

PBL Will Be Obtaining Even More Traction With OSD And With Defense OEM CEOs; A Study Requested By Under Secretary of Defense For Acquisition, Technology And Logistics Will Focus Upon Analyzing Whether DoD Can Primarily Become An Acquirer Of Services

By John Kotlanger and Ron Giuntini (sections excerpted from an article by John Liang)

Under Secretary of Defense for Acquisition, Technology and Logistics Kenneth Krieg has called upon the Defense Science Board (DSB) to determine what kind of defense industry will be needed in the future; will services be the path of choice to meet mission requirements?

It is our strong belief that Performance Based Logistics (PBL) services will be determined to be the "best" path for DoD to follow for the 21st century by the DSB; study will drive DoD contractor CEOs to finally pay attention to PBL's "true" strategic importance to the long-term financial strength of their enterprises.

Krieg noted that DSB studies during the late 1990s looked into issues like the impact on the defense industrial base of corporate consolidation through vertical integration and globalization. Since then, both DOD and the industry have undergone what he termed as "significant transformation," with vertical integration still a topic of interest.

"Some firms and industry observers allege that vertically integrated prime contractors favor in-house capabilities over better external solutions," the memo states. "DOD antitrust evaluations of proposed business combinations increasingly identify vertical capabilities as concerns to be investigated."

It is our belief that DSB will conclude that in order to mitigate vertical integration issues, large DoD OEM contractors can outsource much of their PBL "touch labor" work, and yet retain the majority of PBL profits; this will enable smaller independent entities to remain in the industrial base.

Additionally, networked systems are resulting in "fewer but larger" prime contracts through which the prime contractor has responsibilities for "ensuring competition for key and innovative elements," Krieg writes.

DOD reduces risks to its interests by emphasizing "oversight of make-buy policies and decisions; and imposing behavioral remedies to preclude a newly combined firm from unfairly leveraging new internal capabilities to the detriment of its competitors," according to Krieg.

Further, Krieg warns that the financial viability of the defense sector may be at risk because "as defense expenditures 'top out' (and begin to decline in real terms), the underlying financial viability of the defense sector for the longer term may be negatively impacted."

As a result, Krieg calls on the task force to "characterize the degree of change likely and/or desirable in industry due to the changing nature of DOD and the industrial base.

"The task force should examine the effectiveness of existing mitigation measures and develop recommendations, if necessary, designed to ensure adequate future competition and innovation throughout all tiers of the defense industrial base," he continues.

Krieg wants the task force to answer the following seven questions:

- **What are the implications for the industrial base of increased DOD acquisition of services?**

- Will the existing (or perhaps more consolidated) defense industrial structure evolve into a predominantly service orientation?
- What are the implications of the emerging practice of major defense firms acquiring independent service and support providers?
- To what degree should the globalization of product and service suppliers be enabled by policy and regulation?

Note that OEMs are already moving aggressively in this area:

- Lockheed Martin has recently hired Lou Kratz, the former OSD "guru" of PBL as their new VP of their new Enterprise Logistics Business Office
- Northrop Grumman has created a new Technical Services Sector, in which over 10,000 employees have been transferred from other Sectors
 - Gregg Donley has been appointed vice president and general manager of systems support
 - George Petteys Jr. has been appointed vice president and general manager, strategic operations and planning
 - R. Michael Roberts has been appointed vice president and general manager of training and simulation
 - David W. Werkheiser has been appointed vice president and general manager, life cycle optimization and engineering
 - All report to James L. Cameron, corporate vice president and president of the Technical Services sector

- **If the trends in globalization and services continue, what are the policies and practices which allow DOD to benefit most from the future industrial base?**

- **What have been the trends since the previous DSB study on vertical integration?**

- Are critical component capabilities generally made available to competitors or not?
- After acquiring new companies, are critical or innovative capabilities effectively supplied to the department?

- **What are the implications for the financial viability of the defense industrial base as the sector adapts to changing DOD needs for defense related products and services?**

- If the defense sector further consolidates as it absorbs excess capacity and retools to meet evolving defense needs (e.g. services-centric rather than platform-centric), will DOD acquisition practices and consolidation policy be effective in ensuring that the defense sector will have the financial strength to support the needs of the industrial dimension of transformation?

- **How does vertical integration affect competition among prime contractors, sub-tier suppliers; what are the market opportunities of a merchant supplier of a critical capability and innovation?**

- **For both merger and acquisition antitrust reviews and subcontractor source selection decisions, are the current mitigation measures used by the DoD effective in reducing the risks of anticompetitive behavior and vertically integrated market structures?**
 - How effective are these measures in enabling the DoD to acquire a solution with the best value?
- **What measures or policies could DOD and industry adopt/change to better reduce the risks of anticompetitive behavior and to better ensure the availability of solutions with the best value to the department?"**

These are times of change and OSD is analyzing its path forward in configuring an industrial base that will meet their requirements in being efficient and effectiveness in assuring the U.S.'s security in the 21st century; it is our belief that PBL will be an important part of that solution set!