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What Keeps Defense Industry CEOs Up At Night?

BY

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When chief executives of companies within the nation's defense industrial base take the podium to reassure their shareholders or inform Wall Street analysts of their financial progress and plans, they always prepare for the question, "What keeps you up at night?"

In the past, the answer usually revealed a concern that the trust they had built with their principal customer, the Defense Department, would somehow be eroded: through an engineering failure, a testing lapse or, worse, a fraudulent offering or product.

Ask that question of the current crop of defense leaders and you'll get a different answer.

The CEOs are likely to express the frustration they face regarding looming Defense Department budget cuts. It's not that the defense industry leaders aren't prepared to adjust their own long-range plans to the declining budgets projected over the next five years or so. The problem prompting the CEOs to take a refrigerator break at 3 a.m. is the lack of clarity and priorities in declaratory American defense policy.

This cycle of CEO insomnia is aggravated by the nature and structure of the defense industrial base itself. Many of these executives recall the last major defense drawdown at the end of the Cold War, and the relatively large menu of strategic choices available: consolidation, diversification, divestiture, conversion to a more commercial portfolio, growing adjacent or international markets, or exiting the business entirely.

Then, government encouragement and incentives to rationalize the industry resulted in a leaner and more agile defense industry, able to respond when the tocsin again sounded.

Unfortunately, the menu of options now facing the nation's defense industry is considerably truncated. DoD officials have characterized the defense industrial base as "more global, more commercial and more financially complex and competitive than ever before" — that is, much more dependent on a global supply chain. In this interconnected industrial base, the decision of one company to exit the business could start a devastating chain reaction.

Worse, the choices presented to defense industry CEOs are much more limited than in the past. Mergers and acquisitions at the prime manufacturing level probably reached their limits a decade ago, and sequestration makes any acquisition path problematic.

The nation’s slow economic growth suggests that adjacent markets might be less than profitable, while the overhang from the “great recession” has led international friends and allies to choose austerity over expanding defense budgets.

With DoD personnel furloughs, it’s also unclear how the government-industrial balance in depots, arsenals, plants, shipyards and logistic centers might shift.

What is needed to aid decision-making in corporate boardrooms is greater clarity from the Defense Department on where its future priorities lie.

To its credit, DoD is taking several steps to address concerns regarding the health of the industrial base. One new policy calls for including industrial base factors in major program decisions — particularly as they pertain to the criticality and fragility of third- and fourth-tier suppliers. Defense Secretary Chuck Hagel also promised defense industry leaders that he would seek internal reforms to help offset the reductions facing industry. In search of those savings, the secretary launched a Strategic Choices and Management Review with the purpose of finding cuts of $500 billion from planned military spending over the next decade.

Strategy, of course, is the art of linking objectives with budgets, and it is the objectives of defense policy that the CEOs want to hear about.

The Strategic Choices and Management Review, as a preface to the next Quadrennial Defense Review, could help bridge this strategy gap by enumerating the priorities for defense investment.

A quick survey of the principal military challenges facing the United States in the Western Pacific and the Middle East suggests that long-range non-nuclear precision strikes, dominance of enemy air defenses, undersea warfare, space-based communications and surveillance, special operations, unmanned vehicles, and cyber and directed-energy weapons are the capabilities defense industry CEOs should be managing their resources to achieve.

That clarity of purpose would help them get some sleep.

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