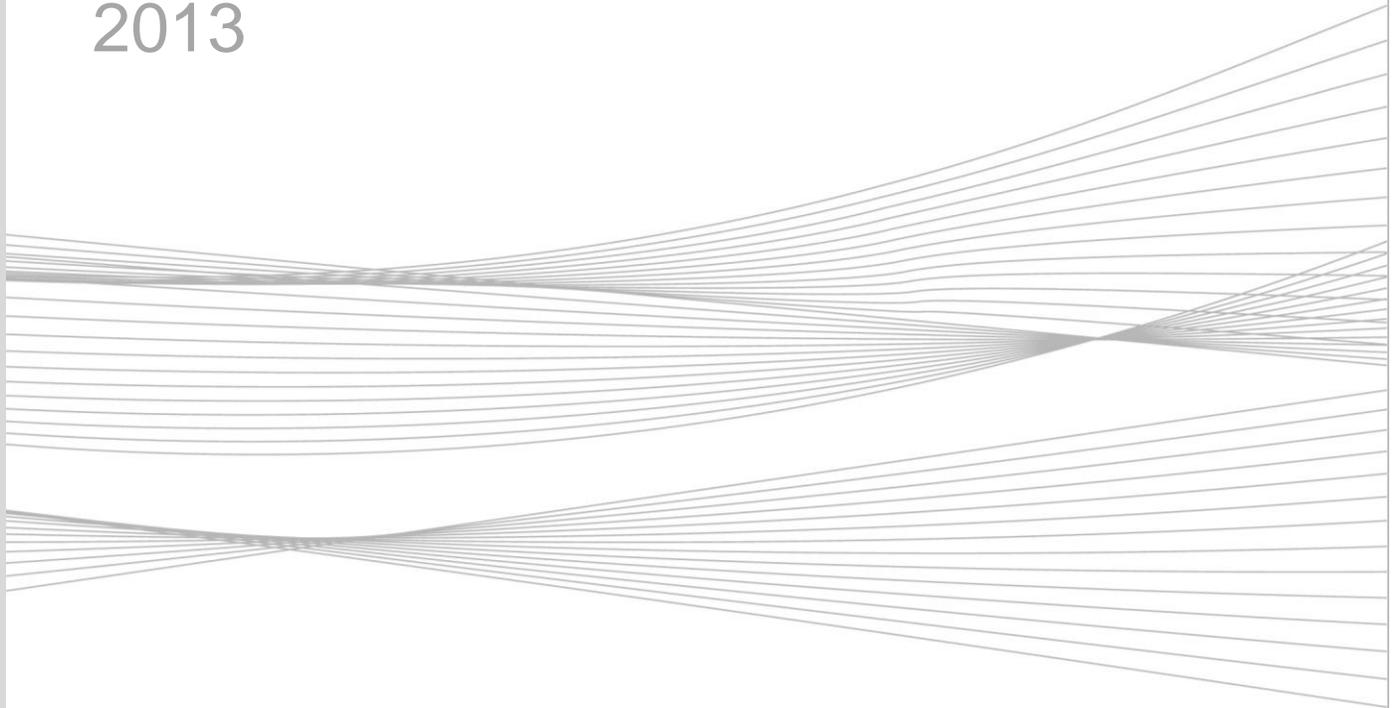




Export Opportunities for Virginia's Defense Industry

2013





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INTRODUCTION

Defense contracting within the Commonwealth represents almost 10 percent of the economy.¹ As the budget cutbacks known as sequestration occur, Virginia companies face job and revenue losses from decreased contracts with the federal government. The White House estimates that, in Virginia, Army base operation funding will be cut by \$146 million, funding for Air Force operations will be cut by \$8 million, and the maintenance of 11 Navy ships in Norfolk would be cancelled with other modernization and demolition projects delayed.² In a worst case scenario, Virginia may lose 82,000 direct jobs at Federal agencies and contractors, and an additional 82,000 indirect jobs supported by business and personal spending shifts. It is anticipated that Northern Virginia will absorb more than 60 percent of these losses, Hampton Roads approximately 20 percent, and Richmond 12percent.³ As the U.S. federal government cuts back on defense spending, there are, however, significant opportunities for Virginia's defense companies to grow sales abroad.

Andrew Shapiro, Assistant Secretary of State for Political-Military Affairs, stated in remarks to the Defense Trade Advisory Group in November 2012 "The growth of the U.S. defense trade has been truly remarkable. Despite the tough global economy over the last four years, demand for U.S. defense sales abroad remains robust." Foreign Military Sales through the U.S. Government doubled from FY2011 to FY2012, and by the end of October 2012 the U.S. Department of State had received 73,000 license requests during that calendar year, 2,000 more than at the same point during the previous year.⁴

To mitigate the effects of decreases in Federal defense spending, VEDP-International Trade has developed this guide to help Virginia's defense companies reduce their dependence on sales to the federal government by growing sales in foreign markets. Whether through direct commercial sales or foreign military sales (FMS), this guide introduces new exporters to the processes, considerations, and strategies for selling abroad.

The Virginia Economic Development Partnership's (VEDP) International Trade division works to increase the number of Virginia companies selling overseas and their volume of international business, year after year. With this guide, VEDP-International Trade aims to prepare Virginia companies to take advantage of opportunities to sell to foreign militaries and security-related organizations, as well as commercialize defense products and services in alternative sectors abroad, and to provide support along the way.

¹ (Chmura Economics & Analytics, 2012)

² (The White House, 2013)

³ (Chmura Economics & Analytics, 2012)

⁴ (Schapiro, 2012)

EXECUTIVE SUMMARY

The sections contained in this guide provide defense companies with an overview of what they need to consider during each step of the export process, as well as resources and links to help them learn more. The following key topics for defense exporters are examined:

ASSESSING EXPORT READINESS

- » There are many factors for defense companies to consider as they decide on an export strategy. Defense companies can prepare themselves for exporting by understanding their ability to adapt for international sales as well as the global environment for their products or services.

UNDERSTANDING EXPORT REGULATIONS

- » All U.S. product and service exports are regulated by the U.S. government. For defense companies that have products regulated by the International Traffic in Arms Regulations (ITAR), registration with the U.S. Department of State is required before pursuing export opportunities.

FOREIGN DEFENSE MARKET ENTRY

- » The two purchasing channels available to foreign defense entities through which U.S. companies may grow international sales are Foreign Military Sales (FMS) and Direct Commercial Sales (DCS). It is important for companies to know the players, processes, and factors involved when pursuing each.

SELECTING INTERNATIONAL MARKETS

- » Selecting foreign markets to pursue is an important step in the export process. Markets' demand potential, political environments, and government procurement regimes are potential components of market evaluations.

DEFENSE TRADE FINANCING

- » Many of the financing options available to commercial exporters are also available to defense exporters. The U.S. government also provides grants and loans to foreign government purchasers that allow for the acquisition of U.S. military articles, services, and training.

COMMERCIALIZING DEFENSE TECHNOLOGIES

- » Many defense companies provide technologies and services that have the potential to be adapted for commercial applications and sold to new markets both domestically and abroad.

ASSESSING EXPORT READINESS

The benefits of exporting are many, but for Virginia defense contractors facing federal budget cuts, the most important is decreased dependence on domestic sales. Under normal circumstances, rushing into exporting to counteract a drop in domestic sales would be ill-advised. Developing export business requires long term commitment; it is not necessarily a good strategy for achieving a short term objective such as a sales correction. The potentially long term effects of sequestration on U.S. defense spending, however, requires defense contractors to explore exporting not as a quick fix to a short slump, but as a path to long term survival. This section outlines considerations defense companies should take into account when making the decision to export.

CONSIDER REGULATORY ISSUES IN SELLING DEFENSE ARTICLES ABROAD

Exports of defense products and services are controlled by a difficult-to-navigate regulatory framework. Under current rules, companies must work through multiple agencies and lists of controlled items to determine whether export is possible. Companies selling to foreign governments must also factor anti-boycott laws and the Foreign Corrupt Practices Act (FCPA) into risk assessments and compliance plans.

CONSIDER PRODUCTS AND SERVICES FROM AN INTERNATIONAL PERSPECTIVE

While most defense companies sell some product or service that carries an added value that differentiates it from substitutes, the federal government's structuring of defense tenders has fostered an industry tendency toward marketing capabilities to acquire talent and skillsets to complete projects. This method of winning bids is unlikely to translate to international markets, however. Defense companies must shift their mindsets and their marketing focus toward the value proposition of the products and services already developed therein.

One aspect of this recalibration and, thusly, evaluation of export potential, is a basic understanding of the global environment for companies' products or services. Perhaps there is international demand, outside of the traditional defense sector, in local law enforcement, emergency management organizations, the private security sector, or an entirely non-defense-related sector. Defense companies looking to expand into international markets should either a) confirm that their products or services are not unique to the conditions, technology, and culture in the U.S. and that they are in demand in other countries, or b) be able to modify their products or services to meet demand in other countries. Past international leads are an indication of demand abroad. Analysis of global competition is another method that can be used to gauge international demand for a company's particular value proposition.

CONSIDER THE INVESTMENT REQUIRED FOR INTERNATIONAL SALES

Procurement standards in international markets may require a greater focus on justification of costs than those in the U.S defense industry. Companies must be cognizant of the factors that foreign procurement officials consider in making purchasing decisions - production costs, shipping, quality, geopolitical loyalties, etc. - and likewise adjust their business development efforts. This may necessitate bridging a cultural gap between traditional defense industry-oriented elements within companies and the producing and consuming sectors of the economy in which they must learn to work. Companies may need to hire staff to modify products or services for international markets, develop new promotional materials, and incur added administrative costs. Moreover, it may take much longer to access and build relationships with procuring officers, make sales, and receive payments. These international initiatives and expenses may require significant cash infusions that defense contractors may not be accustomed to making. Such investments may require seeking outside financing, and it may be difficult to determine in advance their potential return.

Before committing to exporting, companies should evaluate their needs, abilities, and willingness to adapt for their pursuit of international sales.

The following resources may assist in further examining export readiness:

- » [Export Questionnaire](#) - This questionnaire highlights the characteristics of successful exporters.
- » [Management Issues Involved in the Export Decision](#) – This list of questions presents issues that company management should consider before pursuing export operations.

DEVELOP AN EXPORT PLAN

After deciding to pursue export sales, the next step in the export process is developing an export plan of action: a company's guide to growing its international business. It outlines a company's constraints, objectives, and best practices for the purpose of organizing export efforts. The most effective export plan is used as a management tool and is easily accessed and understood so as to ensure companywide teamwork and dedication to international business.

For more information on developing an export plan, refer to the following resources:

- » [Small Business Administration Export Business Planner](#) - This excellent resource contains more information on the export process and provides an electronic document to record your goals.
- » [Department of Commerce Sample Outline for an Export Plan](#)

UNDERSTANDING EXPORT REGULATIONS

All U.S. exports (goods and services) are regulated by the U.S. federal government to protect national security and foreign policy interests. There are two key export control laws:

- » International Traffic in Arms Regulations (ITAR) – U.S. Department of State
- » Export Administration Regulations (EAR) – U.S. Department of Commerce

Companies must determine which regulations apply to their exports. The following chart explains the types of products and services that fall under each agency’s export regulations’ purview.

| Export Administration Regulations (EAR) | International Traffic in Arms Regulations (ITAR) |
|--|--|
| U.S. Department of Commerce | U.S. Department of State |
| <p>EAR regulates the export of:</p> <ul style="list-style-type: none"> » Most commercial goods, software, and technology » Dual use items with civilian and military applications » Technical assistance and information related to any item controlled by EAR <p>The majority of exports under EAR fall under the designation EAR 99, which refers to items that can be shipped without a license to most destinations under most circumstances.</p> | <p>ITAR regulates the export of:</p> <ul style="list-style-type: none"> » Items specifically designed, developed, or adapted for a military application-- regardless of intended use » Services, technical data, and software related to any item controlled by ITAR <p>An export is regulated by ITAR if it is listed on the U.S. Munitions List, or if it is technical data, software, or a service related to an item on the U.S. Munitions List.</p> |

There are many methods by which a product or service can be transferred outside of the U.S., and each of these is considered exporting. Actions such as mailing, faxing, uploading/downloading, e-mailing, discussing over the phone, and releasing the article or information to a foreign national in the U.S. are considered an export and are regulated. In summary, exporting can occur through visual inspection, oral exchange, or the application of knowledge with a foreign customer.⁵

It is important to note that information and technical data related to controlled items are also regulated. This applies to both EAR and ITAR. Examples of such information include blueprints, drawings, layouts, operating manuals, training manuals, and intangible items such as formulas, software, or source code. Services, such as training or consulting, are regulated if they relate to a controlled item.⁶ Defense services, such as furnishing assistance in the design, development, manufacture, testing, maintenance, modification, operation, or use of defense articles, are also regulated if they relate to a controlled item under ITAR.

⁵ (U.S. Department of Commerce, 2012)

⁶ (Old Dominion University Research Foundation, 2012)

If a product or service is in no way related to military use, it is likely regulated by EAR. If companies cannot determine which agency regulates their exports, companies can request a free [Commodity Jurisdiction Determination](#) from the U.S. Department of State, to be delivered within 45 days.

EXPORTING UNDER EAR

If their exports are regulated by EAR, for each prospective sale, companies must determine whether a license is required. To learn more, please refer to the VEDP publication, [Fast Facts – Export Regulations](#), which contains a decision tree to help companies determine whether an export license is required under EAR.

EXPORTING UNDER ITAR

REGISTERING WITH THE U.S. DEPARTMENT OF STATE

If their exports are regulated by ITAR, companies must register with the U.S. Department of State. Registration provides the U.S. Government with information about who is involved in activities related to the export of controlled items. Registration does not grant export privileges; rather, is a precondition for obtaining export rights and licenses.⁷

It is important to note that companies' manufacturer(s), broker(s), and agent(s) must also register with the U.S. Department of State. Registration takes four to six weeks to complete and costs approximately \$2,250. To learn more about ITAR registration, visit the [U.S. Department of State](#) website.

As companies reach this stage in the export process, VEDP can recommend service providers that can help navigate the ITAR registration procedures.

LICENSE REQUIREMENTS

After obtaining ITAR registration, companies should determine whether their export businesses might qualify for one of two agreements that serve to excuse companies from obtaining licenses for each individual export:

- » A Technical Assistance Agreement (TAA) is applicable to companies performing services or disclosing data.
- » A Manufacturing License Agreement (MLA) is applicable to companies needing to grant manufacturing rights to foreign parties.

If neither of these agreements is applicable, the next step is to determine if the exports qualify for one of the following license exemptions:

- » If the Technical Data of General Applicability Exemption applies, no license is required.
- » If the Canadian Exemption applies, no license is required.

If these exemptions do not apply, companies pursuing any route to sale other than Foreign Military Sales (FMS) must apply for a license for each prospective sale. It takes approximately 15-20 days to process a license once an application is received. A license is valid for four years. It expires when the total value or quantity authorized has been shipped or when the date of expiration has been reached, whichever occurs first. Defense exports thereafter require a new application and license.⁸

⁷ (U.S. Department of State Directorate of Defense Trade Controls, 2012)

⁸ (U.S. Department of Defense Directorate of Defense Trade Controls, 1993)

For more information on export regulations and applying for export licenses, refer to the following resources:

- » [U.S. Department of State – Export Licenses](#)
- » [Fast Facts – Export Regulations](#) - This VEDP-International Trade publication outlines additional regulations that all exporters must comply with, including sanctions programs, embargoes and anti-boycott laws.

FOREIGN CORRUPT PRACTICES ACT

Defense companies marketing and selling to foreign governments need to be especially aware of the Foreign Corrupt Practices Act (FCPA), which prohibits offering to pay, paying, promising to pay, or authorizing the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business. Violations of the FCPA can lead to civil and criminal penalties, sanctions, and remedies, including fines, disgorgement, and/or imprisonment.⁹ Since its passage in 1977, there have been more than 200 FCPA cases covering activity in about 80 countries.¹⁰

Though in recent years there has been a growing international consensus that corruption must be combated, and the U.S. and other countries are parties to a number of international anticorruption conventions, the fact is: bribery and corruption are still a common way of doing business in many places. Large multinational companies spend millions annually on proactive training, monitoring, and audits to ensure compliance. They also conduct their own internal investigations when any allegations arise in hopes that they might self-report the incidents and reduce any resulting penalty. Yet these companies with resources aplenty still occasionally find themselves under investigation by the Department of Justice (DoJ) and the Securities and Exchange Commission (SEC) for potential violations.

Companies should develop compliance programs to serve as tangible evidence of their efforts to fulfill their legal obligations to prevent unlawful corrupt payments in overseas operations. Having these programs in place will help avoid prosecution or reduce any penalties imposed should violations be found at any point in the future. Some measures that should be included in these programs and carried out to ensure compliance include:

- » Be sure that all employees and partners know and understand the program.
- » Conduct due diligence on partners to identify any violation risk. This may be done by asking questions in the industry to gauge their overall reputation, such as:
 - How does the company market itself in the industry? What is its general reputation?
 - Who are the company's clients? How does it secure those clients?
 - What are the backgrounds of the leaders and managers of the company?
 - Does it deal with government entities? Does it have political involvement or connections?
 - Are there any known integrity issues? Have there been any allegations of corruption, bribery, illegality or other impropriety?
- » Stay engaged with partners and be aware of every method employed to get business.

For more information on the FCPA and selling to foreign governments, refer to the following resources:

- » [A Resource Guide to the U.S. Foreign Corrupt Practices Act](#) – This guide addresses a wide variety of topics, including who and what is covered by the FCPA's anti-bribery and accounting provisions; the definition of a "foreign official"; what constitute proper and improper gifts; travel

⁹ (U.S. Department of Justice)

¹⁰ (Mintz Group, 2013)

and entertainment expenses; the nature of facilitating payments; and the different types of civil and criminal resolutions available in the FCPA context.

- » [Where the Bribes Are: Penalties in U.S. Government FCPA Cases Since 1977](#) – This map shows total penalties assessed for FCPA violations by country, revealing markets in which companies might be greater risk.

FOREIGN DEFENSE MARKET ENTRY

The five principle means by which the U.S. exports defense products and services are Foreign Military Sales (FMS), Direct Commercial Sales (DCS), leases of equipment, transfers of excess defense articles (EDA) and emergency drawdown of weaponry. This report focuses on FMS and DCS, the two purchasing channels available to foreign defense entities through which U.S. companies may grow international sales.¹¹

Unless regulations require a specific process, foreign defense entities choose between FMS and DCS and evaluate proposals based on criteria such as system cost, performance, product life cycle, delivery schedule, logistics support, and industrial utilization. Geopolitical relationships may also come into play in bid evaluation.

DEFINING FOREIGN MILITARY SALES

Foreign Military Sales (FMS) is the program by which the U.S. government assists allied nations and international organizations in acquiring military technology. Under FMS, the U.S. government assumes responsibility for the procurement and transfer of requested defense articles, services, and training, and the foreign purchaser trusts the U.S. government to negotiate contracts that will meet its standards and needs. The U.S. government completes every step of the acquisition process from customer request through final delivery. It determines the contract type, selects the contract source, and negotiates prices and contract terms with individual contractors.

The FMS program involves both the U.S. Departments of State and Defense (DoD). The Department of State supervises and determines which foreign military sales, leases and transfers will be made; the DoD implements the program. Its Military Departments (MILDEPS) - the Department of the Army, Department of the Navy, and the Department of the Air Force – which are responsible for equipping their respective forces, conduct the actual procurements, and its Defense Security Cooperation Agency (DSCA) manages FMS administrative accounts and supervises end-use monitoring.¹²

Because the DoD controls all aspects of FMS procurement, a company might be supplying a foreign government without even knowing. For this reason, FMS is an exception under ITAR in that, while it is necessary for companies to be registered with the Department of State, an export license is not required for individual sales.¹³

FOREIGN MILITARY SALES PROCESS

Foreign defense entities submit Letters of Request (LOR) including their defense article requirements to MILDEPS, DSCA and the Department of State. In response, DSCA and MILDEPS develop Letters of Offer and Acceptance (LOA) for the foreign purchasers specifying pricing and advanced payment requirements, including a surcharge of 3.5 percent of the total FMS costs for recovery of the U.S. government's costs of procurement. The Department of State then must approve the sales and notify Congress if they exceed a certain value threshold. The LOAs are then delivered to the customers and, once they are signed, MILDEPS begins procurement action.¹⁴ MILDEPS will, in some cases, honor LOR calls for specific products and service providers, called "sole sources," without justification.¹⁵

¹¹ (U.S. Department of Defense Security Cooperation Agency, 2006)

¹² (Wilkinson, 2013)

¹³ (Wilkinson, 2013)

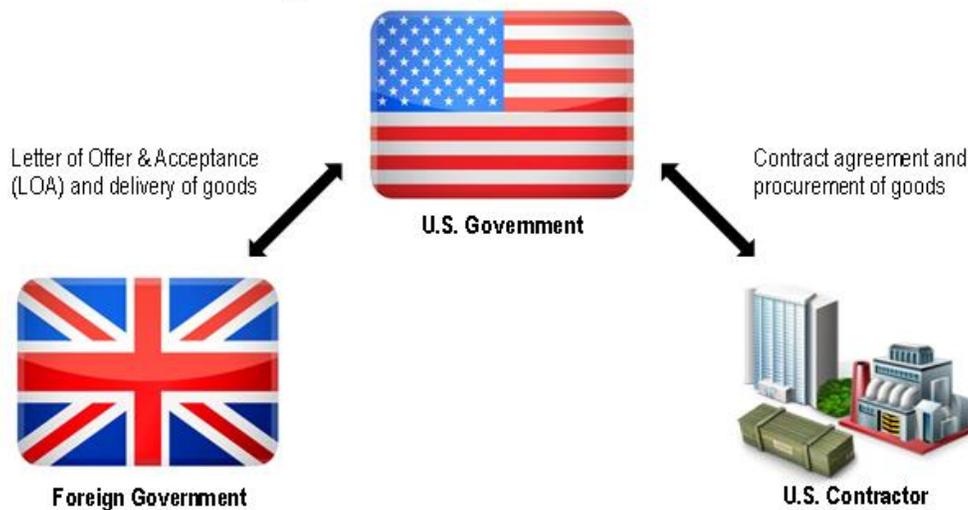
¹⁴ (U.S. Department of Defense Security Cooperation Agency, 2006)

¹⁵ (Wilkinson, 2013)

There are [certain items and situations](#) in which FMS, as opposed to Direct Commercial Sales, must be used. The Department of State works with the DoD's Defense Technology Security Administration (DTSA) to review commercial export license requests and will not issue a commercial export license for sales restricted to FMS only. Historical examples of items that may only be sold through FMS are man-portable air defense missiles, certain cryptographic equipment, and airborne early warning and control systems.

Foreign defense entities may not be limited to one channel of procurement. A purchase can be divided into an FMS portion and a DCS portion. This requires more coordination with all parties involved, but may offer competitive advantages for fulfilling a contract.¹⁶

Foreign Military Sales Process



ENGAGING IN FOREIGN MILITARY SALES

FMS are made on the same basis as procurements for Department of Defense (DoD) purchasers. Familiarity with this process makes FMS an attractive sales channel for many defense companies.

For more information on engaging and selling to the DoD, including FMS, refer to the following resources:

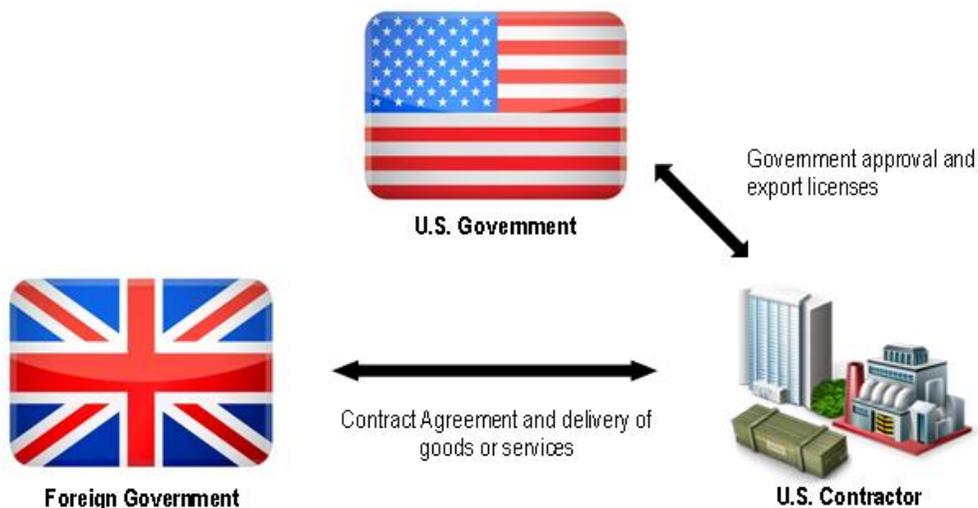
- » [Guide to DoD Contracting Opportunities: A Step by Step Approach to the DoD Marketplace](#) – This Defense Procurement and Acquisition Policy office resource is intended to help companies understand how to engage in the business process with the DoD.
- » [Doing Business with DoD](#) - This DoD resource provides information on business opportunities by military branch.
- » [Management of Security Cooperation \(Green Book\)](#) - This Defense Institute of Security Assistance Management (DISAM) guide covers the full range of security assistance activities.

¹⁶ (Wilkinson, 2013)

DIRECT COMMERCIAL SALES

In Direct Commercial Sales (DCS), U.S. companies negotiate directly with foreign entities, whether they are national governments, local law enforcement and emergency management organizations, or private firms. The U.S. government is only involved in the approval and issuance of export licenses and is not a party to the contracts. Outside of export license requirements, U.S. defense contractors treat direct commercial defense products and services sales contracts with foreign governments the same way they would any other procurement contracts with foreign governments.

Direct Commercial Sales Process



FOREIGN MILITARY SALES VERSUS DIRECT COMMERCIAL SALES

It is important for companies to know the more subtle differences between FMS and DCS in order that they might a) decide to pursue one or both sales channels, and b) try to understand foreign defense purchasers' preferences and adjust marketing and negotiation tactics accordingly.

From the perspective of companies, because the DoD controls all aspects of FMS procurement, FMS are made on the same basis as sales to the federal government. The one consistent difference is that Small Business, Military Veteran, Minority Owned, and other classifications do not offer competitive advantages in FMS. Familiarity with the DoD's procurement procedures makes FMS attractive to U.S. defense contractors. DCS contracts with foreign defense entities may be subject to foreign government procurement, national security, and anticorruption laws that are difficult to navigate and may put U.S. companies at a disadvantage, such as requirements to partner with local companies or use local content.¹⁷ Less complex logistics arrangements and avoiding potential disputes with foreign governments, as well as other typical export issues like financing are further reasons companies might favor FMS. On the other hand, FMS procedural timelines may mean it takes longer to win and execute FMS than DCS, potentially resulting in longer sales cycles and greater expenses. U.S. policy stipulates that most LORs be responded to with an LOA within 120 days. Foreign purchasers have 60 days to accept that LOA. Congressional review, if required, may take an additional 40-60 days.¹⁸ Contrastingly, it takes the Department of State, on average, 17-20 days to process a DCS export license request.¹⁹

¹⁷ (McVey, 2013)

¹⁸ (Wilkinson, 2013)

¹⁹ (U.S. Department of State, 2013)

From the perspective of foreign defense purchasers, though the total package approach of FMS makes comparing overall FMS and DCS outlays difficult, each purchasing channel has its respective pros and cons.²⁰ On the pro side, procurement through FMS can ensure product standardization and interoperability with U.S. and other national defense entity equipment, which may be crucial for allies. Additionally, FMS delivery may be simplified through the employment of the U.S. Government's massive logistics infrastructure. Finally, the FMS channel is required for any purchases under \$100,000 using U.S. Foreign Military Financing (See section on [U.S. Foreign Military Trade Financing](#)) grants and loans. On the con side, because an FMS agreement is not a true contract with the U.S. Government, FMS delivery is not guaranteed, pricing is normally non-negotiable and not fixed, advance payments are required, and the U.S. Government adds to the bill a surcharge of 3.5 percent of the total FMS cost for recovery of its costs of procurement. Moreover, the FMS channel does not allow purchasers access to contracting documentation that enables understanding of contractors' performance obligations in regards to warranties, transportation clauses, and price sensitivities in support contracts.²¹ Foreign defense purchasers may each way these factors differently in determining their preferred purchasing channel.

For more information on the differences in requirements and processes between FMS and DCS, refer to the following resource:

- » [A Comparison of Foreign Military Sales and Direct Commercial Sales](#) – A Chapter of the aforementioned DISAM Security Cooperation Green Book

DIRECT COMMERCIAL SALES TO FOREIGN DEFENSE ENTITIES

If companies prefer to sell to foreign defense entities directly as opposed to via FMS, they may request DSCA to issue a DCS preference for their products and services. Approved DCS preferences are valid for one year. If the DoD receives a request for a DCS-preference article, it notifies the purchaser of the preference and advises them to contact the supplier directly. Support of a DCS preference is a “best effort” commitment by the DoD, meaning that any failure to comply with the DCS preference will not invalidate any resultant FMS transaction. Some items do not qualify for DCS preference.²²

OFFSETS

Provisions for industrial compensation on the part of contractors in foreign government procurement contracts are called offsets. In defense trade, direct offsets are those involving the actual defense articles or services; indirect offsets are not directly related to the articles or services being sold. Direct offsets might include coproduction agreements, licensed production, or the production of a particular part within the purchasing country, but they do not necessarily involve the off-loading of production. They might, instead, entail a technology transfer or training agreement. Indirect offsets could include anything from export assistance to foreign investment.²³

The use of offsets in order to win foreign defense contracts is commonplace. U.S. companies no longer compete with international companies on cost, delivery, and quality, alone, but on offsets as well. In fact, offsets are written into some countries' procurement laws and are part of their formal selection criteria. Negotiations between foreign defense entities and contractors do not usually begin with offset offers, but come up only when required to get the sale.²⁴

OFFSETS IN FMS

²⁰ (Defense Institute of Security Assistance Management, 2013)

²¹ (Wilkinson, 2013)

²² (Defense Institute of Security Assistance Management, 2013)

²³ (U.S. Department of Defense Procurement and Acquisition Policy, 2011)

²⁴ (Wilkinson, 2013)

U.S. policy mandates that no agency of the U.S. Government shall encourage, enter directly into, or commit U.S. companies to any offset arrangement in connection with the sale of defense products or services for foreign governments. In compliance, the DoD has implemented a "hands off" approach to offsets. Under the Defense Federal Acquisition Regulation Supplement (DFARS), offsets are permitted within the FMS framework, but the U.S. Government is not involved in offset negotiations between companies and FMS purchasers, plays no role in judging the merits of these agreements, assumes no obligation to satisfy or administer offset requirements, and bears none of the associated costs. Moreover, neither LOAs (between the U.S. Government and FMS purchasers) nor the contracts associated with those LOAs (between the U.S. Government and the contractors) include any offset agreement terms (such as delivery schedule, acceptance criteria, etc.). Purchasers requesting offset arrangements in conjunction with FMS are informed that the responsibility for negotiating those arrangements and satisfying all related commitments resides with the companies involved.²⁵ However, U.S. policy does allow contractors to include costs associated with offsets attached to FMS financed by purchaser cash or repayable Foreign Military Financing (See section on [U.S. Foreign Military Trade Financing](#)) credits in LOA price estimates, so that the contractors might recover those costs under the FMS contracts.²⁶

If purchasers and contractors sign offset agreements, they remain distinct and independent of the LOAs and the contracts, even though the LOA and the contract may include costs associated with the offset. In such cases, contractors inform the DoD procurement officials when estimated offset costs are included in the FMS pricing information they provide for LOAs. Then, if asked by the purchasers, U.S. Government officials will confirm if offset costs have been included in the LOA price estimates and direct purchasers to contractors for any further offsets-related questions.

OFFSETS REPORTING

U.S. firms are required to report annually on contracts for the sale of defense articles and services to foreign governments and private firms that are subject to offset agreements exceeding \$5 million in value, and offset transactions completed in performance of existing offset commitments for which offset credit of \$250,000 or more has been claimed from the foreign representative.²⁷

DIRECT COMMERCIAL SALES TO NON-DEFENSE FOREIGN ENTITIES

DCS also encompasses sales outside of the foreign national defense sector, including to other public entities like local law enforcement and emergency management organizations, as well as the private security sector. The only pre-requisite for companies to make DCS is to determine and adhere to the export license requirements for the sale of their products or services.

Another option defense companies might consider when developing their international market entry strategies is commercialization, defined here as identifying alternative applications and pursuing commercial sales of technologies and services developed and previously sold exclusively for defense and security purposes. (For more information, see section on [Commercializing Defense Technology](#))

MARKETING TO FOREIGN GOVERNMENTS

The international defense industry, like the domestic, is relationship-driven. It is important for companies pursuing foreign defense business to develop international defense industry networks, so that they might identify foreign decision makers responsible for defining product and service requirements before specific contract opportunities arise. This is important even for defense companies interested only in FMS, as foreign defense purchasers may call for sole sources in their FMS LORs.²⁸ Companies currently engaged

²⁵ (U.S. Department of Defense Procurement and Acquisition Policy, 2011)

²⁶ (U.S. Department of Defense Security Cooperation Agency, 2012)

²⁷ (U.S. Department of Commerce Bureau of Industry and Security)

²⁸ (Wilkinson, 2013)

in FMS might work to build relationships with their foreign purchasers so that the purchasers might offer to continue concluding FMS contracts with restructured DCS contracts, or explore other ways to continue working together.

How companies present themselves to these decision makers is equally important. Marketing efforts should focus on in-hand technologies or services for which companies can offer specific added values or expertise, rather than an array of sourceable technologies or potential capabilities. For example, an information technology solutions provider might focus international marketing efforts on a single application or expertise. Such focus helps foreign decision makers unfamiliar with U.S. companies better understand companies' value propositions, and this understanding allows them to mentally link companies with specific procurement initiatives.

Nonetheless, in defense markets, solid relationships and great marketing campaigns can only be as effective as procurement rules allow. For this reason, companies should understand government procurement in the markets in which they pursue business. Although not required in most cases, companies may want to consider having an in-country representative help them navigate the procurement process. While inserting such middlemen may reduce margins on the front end, they may help reduce costs at the back end. Alternatively, joint ventures or licensing agreements with companies might be beneficial for accessing procurement decision makers or might be necessary to satisfy procurement requirements in certain markets. In such cases, companies should consider partners with existing relationships and physical presence in those markets, and market themselves to potential partners as offering specific products or services that might fill holes in their existing portfolios.

INTERNATIONAL PROPOSAL TIPS

By Colleen Jolly, PPF.APMP

Bidding to a client in the United States (U.S.) can be daunting enough; bidding to a client in another country can seem downright impossible! Below are the top three tips to consider when developing a response to a formal request for a bid, proposal or information. Regardless of your industry, you can follow these tips abroad and at home to improve your proposals, and more importantly, your win rate.

1. **Know your Audience.** Most bids, in the U.S. or elsewhere, are based on relationships developed pre-bid. If you are responding to a bid in a foreign country, you have probably already established a relationship with your intended customer and are working with an in-country representative to guide you through the business and legal eccentricities particular to that country and industry. If not, it may not be worth the time and effort to bid on the opportunity. If you are not, then do not bid on the opportunity.

At the bidding phase, confirm you are speaking and writing about benefits in terms your intended customer will understand and care about. Help them envision receiving the intended benefit through working with you. Explain your process in straightforward terms, avoiding jargon or potentially misinterpreted terminology.

Develop your response in colors and styles appropriate for your audience. In some cases, cultural meanings of color undergo drastic changes around the world; so make sure you are telling the story you intended to tell. Be culturally sensitive in the imagery and overall style that you use while staying industry-relevant. Always work with an in-country or other expert, such as a bid/proposal expert or a visual communications expert, to confirm your images and words will be received in the manner you intend.

2. **Be Compliant with all Instructions.** Requests for bids may come in all shapes and sizes. Read the instructions from your client thoroughly, and develop your response outline based upon their requests. If you are unclear, ask questions. When asking questions is not possible, do your best to respond compliantly. This applies even in cases in which the questions seem out of order or repetitive, asking for the same information multiple times. Several different people may review your bid in individual pieces, so avoid the tendency to simply cite previous paragraphs as a full answer.

Be aware of paper requirements and other submission details, such as printing and electronic submittal. Many countries use the international standard for page format, which differs from U.S. norms. Do not assume that reliable 24/7, on-demand printing exists everywhere in the world. Research an appropriate solution before you print in-country, or allow extra time for shipping and customs processing (and potentially fees) when printing in the U.S. Learn how to submit your bid electronically. This includes understanding file size limitations and the procedures for receipt confirmation as early as possible, not the day the bid is due.

Your customer may receive several bids and can easily disqualify those that do not follow basic instructions.

3. **Answer every Question Clearly.** Your bid should be a project plan that is laid out clearly and consistently, answering all of your customer's questions while highlighting the benefits they receive through working with you. Do not provide extraneous materials, such as marketing documents, that are not specifically requested. If you feel that the provided instructions are lack-

ing or confusing (see #2), and they do not allow you to clearly demonstrate the plan you have in mind for your customer, then you can submit your bid in two parts. One part must follow the instructions exactly. The second part, marked “alternate bid,” may either propose a radically different solution, or simply structure the same solution in a different way.

Do leave time for translation. If possible, work with a translator from the beginning of your project to confirm you are able to tell your story, answer the customer’s questions, and remain within any noted constraints—such as a number of allowed pages. Employ a translator even when the bid is submitted in English! Australian, British and South African versions of English have nuanced differences in spelling, word choice, and overall tone. Reflecting your audience through your words makes them believe you know and understand their unique problems. This encourages them to trust you, which will make them more likely to buy from you.

When appropriate, use graphics to explain complex concepts. Research your intended customer’s website and other marketing materials to understand how they visually represent themselves. Work with an in-country representative or other expert, such as a bid/proposal expert or a visual communications expert, to confirm what type of graphic and style will most resonate. A well-done graphic will tell your story faster than text alone; a poorly done graphic may unintentionally offend or confuse.

Colleen Jolly, a 13+ year proposal veteran, manages a global professional proposal graphic company – 24 Hour Company – with offices in the US and UK. She has also trained thousands of people around the world in visual communication best practices. Colleen is very active in the Association for Proposal Management Professionals (APMP) and serves as the current COO of the international board. She has previously served as the Layout Editor for the APMP Journal and Secretary of the NCA (Washington, DC area) Chapter. She was named an APMP Fellow in 2010, reflecting her significant contributions to the industry, and holds the highest certification possible—Professional Accreditation. She is also an award-winning artist and business professional.

SELECTING INTERNATIONAL MARKETS

Conducting research and weighing alternatives to determine target international markets is a critical step in the export process. As defense companies focus their foreign marketing efforts on specific products and services for which they can offer a specific added value and expertise, they should evaluate markets based on sales potential of the same. The components below play into such evaluations to varying degrees depending on companies' products or services, situation, and objectives. However, personal knowledge about or connections in a target market may also sway a company toward a market.

MARKET SIZE AND GROWTH

Demand is a major factor in market potential. To begin assessing demand, companies should make themselves aware of the impact of general economic and geopolitical situations on defense markets – for example, austerity measures will mean reduced spending in Europe while growth and potential conflicts in parts of Asia, Africa, the Middle East, and South America will likely mean increased defense budgets in those regions. In addition, companies might analyze specific market size and growth indicators to further gauge demand, including national defense spending and specific program investments, defense-related imports from the U.S. and world, and the presence of competition or possible partners. For sub-contractors, it may be beneficial to locate foreign markets in which their past prime contractors are already active.

| Market Size and Growth Assessment Criteria | Research Resources |
|--|--|
| National defense spending | » Military Expenditure by Country – Stockholm International Peace Research Institute (SIPRI) |
| Defense program investments | » Market Research Library: Export.gov » Industry sources |
| International defense trade | » Arms Transfers Database – SIPRI Top arms importers Country imports by arms category Country imports by suppliers Individual transfers within weapons categories by recipient / supplier (for transfers involving the U.S., whether supplier (FMS) or just licensor (DCS) is indicated) |
| U.S. defense trade* | » FMS, Excess Defense Articles, International Military Education and Training (IMET), and Drawdown Assistance, broken down by country – Federation of American Scientists » U.S. Dept. of State-licensed authorizations by destination country and product category and licensed shipments by destination country – Section 655 Annual Military Assistance Reports, U.S. Dept., of State » U.S. exports by HS Code as reported by Customs (in- |

| | |
|-------------------------------|--|
| | cludes DCS shipments, at least) – VEDP – International Trade resources |
| Partner / competitor presence | <ul style="list-style-type: none"> » Arms Industry Database – SIPRI » Industry sources |

*See Appendix for review of the above U.S. defense trade statistics sources and their limitations

POLITICAL ENVIRONMENT

Defense companies' may view markets' political environments differently than commercial companies. Whereas turmoil, whether internal or external, is likely to make markets less attractive to risk averse commercial companies, it could signal increased demand and make markets more attractive to defense companies. However, companies wishing to pursue markets involved in any turmoil need to be particularly aware of the status of U.S. diplomatic relations with those nations, as well as any safety or security issues that they might face in shipping products or providing services there.

| Political Assessment Criteria | Research Resources |
|-------------------------------|---|
| Stability of the market | » Political/Economic by Country: BTI Project |
| Diplomatic relations | <ul style="list-style-type: none"> » Refer to section on Understanding Export Regulations » Political Overviews: U.S. Department of State |
| Safety and security | » Travel Advisories: U.S. Department of State |

MARKET ACCESS

Foreign market access for defense products and services exports is largely dependent on government procurement law and related multilateral and bilateral agreements of specific markets.

GOVERNMENT PROCUREMENT AGREEMENTS

The World Trade Organization (WTO) Agreement on Government Procurement (GPA) is an agreement between 28 WTO members, including the U.S., aimed at opening procurement processes to international suppliers. GPA signatories pledge to use non-discriminatory practices towards contractors from other signatories when tendering procurements, meaning that GPA signatories cannot treat bids from contractors from other signatories differently than bids from national contractors. The GPA consists of two parts: the general rules that signatories must follow, and a series of annexes that detail which divisions and subdivisions of signatories' governments are subject to the GPA. Although signatories' government departments that are subject to the GPA are required to evaluate bids in a "no less favorable" manner, their adherence to the requirement may be difficult to qualify.

Standard U.S. Free Trade Agreement (FTA) language also requires non-discriminatory practices in government procurement, meaning that, like signatories to the GPA, U.S. FTA partners must treat U.S. bidders as they would treat domestic bidders in the tendering process.

Although procurements of almost all of the Departments of Defense of GPA signatories and FTA partners are covered under their respective agreements, the types of goods and services covered vary by country. For example, only certain services are covered under Japan's GPA annex; goods purchased by Japan's Ministry of Defense are not covered and it is, thus, not required to treat foreign bidders in a non-discriminatory fashion.

In addition to such division and contract type carve-outs, GPA and FTA procurement policies apply only to signatory and partner contracts above certain, respective value thresholds. For tenders below these thresholds, the governments are not required to follow the rules set forth by their agreements. These thresholds are updated annually and can be found in the Federal Register.

GPA signatories and the 19 countries with which the U.S. has signed FTAs might qualify as potential target markets for defense exports because they adhere to the abovementioned basic government procurement standards. That being said, the countries also have further, individual rules regarding the registration and participation of foreign bidders that companies should be aware of.

GOVERNMENT PROCUREMENT RESOURCES

Many countries now list their contracts online in English and allow for companies to submit their bids through an online process, but the bids must be in the home language. Companies should be prepared to use a translation service when going through the bidding process. Companies seeking to bid on GPA signatories' and FTA partners' contracts might want to determine whether the contracting departments are covered, whether the contract types are covered, and whether the contract values meet the respective government procurement thresholds. Companies should, moreover, pay attention to countries' rules regarding government procurement registration and participation.

[The VEDP–International Trade Government Procurement Database](#) compiles procurement information on countries that are either signatories of the WTO GPA or with whom the U.S. has an FTA. The database shows countries by whether their defense departments are covered by their respective agreements, by contract type coverage, and by procurement thresholds. It also provides links to countries' participation requirements and online tendering databases.

In countries that are neither GPA signatories nor U.S. free trade partners, government procurement is more complicated and U.S. companies are more likely to need in-country representative assistance. There is also a mechanism in place for dispute settlement if the company feels that there was discriminatory tendering.

OTHER MARKET CONSIDERATIONS

Other considerations not specific to defense companies may impact market selection, including travel considerations, intellectual property and other legal specificities, and culture.

For more information on resources available to help companies select international markets, refer to the following resources:

- » [Fast Facts – Exporting 101 – Selecting an International Market](#) – A VEDP – International Trade publication.
- » [Exporting Services – A Guide for New Exporters – Selecting an International Market](#) – A VEDP – International Trade publication.

DEFENSE TRADE FINANCING

One more major factor that plays into defense export market selection and sales execution is financing. Whether foreign defense entities have funding for relevant program investments is a major component in market evaluation. However, if they do not have funding for a specific purchase in the short term, but plan to in the longer term, there are often financing options available to carry them over. Alternatively, the U.S. government and international organizations may provide some governments funding for specific defense purchases.

FINANCING TOOLS

Financing tools for U.S. exporters are offered by three key parties: commercial banks, the U.S. Small Business Administration (SBA), and the Export-Import Bank of the United States (Ex-Im Bank). Commercial Banks are rarely willing to take the risk of financing export projects on their own. To help exporters get the capital necessary to begin or maintain existing international business, the federal government, via the Small Business Administration (SBA) and the Export-Import Bank (Ex-Im Bank), mitigates commercial banks' risk of export financing through intermediate export finance products. The agencies assume the country and credit risks that banks are unable to accept by guaranteeing loans and otherwise extending credit to a company. The agencies' products come with their own applicant qualifications and requirements to which commercial banks may add different and more stringent parameters. Nearly all finance options require an evaluation of an exporter's assets: collateral, accounts receivable, cash flow statements, and ability to repay, to name a few.

EXPORT-IMPORT BANK PROGRAMS

The caveat specific to defense companies, however, is that **the Ex-Im Bank does not typically provide financing for export of defense products and services**. Ex-Im classifies defense products and services based on the foreign end-user, the nature of the item, and its use. There are, however, several exceptions that might allow companies to obtain export financing from the Ex-Im Bank for the following items:

- » Humanitarian items and medical equipment, even if sold to a military entity
- » Small marine vessels and aircraft used for routine border patrol, drug interdiction or natural resource monitoring, even if sold to a military entity
- » Food that will be consumed by the U.S. military
- » Dual use items with both military and commercial applications, provided there is convincing evidence the item is non-lethal in nature and will be used primarily for civilian activities
- » Items used for drug interdiction purposes that have been granted a limited waiver by Ex-Im or a Presidential Determination of National Interest²⁹

Additionally, the Ex-Im Bank offers other programs not specific to individual export transactions that defense companies may be able to take advantage of:

GLOBAL CREDIT EXPRESS

Global Credit Express is a pilot program aimed at financing the business of exporting rather than specific export transactions. It offers small businesses with a minimum of three years of revenue producing operations and one year of exporting experience a 6-12 month revolving line of credit of up to \$500,000.

²⁹ (Export-Import Bank of the United States, 2012)

Participating commercial banks facilitate the application process for the Ex-Im loan. For more information, visit the Ex-Im Bank [Global Credit Express Product Page](#).

SUPPLY CHAIN GUARANTEE

The Ex-Im Bank's Supply-Chain Guarantee supports suppliers' sale of accounts receivable from a U.S. exporter to a commercial lender by providing a 90 percent guarantee on the invoice. The program helps exporters' suppliers obtain cash quickly (often at lower rates that reflect the credit of the exporter) and increase liquidity to fulfill new orders. For more information, visit the Ex-Im Bank [Supply Chain Guarantee Product Fact Sheet](#).

SMALL BUSINESS ADMINISTRATION PROGRAMS

Alternatively, SBA export finance programs place no limitations on defense product and service exports:

EXPORT EXPRESS LOAN PROGRAM

SBA Export Express offers up to \$500,000 in loan proceeds – in the form of a term loan or revolving line of credit - to be used for business purposes that will enhance a company's export development. Any service company that has been in operation for at least one year and can demonstrate that the loan proceeds will support its export activity is eligible. Participating commercial banks facilitate the application process for the loan. For more information, visit the SBA [Export Express Loan Program Product Page](#).

INTERNATIONAL TRADE LOAN PROGRAM

The International Trade Loan Program provides lenders with a 90 percent guaranty on term loans for fixed assets and working capital of up to \$5 million for the purpose of enabling the borrower to be in a better position to compete. The program is intended to assist businesses that plan to start or continue exporting, or that may have been adversely affected by competition from imports and need to retool to become more competitive. Funds may be used for mergers & acquisition; construction, renovation & expansion; modernization & improvement; and for refinancing of an existing loan. For more information, visit the SBA [International Trade Loan Program Product Page](#).

EXPORT WORKING CAPITAL PROGRAM

The Export Working Capital (EWCP) Program loan provides advances for up to \$5 million to fund export transactions. Companies can apply for EWCP loans before finalizing an export sale or contract. With an approved EWCP loan in place, they have greater flexibility in negotiating export payment terms. Disbursements can only be made against firm purchase orders from a foreign buyer or to support foreign accounts receivable. For more information, visit the SBA [Export Working Capital Program Product Page](#).

In addition to payment terms and export finance, foreign transactions might be impacted by foreign currency exchange regulations, in-country legal requirements, banking costs, and political/country uncertainty. Developing relationships with international banking institutions is an easy way to help lessen the financial risks of international trade. Many experienced lenders provide free advice and information to assist exporters in understanding their exposures and the financing options available.

For more information on export financing and payments, refer to the following resources:

- » [Fast Facts – Exporting 101 – Financing and Payments](#) - A VEDP – International Trade publication.
- » [Exporting Services – A Guide for New Exporters – Financing and Payments](#) - A VEDP – International Trade publication.
- » [Ex-Im Bank's website](#) – This resource provides further information on limitation on defense export financing.

U.S. FOREIGN MILITARY FINANCING PROGRAM

Foreign Military Financing (FMF) is a U.S. government program that provides grants and loans to foreign government purchasers with demonstrated need for acquisition of U.S. military articles, services, and training. Funds provided through the FMF program can be used for purchases through FMS or, as approved on a case-by-case basis by the DSCA, DCS. In general, FMF is not approved for DCS contracts under \$100,000.³⁰

For more information on FMF, refer to the following resources:

- » [Guidelines for Foreign Military Financing of Direct Commercial Contracts](#) – A DSCA resource
- » [Foreign Military Financing Account Summary](#) – This table on the Department of State website shows country account levels for FMF for fiscal years 2006-2011.

In addition to FMF, Section 1206 of the National Defense Authorization Act (NDAA), which gives the Secretary of Defense the authority to train and equip foreign military and maritime forces, and several other security cooperation programs funded by the Departments of State and Defense provide foreign states with military and related assistance. For example, the Department of State offers grant aid related to the war on drugs through its International Narcotics Control and Law Enforcement (INCLE) fund and the DoD administers the Peacekeeping Operations (PKO) program in conjunction with the policy guidance of the Department of State. These programs may also directly and indirectly support defense contractors.

For more information on U.S. Government Security Assistance, refer to the following resources:

- » [Foreign Aid: An Introduction to U.S. Programs and Policy](#) – This Congressional Research Service (CRS) report provides an overview of U.S. foreign aid, including security assistance.
- » [Security Assistance Reform: “Section 1206” Background and Issues for Congress](#) – This CRS report provides an overview and update on Section 1206 and shows Section 1206 funding for FY2011-FY2012 by country and program.
- » [U.S. Department of State Security Assistance](#) – This website provides summaries of Political-Military-administered security assistance funds planning and disbursement by country
- » [U.S. Overseas Loans and Grants](#) – This website provides a complete historical record of all grants and loans provided by the U.S. Government, including those related to the security assistance programs explained in the above documents.
- » [Foreign Assistance Dashboard](#) – This website provides data on all foreign aid provided by the U.S. government, including those related to the security assistance programs explained in the above documents.

³⁰ (Defense Security Cooperation Agency, 2011)

COMMERCIALIZING DEFENSE TECHNOLOGY

Another option defense companies might consider in developing their international market entry strategies is commercialization, defined here as identifying alternative applications and pursuing commercial sales of technologies and services developed and previously sold exclusively for defense purposes. Many contractors possess some unique technology or capability that, with little adaptation, can be marketed and sold in other industries or sectors both domestically and abroad.

IDENTIFY ALTERNATIVE APPLICATIONS

Companies devising initial commercialization strategies should focus on a single technology they sell or a service for which they offer the greatest expertise. Identifying alternative applications or industries in which these might be employable, as well as any alterations necessary to make them so, might be an exercise of trial and error, but many products and services developed for the defense industry can be found to have some industrial or consumer use. For example, a company contracted by the Navy for ship maintenance might market its services in the energy sector for maintenance of offshore wind turbines, or a company with a bulletproofing technology developed for defense purposes might apply it to non-defense products to sell in consumer markets for personal safety uses.

Furthermore, many prime defense contractors have already begun to diversify into commercial markets, both domestically and abroad, and sub-contractors might follow their leads to gain insight into potential industries for commercialization of their own products or services. For example, some prime contractors have pursued opportunities in infrastructure development, in which their engineering and project management expertise have a high value proposition.

Companies must beware, however, not to waste time and energy trying to fit into an industry in which there just is not a place for them. Reuters quotes Northrop Grumman Chief Executive Wes Bush: “The experience of our industry suggests that the longer you have to stretch out your tape measure to measure how adjacent [an industry] is, the less likely it is that you’re going to really create value.”³¹

IDENTIFY POTENTIAL MARKETS

Once companies have identified non-defense related applications for and sectors and industries in which to begin marketing their products or services, they should examine those sectors and industries from a global perspective to identify potential markets. For example, in the previous example of companies commercializing into infrastructure development, potential markets would include those planning major infrastructure investments.

As subcontractors might follow primes’ leads into commercial industries, they might similarly wish to evaluate the sales potential for their own commercialized products or services in the foreign markets in which these primes have pursued commercial sales. Moreover, they might consider strategic alliances with primes in their commercialized industries.

As defense companies find commercialization opportunities in infrastructure development-related industries, they might look to countries in which the U.S. Government and international development organizations offer aid for such projects. However, they should beware that in some markets government

³¹ (Shalal-Esa, 2013)

procurement laws (For more information, see section on [Market Access](#)) place restrictions or requirements for local partners or content on procurements in state-controlled industries such as infrastructure, energy, etc.

For more information on resources available to help companies select international commercial markets, refer to the following resources:

- » [Fast Facts – Exporting 101 – Selecting an International Market](#) – A VEDP – International Trade publication.
- » [Exporting Services – A Guide for New Exporters – Selecting an International Market](#) – A VEDP – International Trade publication.
- » [U.S. Aid Opportunities](#) – This VEDP-International Trade publication provides an overview of U.S. Government entities that provide opportunities for procurement in international aid.

CHALLENGES

Companies interested in commercializing defense technologies must assess their internal commitments, resources, and competencies to determine whether their organizations are capable of such strategic shifts. Top management support is critical to the success of companies' commercialization efforts, as various units, including product development, manufacturing, and distribution, may have to be altered.³² Perhaps the greatest challenge to defense companies' commercialization strategies, however, is staff adaptation. Employees with extensive defense industry backgrounds may not have sufficient commercial market knowledge, contacts, or experience navigating commercial routes to market and negotiations. Companies pursuing commercialization strategies must determine where they have inadequacies in regards to these capabilities and reassign staff accordingly.

Although commercialization strategies can take several years to execute and require significant resources, they may be the best alternatives or good complements to defense export plans.

³² (Marolda, 1997)

EXPORT ASSISTANCE IN VIRGINIA

Virginia Economic Development Partnership - International Trade assists both new and experienced Virginia businesses with identifying new markets, developing market entry strategies, and locating distributors and representatives—all at little to no cost. Businesses interested in increasing international sales and growing market share can benefit from our export development programs, publications, special resources, and market research.

For more information, please visit our website at www.exportvirginia.org.

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APPENDIX: REVIEW OF U.S. DEFENSE TRADE STATISTICS SOURCES

The U.S. Departments of Commerce, State and Defense each publish elements of U.S. defense trade data as it relates to their respective purposes:

- » The Department of Commerce publishes data on goods that cross U.S. borders by Harmonized System code, including defense products;
- » The Department of State publishes data on the value of the licenses it approves under ITAR for defense products; and
- » The Department of Defense publishes³³ data on FMS.

Each agency's reporting leaves holes in the defense trade data puzzle pieces for which it is responsible. Beyond that, the agencies' various methodologies make it impossible to put the pieces together to form a complete picture. That being said, the data that is reported can individually provide insight on trends by transaction type.

Below are detailed descriptions of the various sources for U.S. defense trade data and their respective limitations. Companies seeking to analyze U.S. defense trade data in order to determine target international markets should understand these limitations.

U.S. DEPARTMENT OF COMMERCE CENSUS BUREAU

The export data reported by the U.S. Department of Commerce's Census Bureau is sourced from the U.S. Department of Homeland Security's department of Customs and Border Protection (Customs), which oversees the movement of goods into and out of the United States at ports of entry and departure. Its origin is Customs' Automated Export System (AES), in which exporters are required to file all export shipments. While the trade statistics published by the Census Bureau can be expected to report DCS shipments fairly accurately, inclusion of FMS shipments in these statistics is based on a rule requiring the exporting DoD entity to report them, and compliance with that rule can be spotty. For example, if parts and components are being shipped via military assets, there is no formal customs clearance process, so those items may or may not be reported. Additionally, when FMS exports are reported, the value reported may include U.S. Government surcharges billed to the customer.³⁴

U.S. DEPARTMENT OF STATE

The U.S. Departments of State and Defense are legally required to prepare an annual report on arms exports, known as the "Section 655" report. The State Department's contribution is produced by the Directorate of Defense Trade Controls and gives information on all licenses granted during a fiscal year for the export of defense goods and services.

- » [U.S. Department of State Section 655 Annual Military Assistance Reports – Value of licensed authorizations \(by product category\) and value of licensed shipments](#)

³³ (Cralley & Johnson, 2010)

³⁴ (Cralley & Johnson, 2010)

Per the framework of the report, it should be noted that the year a license is issued is often not the year in which an export will actually occur. Additionally, licenses are issued for sales that never fully materialize. Using Customs data, the Department of State can match license numbers on export shipments with a database of approved licenses to both insure that an export conforms to a license, and to “decrement” the value of a specific shipment against the total value allowed in a license. Similarly, it ought to be able to publish data on licensed shipments by country and by category. However, in the latest 655 Report, the Department of State does not show actual shipment data by individual weapons categories.

Furthermore, the Department of State’s data does not differentiate between shipments that are actually going to U.S. military forces or other agencies overseas, versus to foreign governments, possibly inflating foreign export data by as much as 50 percent.

Finally, it does not report data on the use of technical assistance or service licenses.³⁵

U.S. DEPARTMENT OF DEFENSE

The Defense Security Cooperation Agency (DSCA) produces the DoD’s contribution to the “Section 655” report. DSCA maintains data on FMS and publishes it annually in its [Foreign Military Sales, Foreign Military Construction Sales and Other Security Cooperation Facts](#) report. This report contains data by country on FMS agreements, FMS deliveries, foreign military construction sales agreements, foreign military construction sales deliveries, and foreign military financing programs. The data in this report is not broken down by product or service type, but the Federation of American Scientists regularly obtains it with this further breakdown via Freedom of Information Act (FOIA) request.

- » [Federation of American Scientist FOIA requests on FMS, Excess Defense Articles, International Military Education and Training \(IMET\), and Drawdown Assistance, broken down by country](#)

DSCA also maintains the [Arms Sales Notifications Index](#), which gives information of notifications to Congress of possible FMS, and the [Excess Defense Articles Online Database](#), which gives information on surplus weaponry given away to U.S. allies for free or at substantially reduced prices. Additionally, the DoD is legally required to prepare an annual report on sales of significant military equipment in excess of \$2 million, known as the “[Section 1231](#)” report. The report covers FMS and - when available - DCS and includes value, descriptions, manufacturers, state of the goods sold, and destination country, broken down by individual contract.

Finally, the DoD’s Defense Procurement and Acquisition Policy (DPAP) office provides procurement data on behalf of the DoD to Congress, the GAO, and the public. However, because it is not, itself, a primary data collection agency, the data it reports is sourced from the aforementioned agencies and reflects the limitations previously discussed. Moreover, its country-specific data reports generally add FMS Agreements signed during a fiscal year and DCS exports, which are two different concepts entirely.³⁶

³⁵ (Cralley & Johnson, 2010)

³⁶ (Cralley & Johnson, 2010)