



## **Federal contracts awarded to the RUAG technology company**

### **Audit of federal contract processing**

#### **Key facts**

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RUAG Holding emerged from the federally-run armament enterprises and was converted into a corporation under private law effective 1 January 1999. The Swiss Confederation is the sole shareholder. RUAG Holding's Board of Directors consists of seven members, the Federal Department of Defence, Civil Protection and Sport (DDPS) being represented by the Chief of the Armed Forces Planning Staff. The technology group manufactures military and civilian products and offers corresponding services. It is involved in the "Aviation & Space", "Defence & Security", and "Ammunition & Products" markets and operates production sites in Switzerland, Germany, Sweden, and Hungary.

When the federal armament enterprises began operations as RUAG in 1999, DDPS contracts amounted to 86% of its sales. Only 14% of sales totalling CHF 960 million went to third-party clients. In 2007, sales were CHF 1,409 million, of which only 34% went to DDPS. The sales growth is primarily due to the acquisition of enterprises in Switzerland and abroad. Today, RUAG employs 6,700 people, 3,800 of whom work in Switzerland.

In 2007, the National Council's Defence Committee commissioned an Administration-independent audit of RUAG's business activities. The matter was delegated to the parliamentary Finance Delegation, which mandated the Swiss Federal Audit Office to conduct the audit.

#### **Object and purpose of the audit**

With the help of an overview and a brief assessment of the current DDPS procurement system, the audit examines the current situation with respect to compliance with the principles of fair competition and best cost/performance ratio. The audit examines the individual subsidiaries with regard to the margins of DDPS orders in comparison with third-party orders. The comparison aims to show whether impermissible cross-financing occurs. With a view across the borders, the audit outlines how government armament enterprises are structured in comparable countries.

#### **Owner's expectations of RUAG**

The objectives for RUAG are defined in owner strategies covering four years. First of all, the RUAG companies must guarantee the Armed Forces' equipment; hence the companies constitute an integral part of the federal government's defence policy mandate. RUAG primarily ensures the maintenance of material, maintenance of combat readiness, upgrading of combat readiness and, to the extent necessary, disposal of weapons systems, devices and ammunition. RUAG is expected to be competitive both in the civilian and in the military field. A reasonable EBIT margin (earnings before interest and tax) of more than 6% should be achieved, without achieving "unreasonable" profits on DDPS monopoly orders. The expected earnings have not been achieved so far, however; in 2007, earnings were 5.4%.

The expectations of the owner and the owner's representatives with respect to reporting and controlling are also part of the owner strategy. The desired business information is not always clearly defined, however, which has led to discussions concerning the type and scope of reporting (e.g. segment and margin information). To prevent uncertainties in this regard, the owner should in future specify in more detail the key data to be provided by RUAG.



### **Unequal relevance of RUAG subsidiaries to DDPS**

The dependence of RUAG subsidiaries on DDPS contracts varies. This is evidenced by the sales figures. At RUAG Electronics, the average sales share of DDPS contracts between 2003 and 2007 (five years) was more than 80% (CHF 710 million); at RUAG Land Systems, the share was nearly 50% (CHF 433 million); at RUAG Aerospace 40% (CHF 1,120 million); at RUAG Ammotec 12% (CHF 124 million); and at RUAG Components 5% (CHF 25 million). The question of cross-financing between DDPS and third-party contracts must therefore be examined in a differentiated manner for each subsidiary.

### **No cross-financing for the benefit of third-party contracts**

On average, domestic DDPS orders had a slightly lower profit margin than third-party orders. Only at RUAG Land Systems is the profit margin higher – albeit due to the structure maintenance effect.

The RUAG companies in Switzerland have a higher profit margin than those abroad. Since foreign business, including several new business fields, is often still under development, it is understandable that lower margins must still be accepted, taking into account the product cycles.

For the SFAO, cross-financing at RUAG is only relevant in cases where resources are fed to a business segment on a permanent basis to ensure its survival. The SFAO did not determine that this is the case. On the contrary: loss-generating activities were either sold or abandoned completely.

The SFAO concludes that no cross-financing takes place for the benefit of third-party contracts.

### **Somewhat higher profit margins at foreign armament enterprises**

A comparison on the basis of publicly available financial statements of foreign armament enterprises shows that their profit margins tend to be higher than those of RUAG.

### **Special provisions apply to procurements in the armament sector**

National procurement laws and international procurement provisions do not apply fully to armament purchases. The Federal Council has therefore established rules to be observed in such cases.

The SFAO concludes that the provisions currently in force for procurements in the armament sector are complied with.

### **Optimisation potential for armament procurement**

Already at an earlier time and independently of this audit, the Parliamentary Control of the Administration and the ETH Zurich examined armament procurement in detail. The current procurement practice was evaluated from a legal and business management perspective. Both reports concluded that optimisation potential exists for armament procurement, and they drew attention to the various interests and focuses relating to the armament industry. Political, security policy, business management, and legal parameters conflict in some areas or should be harmonised more closely with each other and with the actual needs of the Armed Forces. The recommendations were taken up by the competent bodies. They have been included in various projects and continue to be pursued.

This audit did not further examine the status of their implementation.



### **Reduction of State participation in Finland and Norway**

The situation in Finland and Norway is largely comparable to the situation in Switzerland. Also in those countries, an independent guarantee of procurement, maintenance, and support of armaments is a key criterion of defence policy. Despite the defence policy mandate, State participations in armament enterprises – incidentally not only in Finland and Norway – have been reduced, however. Finland is strengthening its industrial position in the armament field with the help of a major international partner. Norway, by comparison, has chosen to go public, combined with diversification into non-military markets. Also in Switzerland, it has been recognised that an armament enterprise requires a certain size as well as diversification into other sectors in order to survive in the long term. In recent years, RUAG has primarily pursued this goal by acquiring other companies.

**Original text in German**