ultimately remained in the UK. *The Ministry of Defence should prioritise the maintenance of sovereign capability within the UK defence industry. (Paragraph 32)*
- 8.** The UK previously lacked foreign direct investment screening legislation which left the defence supply chain, alongside other sectors of the UK's economy, vulnerable to influence from hostile foreign investors. The National Security and Investment Bill, once law, will change this situation and offer greater protection to the UK's economy. Alongside industry and many expert commentators, we support the introduction of this Bill and the planned regime. (Paragraph 41)
- 9.** Some commentators have questioned the placement of the 'Investment Security Unit' within the Department for Business, Energy and Industrial Strategy, suggesting that it does not have the necessary expertise and knowledge. We are content, however, that the unit will be able to draw on experience across Whitehall. *The Ministry of Defence, alongside other departments and agencies, should proactively feed into all relevant assessment processes. (Paragraph 46)*
- 10.** Venture capitalism helps to drive innovation in defence and associated industries. However, we heard concerns that venture capitalist funding could represent an avenue for hostile foreign investors to gain entry into the UK defence supply chain. The Minister for Business and Industry told us that the National Security and Investment Bill legislates in this area to protect national security-sensitive entities. (Paragraph 50)
- 11.** The new regime's impact on foreign direct investment is, as yet, uncertain. If implemented efficiently the new regime should have little to no harmful impact on foreign direct investment to the UK defence supply chain, only preventing investment that is undesirable. (Paragraph 55)
- 12.** The defence industry in the UK has remained broadly resilient in the face of financial pressures resulting from the COVID-19 pandemic. Unfortunately, the same cannot be said for all businesses within the defence supply chain, particularly those that also operate in commercial aerospace and are small

and medium sized enterprises. The financial vulnerability of such businesses could increase the risk of hostile foreign involvement in the defence supply chain. (Paragraph 59)

- 13.** The Ministry of Defence and wider Government have provided substantial support to businesses in the defence supply chain. Unfortunately, we heard that this support has not always reached its intended beneficiaries or had the intended consequences. *The Ministry of Defence should improve its communication strategy with small and medium sized enterprises to ensure that they are aware of the support that they are eligible for at this difficult time.* (Paragraph 66)
- 14.** The commercial aerospace industry remains financially fragile. *The Ministry of Defence should already be aware of the close links between this industry and the defence supply chain and should consider what more it can do to support businesses which operate here, particularly small and medium sized enterprises.* (Paragraph 67)
- 15.** The COVID-19 pandemic impacted the supply chains of defence businesses as well as their finances. Global supply chains for defence represent a vulnerability, especially when these supply chains include materials from countries not closely aligned with the UK. *The Ministry of Defence should set out how it is proactively supporting efforts from defence businesses to seek domestic alternatives for supply and to shorten supply chains.* (Paragraph 72)

Sub-Committee Formal minutes

Tuesday 9 February 2021

Members present:

Richard Drax, in the Chair

Stuart Anderson

Sarah Atherton

Martin Docherty-Hughes

Rt Hon Tobias Ellwood

Rt Hon Mr Mark Francois

Gavin Robinson

Rt Hon John Spellar

Derek Twigg

Minutes

Foreign Involvement in the Defence Supply Chain

Draft Report (Foreign Involvement in the Defence Supply Chain), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 72 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Second Report of the Sub-Committee to the Committee in this session.

Ordered, That the Chair make the Report to the Committee.

Next meeting

[Sub-Committee Adjourned]

Committee Formal Minutes

Tuesday 9 February 2021

Members present:

Rt Hon Tobias Ellwood, in the Chair

Stuart Anderson

Sarah Atherton

Martin Docherty-Hughes

Richard Drax

Rt Hon Mr Mark Francois

Gavin Robinson

Rt Hon John Spellar

Derek Twigg

Minutes

Foreign Involvement in the Defence Supply Chain

Draft Report from the Sub-Committee (Foreign Involvement in the Defence Supply Chain), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 72 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available (Standing Order No. 134).

Ordered, That the following written evidence be reported to the House for publication:

Henry Jackson Society (FSC0006)

Next meeting

[Adjourned till Tuesday 23 February at 2.00pm]

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee's website.

Monday 09 November 2020

Panel one: [Q1–30](#)



Paul Everitt, CEO, ADS



Andrew Kinniburgh, Director General, NDI

Panel two: [Q31–43](#)



William Hynett,
Chief Executive, Britten-
Norman



Jayne Moorby,
Marketing Manager, Oxley
Group



Mandy Ridyard,
Finance Director, Produmax

Monday 23 November 2020: [Q44–95](#)



Francis Tusa, Editor, Defence Analysis



Elisabeth Braw, Visiting Fellow, American Enterprise Institute



Michael Formosa, Managing Partner, Renaissance Strategic Advisors

Monday 14 December 2020

Panel One: [Q96–122](#)



Nadhim Zahawi MP,
Parliamentary Under-Secretary, Department for Business, Energy and Industrial Strategy



Dr Sarah Mackintosh,
Deputy Director for National Security and Investment,
Department for Business, Energy and Industrial Strategy

Panel Two: [Q123-161](#)



Jeremy Quin MP, Minister of State (Minister for Defence Procurement), Ministry of Defence



Huw Walters, Director Economic Security and Prosperity, Ministry of Defence



Air Marshal Richard Knighton CB, Deputy Chief of the Defence Staff (Military Capability), Ministry of Defence



Lieutenant General Jim Hockenhull OBE, Chief of Defence Intelligence, Ministry of Defence

Published written evidence

The following written evidence was received and can be viewed on the [inquiry publications page](#) of the Committee's website.

FSC numbers are generated by the evidence processing system and so may not be complete.

- 1 ADS ([FSC0002](#))
- 2 Airbus ([FSC0004](#))
- 3 Henry Jackson Society ([FSC0006](#))
- 4 Ministry of Defence ([FSC0001](#))
- 5 Nadhim Zahawi MP (Parliamentary Under-Secretary of State, Department for Business, Energy and Industrial Strategy) ([FSC0005](#))
- 6 Patel, Jag ([FSC0003](#))