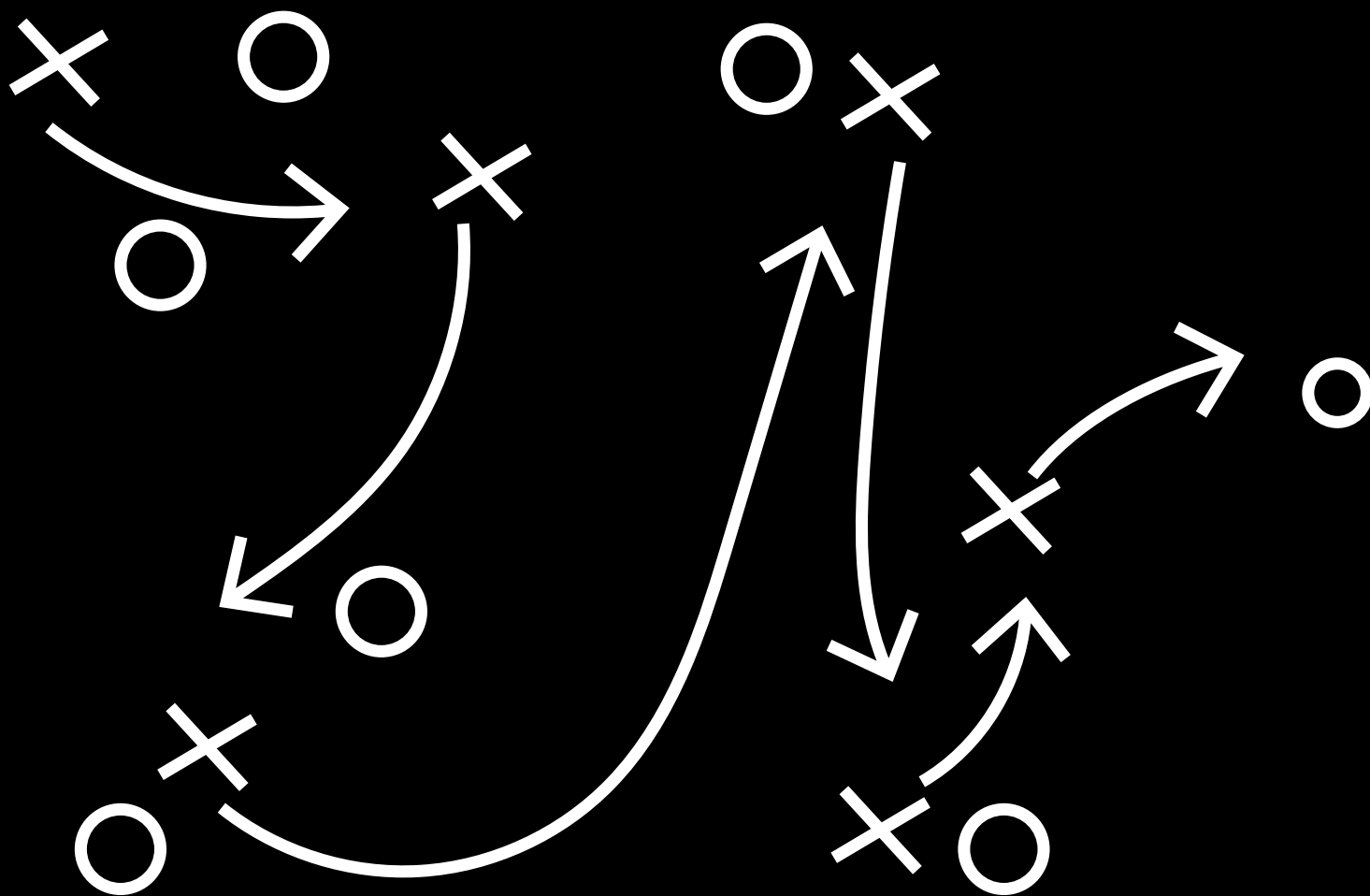


EUROPE'S DEFENSE INVESTMENT BOOM DEMANDS A NEW DEAL PLAYBOOK



BY PHILIPP GRENZEBACH, STÉPHANE DIONNET, SABINE NAUGÈS & RAMINTA DERESKEVICIUTE¹

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Europe's defense sector is entering a period of significant investment and consolidation as governments increase defense spending, technological innovation accelerates and policy-makers seek to strengthen European industrial capacity. These developments are creating substantial opportunities for private capital, but the assets attracting the greatest investor interest are often those facing the greatest regulatory scrutiny. Competition law, foreign investment screening, export controls and sanctions increasingly converge around the same strategic technologies and transactions. At the same time, European competition policy is adapting to an environment in which industrial scale, resilience and security of supply have assumed greater importance. This article considers how those developments are changing the deal landscape and why regulatory strategy increasingly needs to form part of investment planning from the outset. For investors, understanding the interaction between competition policy and national security will be increasingly important to transaction structure, execution certainty, valuation and exit strategy.

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I. EUROPE'S CHANGING DEFENSE INVESTMENT LANDSCAPE

Finding attractive assets has always been central to successful investment. In Europe's rapidly evolving defense sector, however, investors are increasingly recognizing that identifying the right opportunity is only part of the equation. Understanding how competition policy, industrial strategy and national-security regulation are reshaping the transaction landscape is becoming just as important.

Europe's defense sector is entering a period of significant growth. Heightened geopolitical tensions, the war in Ukraine and renewed attention to the resilience of European industrial capacity have transformed defense policy across the region. Governments are committing substantially more public money to defense and security while seeking to strengthen domestic and European supply chains and reduce strategic dependencies.

At the 2025 NATO Summit in The Hague, NATO Allies committed to investing 5 percent of GDP annually in defense and defense- and security-related expenditure by 2035. At least 3.5 percent is intended for core defense requirements, while up to 1.5 percent may be devoted to broader expenditure including critical infrastructure, resilience, innovation and the defense industrial base.² At EU level, the ReArm Europe Plan/Readiness 2030 envisages mobilizing up to €800 billion of additional defense expenditure, including through greater national fiscal flexibility and the €150 billion Security Action for Europe ("SAFE") instrument.³

The commercial opportunity extends well beyond traditional defense contractors. Modern defense capability depends on communications networks, cybersecurity, artificial intelligence ("AI"), semiconductors, autonomous systems, advanced manufacturing, logistics, software and space capabilities. The boundary between the defense industrial base and the wider technology economy is consequently becoming less distinct, particularly for businesses developing technologies with both civilian and military applications.

This expansion is taking place alongside an important change in the way European policymakers think about defense capability. The objective is not simply to increase expenditure, but to strengthen the industrial base capable of supplying European governments, increase production capacity and resilience, and reduce dependencies in strategically important areas. That combination of public spending and industrial policy is creating significant opportunities for investors, while also increasing scrutiny of the ownership and control of the businesses expected to deliver those capabilities.

Many of the assets likely to benefit most from Europe's defense priorities possess technologies, intellectual property or industrial capabilities that governments regard as strategically important. As a result, some of the businesses offering the greatest potential upside are also those most likely to attract regulatory attention, making regulatory strategy an increasingly important part of investment strategy.

II. INVESTMENT AND CONSOLIDATION ACROSS THE SECTOR

Investment activity already reflects this shift. European venture capital is supporting a new generation of defense-technology companies focused on drones, autonomous systems, AI, sensors, software and cybersecurity. European defense-technology venture funding has risen sharply, from approximately €200 million in 2021 to around €2.6 billion in 2025. Some have achieved valuations that would have been unusual for European defense startups only a few years ago, while private equity investors are establishing dedicated defense strategies or reconsidering investment policies that historically limited exposure to the sector.

Private equity activity tells a similar story. Dedicated defense and security vehicles have been launched by established sponsors, including Tikehau Capital's defense and security fund and Warburg Pincus's European defense investment platform, while recent buyouts and IPO exits of European defense assets point to increasing sponsor confidence. Consolidation is gathering pace more broadly: more than 130 M&A transactions involving European defense-industry targets were executed between January 2025 and April 2026.

At the same time, the relationship between emerging technology companies and established defense contractors is changing. Innovation increasingly occurs outside traditional defense primes, particularly in software, autonomy and AI, while established contractors continue to possess the manufacturing capacity, procurement relationships, certification expertise and industrial infrastructure required to deliver at scale.

² NATO, [The Hague Summit Declaration](#) (June 25, 2025); NATO, [Defence Investment and NATO's 5% Commitment](#) (updated June 29, 2026).

³ European Commission, [White Paper for European Defence – Readiness 2030](#) (Mar. 2025); European Commission, [Future of European Defence](#). The ReArm Europe Plan/Readiness 2030 envisages mobilizing up to €800 billion, including the €150 billion SAFE instrument.

This creates opportunities for acquisitions, but also for joint ventures and strategic alliances. Emerging technology businesses may need industrial scale and access to procurement programs, while traditional primes may need technologies that can be integrated into existing platforms. In some cases, cooperation may offer a more effective route than an outright acquisition.

European defense procurement also retains a strong national dimension. Local-content requirements, security-of-supply considerations and government preferences can make cooperation with domestic industrial partners commercially important or effectively necessary. Transaction structures may therefore be influenced not only by conventional considerations of price, control and financing, but also by the ability of the resulting business to participate in future procurement programs.

For investors, this makes the regulatory environment relevant much earlier in the investment process. A commercially attractive target may have a materially different value depending on who owns it, where its technology is held, which governments it supplies and whether its ownership structure affects access to future contracts.

III. COMPETITION POLICY AND EUROPE'S DEFENSE PRIORITIES

The expansion of Europe's defense industrial base presents a particular challenge for competition policy. EU merger control has traditionally focused on preserving effective competition, preventing harmful concentration and protecting innovation and consumers. Those objectives remain central, but defense markets have characteristics that can make conventional competition analysis more complex.

Governments are frequently the principal customer and, in some markets, effectively the only customer. Markets remain fragmented along national lines, while interoperability and security of supply may be strategically important. Defense businesses may also need to maintain production capacity during periods of lower demand so that output can be increased quickly in response to changing security requirements.

Scale therefore has a particular significance in the sector. Europe needs effective competition between suppliers, but it also needs companies with sufficient manufacturing capacity, technological depth and financial resources to deliver major programs and compete with large defense groups outside Europe.

This creates a real tension for both policymakers and dealmakers. European competition rules continue to guard against excessive concentration, while the broader industrial-policy agenda increasingly favors the scale, capacity and cross-border cooperation needed to meet Europe's defense requirements. For transactions in the sector, the challenge is therefore to demonstrate that greater industrial scale can be achieved without undermining effective competition.

The debate has parallels with the discussion that followed the Commission's prohibition of Siemens/Alstom in 2019, which became a focal point for arguments over whether EU merger control gave sufficient weight to international competition and the ability of European businesses to achieve global scale. More recently, the Draghi Report gave renewed prominence to questions of European competitiveness, industrial consolidation and strategic autonomy.

Policy has moved quickly in the same direction. The ReArm Europe Plan was followed in June 2025 by the Commission's Defence Readiness Omnibus and in October 2025 by the Defence Readiness Roadmap 2030.⁴ The Omnibus signals a more supportive application of EU competition rules in the defense sector, including a more permissive environment for horizontal cooperation such as joint purchasing and joint production arrangements under Article 101 TFEU and a pragmatic approach to State aid under Articles 346 and 107(3)(c) TFEU.

Against that background, the Commission's draft revised Merger Guidelines, published on April 30, 2026, are particularly significant.⁵ The consultation closed on June 26, 2026, and the final Guidelines are expected in the fourth quarter of 2026. The draft places greater emphasis on innovation, investment, resilience and dynamic competition and expressly recognizes circumstances in which scale-enhancing mergers may support European competitiveness.

⁴ European Commission, *Defence Readiness Omnibus* (June 2025); European Commission, *Defence Readiness Roadmap 2030* (Oct. 2025).

⁵ European Commission, DG Competition, [Draft Merger Guidelines](#) (Apr. 30, 2026).

For the defense sector, the draft Guidelines identify mergers enabling defense projects that strengthen the internal market for defense and European defense readiness, including security of supply, provided they do not create excessive dependencies or resilience risks.⁶ This represents an important development in the way the Commission frames the potential benefits of consolidation in strategic industries.

It does not amount to a relaxation of merger control for defense transactions, and strategic autonomy will not provide a general answer to substantive competition concerns. The more significant change is that the assessment of a defense transaction may increasingly need to take account of the industrial context in which the parties operate. Member States separately retain the ability under Article 21(4) EUMR to take appropriate measures to protect legitimate interests such as public security, although such measures may be relied on only where there is a genuine and sufficiently serious threat to a fundamental interest of society.

A combination of complementary R&D, manufacturing or systems-integration capabilities may, for example, allow the merged business to increase production, improve security of supply or participate in procurement programs that neither party could address independently. For investors and transaction parties, this makes it important to consider not only where the parties compete today, but also what the proposed combination would enable them to do.

IV. THE GROWING ROLE OF JOINT VENTURES AND COOPERATION

The same considerations apply outside the context of full acquisitions. Europe's defense ambitions are likely to require significant cooperation between businesses through joint production, shared R&D, platform development and cross-border industrial partnerships.

The Leonardo/Rheinmetall joint venture provides a useful illustration. Germany's Bundeskartellamt cleared the creation of Leonardo Rheinmetall Military Vehicles in January 2025, noting that the companies' activities were largely complementary and that neither would have been capable independently of satisfying the anticipated requirements of the Italian Ministry of Defense. Leonardo lacked the necessary tank platforms, while Rheinmetall could not independently satisfy the requirement that 60 percent of value creation occur in Italy.⁷

The transaction illustrates why the competitive analysis of defense-sector cooperation can differ from a straightforward assessment of consolidation between existing competitors. Depending on the procurement requirements and the capabilities of the parties, cooperation may create an additional viable offering rather than remove one from the market.

Similar issues arise in R&D and next-generation technology programs where the costs, technological complexity or production requirements may make cooperation commercially necessary. Joint ventures can also allow traditional primes to combine industrial capacity with technology developed by newer market entrants.

These arrangements will continue to require careful antitrust analysis. Information sharing, coordination extending beyond the scope of the collaboration, customer or market allocation and restrictions on independent activities can all raise concerns under Article 101 TFEU. Nevertheless, the industrial rationale for cooperation is likely to assume greater importance where parties can demonstrate that collaboration creates capabilities, capacity or competitive offerings that would otherwise not exist.

V. FOREIGN INVESTMENT SCREENING

The evolving approach to competition policy is only one part of the changing deal environment. FDI screening is simultaneously bringing a wider range of defense and technology transactions within the national-security perimeter.

European national screening regimes continue to differ in their thresholds and procedures, but the revised EU framework strengthens the overall architecture by requiring Member States to maintain screening mechanisms and establishing a common minimum scope covering strategically sensitive areas.⁸ These include not only traditional defense assets but also dual-use items, critical technologies, critical raw materials, transport and energy.

⁶ European Commission, *Draft Merger Guidelines* (Apr. 30, 2026), addressing scale-enhancing mergers and defense projects supporting European defense readiness and security of supply.

⁷ Bundeskartellamt, [Joint Venture Between Rheinmetall and Leonardo Cleared](#) (Jan. 20, 2025).

⁸ European Commission, [EU Strengthens Its Foreign Investment Screening Framework](#) (June 26, 2026); European Commission, [Investment Screening](#).

This wider scope matters because many of the companies attracting investment do not fit neatly within a traditional definition of the defense sector. AI, semiconductor, quantum, cyber and space businesses may all be relevant to defense capability, even where their principal customers are commercial.

The framework also places greater emphasis on indirect foreign investment undertaken through EU entities ultimately owned or controlled from outside the EU. Investors therefore need to consider ultimate beneficial ownership, governance arrangements and access to sensitive information rather than focusing solely on the immediate acquiring entity.

FDI review can also influence the substance of a transaction. Authorities may seek commitments relating to technology transfer, access to sensitive information, continuity of supply, R&D capacity, governance, local manufacturing or security arrangements. Even where a transaction is approved, conditions of this kind can affect the economics of the investment and the way in which the target can be integrated after closing.

These considerations are particularly relevant in competitive processes, where execution certainty may influence a seller's assessment of competing bids. An investor that identifies the relevant filing requirements early and has considered potential mitigation measures may be able to offer a more credible route to closing than a bidder that addresses national-security issues only after agreeing the principal commercial terms.

VI. EXPORT CONTROLS AND SANCTIONS

Export controls have similarly moved beyond the realm of back-office compliance and can influence market access, transaction structure, post-closing operations and future exit opportunities.

Dual-use controls are particularly important because they capture technologies with both civilian and military applications, including semiconductors, encryption, drones and certain software. Businesses operating in AI, quantum technologies, sensors, cyber and space may therefore possess controlled technology even where defense represents only a relatively small proportion of their revenues.⁹

For investors, the analysis cannot be confined to the jurisdiction in which the target is incorporated. A European business may have significant U.S. export-control exposure if its products incorporate controlled U.S.-origin components or rely on particular U.S. technology or software. This can affect where the company can sell, which customers it can support, and which future buyers may be able to acquire the business.

Technology transfers are also becoming increasingly important because controlled technology does not move only through physical shipments. Source code, algorithms, engineering documentation, software updates, cloud access, shared repositories and remote technical support can all raise regulatory questions. This is particularly relevant to post-closing integration and joint ventures, where changes to technology access or shared development environments may alter the regulatory position.

Sanctions add a further layer because a product that is technically licensable under export-control rules may still be unusable in a particular market if the relevant customer, destination or commercial relationship is prohibited. Customer and supply-chain diligence therefore increasingly needs to extend beyond direct counterparties to include distributors, resellers, end users and destinations, particularly as regulators focus more closely on circumvention through intermediary jurisdictions.

VII. REGULATORY CONSIDERATIONS FOR DEFENSE TRANSACTIONS

The growing interaction between competition law, FDI screening, export controls and sanctions means that regulatory diligence increasingly needs to sit alongside commercial, financial and tax analysis from the beginning of a transaction.

Competition analysis should address not only whether the parties overlap, but whether a transaction combines complementary capabilities, creates additional capacity or enables participation in procurement programs that neither party could pursue independently. National-security analysis should identify applicable FDI regimes, ultimate ownership and governance rights, while export-control diligence should examine controlled products and technology, license dependencies and the implications of post-closing access to sensitive information.

⁹ Regulation (EU) 2021/821 of the European Parliament and of the Council setting up a Union regime for the control of exports, brokering, technical assistance, transit and transfer of dual-use items.

These issues also need to be considered together because a solution developed under one regime may create difficulties under another. A joint venture may present limited competition concerns because the parties have complementary capabilities, for example, while the governance rights necessary to make the collaboration commercially effective could create FDI concerns if a foreign participant gains access to sensitive technology. Restrictions introduced to address those concerns may then affect the commercial benefits of the venture.

For private equity and other financial investors, exit analysis is particularly important. The universe of potential buyers for a strategic technology company may be constrained by FDI rules, export controls, procurement requirements or restrictions on technology access. Understanding those limitations when an investment is made allows them to be reflected in valuation and the post-closing business plan rather than becoming an issue only when the asset is brought back to market.

Regulatory preparedness can also become an indicator of operational maturity. Businesses with well-developed classification processes, reliable customer and end-user information, effective licensing strategies and clear controls over access to sensitive technology are likely to be easier to diligence and integrate. Improving those systems during the investment period can reduce regulatory risk while potentially increasing the range of future strategic or financial buyers.

VIII. OUTLOOK

Europe's defense investment landscape presents one of the most significant industrial opportunities of the coming decade. Public funding is increasing, private capital is becoming more comfortable with the sector and technological change is creating new markets across AI, autonomy, cyber, semiconductors and space. At the same time, governments are seeking greater industrial capacity, security of supply and control over strategically important technologies.

These developments are also changing the relationship between competition policy and national security. European policymakers continue to place importance on effective competition, but there is growing recognition that defense readiness may require greater scale, cross-border industrial cooperation and investment in production capacity. At the same time, broader FDI screening, export controls and sanctions mean that greater regulatory scrutiny is accompanying the investment needed to build that capacity.

For investors, regulatory analysis can therefore no longer be deferred until an attractive asset has been identified and the principal commercial diligence completed. The regulatory environment increasingly bears directly on the attractiveness of the asset itself by influencing transaction structure, execution certainty, post-closing integration, access to government customers and the assumptions underpinning valuation and exit.

The technologies driving much of the growth in European defense investment are also those attracting the greatest attention from governments. Investors that consider competition, FDI, export controls and sanctions together from the outset will be better positioned to identify execution risks, develop credible regulatory strategies and structure investments that can operate effectively within Europe's evolving defense ecosystem.

As industrial policy, competition policy and national-security objectives become more closely connected, the ability to navigate that interaction will increasingly distinguish successful defense investments from transactions that encounter avoidable regulatory obstacles. Europe's defense investment boom offers substantial opportunities, but capturing them will require a deal playbook that treats regulatory strategy as an integral part of the investment case rather than as a compliance exercise undertaken after the commercial decisions have already been made.



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