



**C4ISR & NETWORKS**  
www.C4ISRNET.com  
Fresh daily news ■ Focused analysis ■ Programs, projects and technology  
Online. Print. E-Newsletters. Events. [Click Here!](#)

ADVERTISEMENT

# Industry Girds For Extended US Sequester

Oct. 20, 2013 - 03:45AM | By ZACHARY FRYER-BIGGS | [Comments](#)

Recommend 4 Tweet 4 0 A A



New industry players, such as SpaceX, are taking on large contracts that typically went to the primes. (SpaceX)

**WASHINGTON** — Long expressing optimism about the prospects that the sequester would be replaced, defense executives seem to be coming to terms with the permanence of the cuts, and shaping their business models around them.

A new report released by TechAmerica, based on interviews with defense executives and industry analysts, pegs the likelihood of sequester cuts staying in place for at least through 2015 at 50 percent, with the majority of the sequester cuts getting an 80 percent likelihood of continuing.

The report, released to coincide with the organization's Vision conference held last week, describes a "trough" in investment account spending from 2014-2017, returning spending to 2004 levels, before increasing once again.

That investment will be hit hard is inevitable given that operations and maintenance have borne the brunt of the cuts thus far, said Frank Finelli, a managing director with the private equity firm Carlyle Group.

"Readiness has already paid; the bill payer going forward is force structure and investment accounts, both procurement and R&D [research and development]," he said, speaking at the conference on a panel with Byron Callan of Capital Alpha Partners, Pierre Chao of Renaissance Strategic Partners and Steve Grundman of the Atlantic Council.

To manage slowing spending ahead of the downturn, and with what appears to be a growing acceptance of the sequester cuts,



**FREE WEBCAST**  
ON-DEMAND VIEWING [CLICK HERE](#)

*Simultaneous 2-Channel Communications in a Handheld Radio: Less Weight, More Capability*

PRESENTED BY **THALES** BROUGHT TO YOU BY **DefenseNews**  
A GANNETT COMPANY

ADVERTISEMENT

## Subscribe to Defense News e-Newsletter

Let us help you get caught up on the news. Sign up for the [Early Bird Brief](#) and/or [Daily News Roundup](#). Delivered daily, via email.

## More Headlines from the Americas

[Research Alliance Looks to Guide US Army's Cyberwarfare Future](#)

[Sergeant Major of the Army Outlines His Priorities for 2014](#)

[TRADOC Chief Looks to the Future](#)

[Army Studies Effect of Opening Jobs to Women](#)

[US Army Takes 'Unvarnished' Look At Its](#)

FILED UNDER

[World News](#)  
[Americas](#)

companies have already turned to throwing cash back at investors in the form of hiking dividends and share repurchases.

“The pattern of capital deployment that we see exhibited, particularly among prime contractors, is a case study, is a book on disinvestment,” Grundman said. “When you’re following that strategy, a disinvestment, you either run out of money or your share prices get too high to make doing that accretive, the best thing to do is to sell assets. That’s the further logic of that strategy.”

Focusing on handing cash back to investors isn’t new. The last time defense went through a downturn, companies followed the same play, Chao said.

“The capital allocation story also occurred right around now when we were shifting into the downturn after the 1990s,” he said. “I vividly remember in 1991 people were saying, ‘Why the heck would you want to invest in defense; don’t you understand the Berlin Wall fell; peace on earth is here.’”

The result of that strategy has been a steady decline in industry R&D spending, something that has alarmed Defense Department officials.

But Chao said the structure that has been created for defense contractors is not one in which primes should be on the leading edge of innovation and technology.

“The role of the big five guys, as was constructed in the 1990s, was to generate large financially viable guys who could handle the downturn and preserve capability set in the form of engineering talent and systems integration expertise,” he said. “Not to be the most innovative guys, but to survive and preserve capability sets. If that’s all they do, they will have achieved their goal as constructed.”

Defense companies have also been hesitant to remove the innovation or tech-nology tag, lumping themselves in the same category as major technology firms such as Google.

Compensation packages for defense executives often are built around comparisons to those types of leading companies that take substantial risk to develop market shaping technologies.

Another reason that the companies may not want to give up the innovator tag is that it might exacerbate a growing talent problem. Engineers aren’t entirely drawn by the largest paycheck but rather by the opportunity to work on cutting-edge technology. Even if large primes don’t lead with technology, they’ll still need talent, and that may be one of the dividers in the industry, Callan said.

“I think one of the critical discriminators is going to be the ability to attract and retain talent,” he said.

One of the effects of the engineering drain at the primes, as well as some of the general anti-incumbency attitude that has taken hold at the Defense Department, has been a rise of new players in defense. Whether it be SpaceX or Palantir, new groups are taking

GETTING MORE FROM BLUE | FREE ONLINE CHAT

Nov. 13 • 1 PM EST  
REGISTER  
CLICK HERE

PRESENTED BY  
Federal Employee Program

BROUGHT TO YOU BY  
FEDERALTIMES

ADVERTISEMENT

The advertisement features a photograph of a smiling family (a man, a woman, and a child) in front of pumpkins. The text is overlaid on the image, providing details about an event titled 'GETTING MORE FROM BLUE' which includes a 'FREE ONLINE CHAT'. The event is scheduled for November 13 at 1 PM EST. A 'REGISTER CLICK HERE' button is visible. The event is presented by the 'Federal Employee Program' and brought to you by 'FEDERALTIMES'.

on large contracts that might have historically gone to the primes.

“Entrants are taking market share from incumbents, not tomorrow, not five years from now, right now,” Grundman said.

So what can primes do if they don’t want to lag in innovation, remaining system integrators but not technology companies? Share the burden with government on joint investment programs.

“I would recommend that CEOs go on co-investment road shows,” Finelli said. “If you’ve got money that you want to put to work, if you’ve got ideas as to where to invest, I’d go to your customers and say ‘I want to invest with you on this.’”

It’s a model several experts agreed with.

“I think you can differentiate with the customer by sharing the risk, by putting some skin in the game,” Grundman said.

That’s part of a larger need to have CEOs explain their strategies to investors if they want to change the defense paradigm.

“CEOs are going to have to be far more vocal about what their vision is,” Finelli said. “I would argue that in order to differentiate yourselves, either invest or divest or both. Right now you don’t see many CEOs that are communicating their strategy to the marketplace.”

[View Comments](#) | [Share your thoughts »](#)

## SUBSCRIBE!



[Login](#) to This Week's Digital Edition

[Subscribe](#) for Print or Digital delivery today!

## EXCLUSIVE EVENTS COVERAGE

In-depth news and multimedia coverage of industry trade shows and conferences.

### TRADE SHOWS:

- [Paris Air Show](#)
- [SOFIC](#)
- [AUSA](#)
- [Modern Day Marine](#)
- [Eurosatory](#)
- [Farnborough](#)

### CONFERENCES:

- [C4ISR Journal Conference](#)



Sign-up to receive weekly email updates about Vago's guests and the topics they will discuss.

**Simultaneous 2-Channel Communications in a Handheld Radio: Less Weight, More Capability**  
**FREE WEBCAST ON-DEMAND VIEWING [CLICK HERE](#)** PRESENTED BY **THALES** BROUGHT TO YOU BY **DefenseNews**  
A GANNETT COMPANY

ADVERTISEMENT

[Site Map](#) | [Back to Top](#)

[HOME](#)

[WORLD NEWS](#)

- [Americas](#)
- [Asia & Pacific Rim](#)

[TOPICS](#)

- [Air](#)
- [Land](#)

[VIDEO](#)

- [Video Network](#)
- [Defense News TV](#)

[AFJ](#)

[FOLLOW US](#)

- [Twitter](#)
- [Facebook](#)

C4ISR & NETWORKS

Services: [Customer Service](#) | [About](#) | [Contact Us](#) | [Site Map](#) | [E-Newsletters](#) | [Register](#) | [Subscribe](#) | [Renew](#) | [Advertising](#) | [Editorial](#)  
Users of this site agree to the [Terms of Service](#), [Privacy Notice/Your California Privacy Rights](#), and [Ad Choices](#)

Not A U.S. Government Publication  
A Gannett Government Media Site

GANNETT

All content © 2013, Gannett Government Media Corporation

## Industry Girds For Extended US Sequester

Oct. 20, 2013 - 03:45AM

| By ZACHARY FRYER-  
BIGGS |

[defensenews.com](#)



*New industry players, such as SpaceX, are taking on large contracts that typically went to the primes. (SpaceX)*

**WASHINGTON** — Long expressing optimism about the prospects that the sequester would be replaced, defense executives seem to be coming to terms with the permanence of the cuts, and shaping their business models around them.

A new report released by Tech-America, based on interviews with defense executives and industry analysts, pegs the likelihood of