

By Dr Jeffrey Bradford
Complexity Management International Ltd.

Reflections from the Janes US defence conference, April 22nd 2008 held in Washington DC.

Considering the period from the end of the second World War through 2013 the latest defence budget covering FY2009 through FY2013 shows defence as consuming a record low proportion of resources:

1945 35.0% (Defense spending as % of GDP)
1953 11.7%
1968 8.9%
1986 16.0%
1991 4.4%
2009 3.4%
2013 3.0%

KEY TRENDS

Procurement is expected to break \$1 billion for the first time in FY2009 and expected to grow by 13% over the period 2009 through 2013. This should translate into improved margins for the Prime manufacturers of major systems.

Research & Development (R&DTE) is set to fall some 21% between FY2009 and 2013. In the medium term shrinkage of the R&D pipeline will impact on future opportunities and possible create an opportunity for industry led R&D to fill the gaps. Qualitative evidence suggests that the axe is falling on Research more than Development as the DoD struggles to get products under development into service.

DoD is concerned as to the increase in the pensions, health care and wages bill.

Oil is impacting on in-year operational costs. A \$1 increase in the price of oil translates into a \$130 million increase in annual operating expenses.

These costs represent an opportunity for outsourcing in the medium term as should the level of commitments and tempo of operations do not reduce something in the budget needs to give.

DoD sees the integration of precision strike with persistent ISR as the key military development that DoD wishes to harness.

New entrants to the industry will likely be in the specialist electronics, information technology and robotics areas.

US Defense primes have strong balance sheets and little appetite for overseas expansion given the current economic climate and exchange rates.

M&A is likely to be focused in a manner similar to the pharmaceuticals industry where the 'primes' gobble up smaller companies which make innovative discoveries of interest to the DoD.

A 2004 foreign sourcing study conducted by DoD identified that the top 5 countries received over two-thirds of the \$ value of defence equipments.

The key political issues affecting the outlook for the US defense industry include;

- * Outcome of the US Presidential election. A Republican victory will likely lead to a slower reduction in operations. Democrat success will likely see faster drawn-downs in operational commitments and more investment in R&D.
- * The final outcome of the KC-45A Tanker battle between Boeing and Northrop Grumman has major implications for future outsourcing and the role of foreign based defence companies in the US marketplace.
- * The propensity to resort to supplements to the defense budget have enabled the department to live beyond its budget and a certain measure of dependency has emerged. A political shift against the use of supplementals would create a crunch for budgetary decision-makers.

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