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Bellwethers of the Post-Afghan Defense-Industrial Base

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After three years of the “age of austerity” in Western military spending, investors’ imperatives and corporate strategies indication of how the defense-industrial base will evolve over the next decade. Investors want public companies that demonstrate an attractive risk-adjusted total return, not just M&A-fueled arbitrage plays. In response, companies are husbanding or harvesting their financial strength by making cautious choices about the strategic direction and capital deployments of their companies.

But the customers — the Defense Department and Intelligence Community — want offerings that reflect more commercial-styled innovation, not just simple cost-reduction. In response, key segments of the market are witnessing the entry of competitors who differentiate by a “better-quicker-cheaper” proposition that is taking share from incumbents still indulging the mantra “higher-faster-farther”. Notable bellwethers of this trend are in evidence at the leading edge and trailing ends of the product-lifecycle S-curve.

At the leading edge, where new products and services are inducing customer demand and growth is the name of the game, powerful entrants are reshaping the competitive landscape in.

- Cloud computing. Amazon defeated IBM in the competition last year to win a 10-year, \$600 million Commercial Cloud Services (C2S) contract from the Central Intelligence Agency. In defending the award, the agency’s chief information and chief technology officers both cited the need to leverage the commercial sector’s innovation cycle and touted Amazon’s software-as-a-service business model over more traditional enterprise licensing agreements;
- Big data analytics. Palantir Technologies remains in a pitched battle to up-end the Army’s Distributed Common Ground Systems (DCGS-A) program. Palantir’s off-the-shelf offering had gained an enthusiastic following among front-line soldiers contending with the threat of improvised explosive devices in Kandahar, Afghanistan. The prime and subcontractors of DCGS-A comprise no less a formidable combination of big-brand incumbents than Northrop Grumman, General Dynamics, Lockheed Martin, Textron, and SAIC.

At the trailing ends of the S-curve, where sustaining mature-product offerings requires exquisite customization and other process innovations, new entrants are undoing incumbents’ longstanding franchises.

- Tactical wheeled vehicles. Oshkosh, a predominantly commercial truck manufacturer, took the contract in 2011 to build the Family of Medium Tactical Vehicles (FMTV) from the 20-year incumbent, BAE Systems/Stewart & Stevenson. It is now competing against the HUMVEE franchise holder AM General and against Lockheed Martin in the competition to build the Joint Light Tactical Vehicle (JLTV), the next-generation successor to the venerable HUMVEE and specialized Mine Resistant Ambush Protected (MRAP) vehicle;
- Space launch. Space Exploration Technologies (SpaceX) and Orbital Sciences are beginning to deliver NASA payloads to the International Space Station under NASA’s Commercial Orbital Transportation Services (COTS) program for the first time since the

retirement of space shuttle, which had been built by the United Space Alliance joint venture of Boeing and Lockheed Martin. SpaceX also is now challenging these same competitors for the right to compete for national security space launches under the Air Force's Evolved Expendable Launch Vehicle (EELV) program. Elon Musk's company is also competing against Boeing and another newcomer, Sierra Nevada, for NASA's Commercial Crew Integrated Capability program, which would restore a U.S.-based capability for human spaceflight.

Unfortunately, these examples also illustrate another of the telling indicators of this trend: bid protests and litigation. To succeed against incumbents, new entrants not only have had to offer better-quicker-cheaper offerings but also have to defend against incumbents' litigious resistance. IBM's protest of the CIA's C2S initially was upheld in part by the Government Accountability Office. However, Amazon, in turn, filed suit at the U.S. Court of Federal Claims, which in a decisive ruling last October told the agency to stick with Amazon.

In another example, SpaceX filed suit at the end of April with the Court of Federal Claims to block the Air Force from making an advanced purchase of 36 rocket cores for EELV launches. The company claims that the block award would effectively prevent it from competing in the program. It seems that where entrants gain traction at the expense of incumbents, lawyers flourish.

A decade from now, the defense industry will comprise more varied companies and competition dynamics than those that arose from the post-cold-war restructuring. Among the forces driving this will be the success of entrants employing commercial technologies and using private capital to address the still-challenging problems of defense, space, and security.

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