

Written by Nick Sanders

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We [recently wrote about](#) the budget pressures facing the Federal government in the context of comparing the costs of “in-sourcing” versus “outsourcing”. But the policy battles between the in-sourcers and the outsourcers is simply one aspect of the overall budgetary debate taking place in this election year—and the Pentagon is at the center of the budgetary cross-hairs.

The Pentagon’s policy problem may be described as one of “defense industrial policy”—*i.e.*, how to effectively manage the defense industrial base to cut the costs of weapon systems, while at the same time preserving critical skills unique to the aerospace/defense industry and making sure key strategic suppliers don’t fold-up their tents and sneak away in the night, leaving landlords looking for back rent money. It’s not a skill that the Pentagon historically has been known to possess.

In [this article](#) in National Defense magazine, author Sandra Erwin discusses the defense

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industrial policy debate. She wrote—

The Pentagon [historically] has shown little appetite for picking winners and losers, and has been more comfortable with a laissez-faire approach. After the Cold War ended, the Defense Department stepped out of the way and for five years let contractors consolidate at will. ... Industrial policy mandates have existed since the 1950s but most administrations have ignored them, particularly in the post-Reagan era when even the suggestion that the government should manage the private sector is laughed off as a grandiose Stalin five-year plan. ...

A recent study by the nonpartisan Center for Strategic and Budgetary Assessments predicts an 'erosion of design capabilities for military-unique products' and calls for the Defense Department to actively protect segments of the defense industrial base that are 'truly important to retain,' such as tactical aviation, nuclear submarines and spy satellites. 'It is not unrealistic to foresee a day in which the U.S. defense industry no longer possesses the design or production capabilities for certain weapons systems,' says the study.

The prevailing attitude that the defense industry is a free-market, Darwinian system is a myth, CSBA analysts contend. They note that the defense industry is a highly regulated sector of the U.S. economy in which the government is both the sole customer and the regulator. It is a 'serious misunderstanding of the realities of weapons acquisition in the United States to think that the U.S. defense industry operates like a normal free market,' says the study.

Defense policymakers assume that the industry has the ability to automatically resize as demand changes and still maintain competitiveness, but that is not how it works, says Marty Bollinger, director of Booz & Company's aerospace and defense practice. Within the core of defense companies that produce military-unique equipment, the idea that there is a free market or real competition is a fairy tale, Bollinger says.

In [this Reuters article](#), Frank Kendall (Under Secretary for Defense, Acquisition, Technology & Logistics, Acting) tried to walk a nice tightrope between reassuring contractors that the Pentagon will protect them, while warning them that they better reduce prices and focus on delivering on-time and on-budget. The article reported—

The Pentagon's acting acquisition chief Frank Kendall assured industry executives on Tuesday that there was still money to be made in defense, but said companies would have to deliver weapons within budgets and on time to be competitive. ... 'If you are not delivering on cost and schedule ... you are very vulnerable,' Kendall ... told a conference hosted by Aviation Week. ...

Tighter budgets will increase competition for fewer programs, U.S. defense officials and industry executives said at the conference ... They predicted that the number of bid protests

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would grow, and said companies would have to redouble their efforts to cut costs and overhead to be competitive. ...

Discord between the U.S. Defense Department and its suppliers has led to protracted contract competitions because of what they called onerous contract terms. ...

‘We’re not looking to put you out of business,’ Robert Hale, the Pentagon’s top budget official, said at the conference on Tuesday.

Readers will note that Messrs. Kendall and Hale were reiterating the same talking points Mr. Shay Assad [recently uttered](#). We wrote at the time—

Mr. Assad has emphasized several times that he’s not looking to impact contractor profitability—just their costs. He’s fine with contractors making a reasonable profit (as he should be, given that it’s official Government policy). He reiterated this position again, quite recently, and the MSM and others who follow the defense industry picked-up on his words and reported them (again) as if they were some kind of promise of safe-harbor in the upcoming storm of sequestered DOD budgets.

Here’s a [GovExec article](#) on the subject. It discusses Mr. Kendall’s assurances as well as warnings from industry associations that cuts are going to hurt smaller companies the most. It reported—

Fred Downey, vice president of national security at the Aerospace Industries Association, told *Government Executive* that ‘ongoing reductions in defense spending coupled with the threat of sequestration cuts are causing a great deal of concern among smaller companies in the supply chain. Many of these companies have unique capabilities that could be lost if their workflow is interrupted by cancellations and delays.’ ...

Alan Chvotkin, executive vice president and counsel of the Professional Services Council, which represents contractors, said the comments were ‘reassuring in that they demonstrate renewed attention at high levels. But a bailout, for lack of a better word, should not be counted on as a strategy by companies as the Pentagon takes steps to make sure the supply chain is not disrupted.’

On a related note, Jim McAleese issued a detailed look at the DOD’s FY 2013 budget request, and concluded, “*Strong Performers are being rewarded. Poor Performers will be fired.*” So it’s not necessarily only critical skills that the DOD Industrial Policy Directorate needs to consider; it’s program execution skills as well.

The foregoing messages should not be news to readers of Apogee Consulting, Inc.’s blog.

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We've been pushing program execution and supply chain management for years. For example, in [this article](#) we opined that—

We can save quite a bit of money if we manage programs better in an environment that's conducive to effective program management. Congress can save money by reducing funding uncertainty and by rationalizing acquisition statutes and regulations. DOD can save money by partnering with its contractors instead of attacking them and by improving the quality of its acquisition management workforce. And contractors can save money by partnering with their subcontractors instead of trying to maximize their own profit at the expense of their subs

What's more, way back in August, 2009, we warned readers by saying, "Look for increased pressure to cut costs and to trim overhead." In this [self-titled "rant,"](#) we opined—

As we reported in [this article](#), many major defense acquisition programs are dependent on rare earth magnets produced in China. You have a problem with that? It's called *free-market capitalism*, cupcake. Free-market capitalism is what our country is supposed to be about.

Free-market capitalism is what happens when companies close-down production in locations with high labor costs or high insurance costs or high income taxes, and move their production facilities and/or workforce down the road a piece to where it's cheaper to operate and the margins are higher. If by "down the road" one means "across the ocean to a foreign land" then so be it. You don't like the results, then change the business climate, sweetheart.

You got a problem with loss of manufacturing capacity, loss of skilled jobs and industrial capacity, loss of critical technologies, and/or loss of ability to produce "American-made" defense weapons and programs? Then you better turn the Titanic around, Einstein, 'cause the Pentagon hit that particular iceberg about 20 years ago.

In the meantime, while you're running for the wheelhouse and pleading with the Captain to turn the ship around, we have work to do.

Finally, we want to point readers toward [this little piece](#) discussing DOD's FY 2012 budget request to Congress. In that blog article, and in the context of surviving DOD budget cuts, we asserted—

Program execution matters. ... Perhaps you should let the funding games play out as they may, trusting that your political action committees and lobbyists will do their jobs while you do yours. To that end, may we suggest (once again) that program execution and supply chain management be your priorities. In this new age of fiscal slash-and-burn, with a new (and

The Defense Industrial Policy Debate, Election-Year Version

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perhaps newly focused) Congress sensitive to taxpayers' concerns, nobody wants any more bad news. Your program's on-time delivery and on-budget spending will be the good news that may guarantee you continued funding, now and into the future.

As we look at the recently enacted FY 2012 National Defense Authorization Act, or as we peruse McAleese's analysis of the DOD FY 2013 budget request to Congress, we see no reason to change our consistent position on how best to handle the current and forecasted budgetary pressure on DOD programs.

While the DOD Industrial Policy Directorate pursues its "S2T2" analysis of the defense industrial base (and we wish them good luck with that), and while industry associations such as AIA, PSC, and NDIA fire up their legislators to oppose defense cuts while current law (and several grass-roots political groups) call for them, we think the best strategy for contractors is to execute *spectacularly well* on the contracts they have in-house. And as our readers know, this means managing program supply chains *spectacularly well*, as well.