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The Defence Industrial Base – One Half of the Military Capability Equation

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A period of tumultuous geopolitics has led to a surge in articles and opinion on all aspects of defence and security. In the UK and across NATO, one consistent theme is the percentage of Gross Domestic Product that should be spent on defence. In other words, the focus is on an input rather than the outputs.

If money is one of the inputs, military capability is the output. NATO officially defines a capability as "the ability to create an effect through employment of an integrated set of aspects categorised as doctrine, organisation, training, materiel, leadership development, personnel, facilities and interoperability." I crudely translate that to:

Capability = People + Materiel.

The materiel is provided by the defence industrial base (DIB). It follows that the DIB is critical to the generation and sustainment of military capability. The importance of the DIB is further demonstrated by the conflicts in Ukraine and Iran, where the facilities that manufacture and store materiel have been key targets.

In this essay I offer a response to the following questions: What is the Defence Industrial Base? What is its current state? How did we get here? What Defence Industrial Base do we need? How could that be delivered?

1. What is the UK Defence Industrial Base?

In most aspects this question has a straightforward answer. The DIB comprises those businesses that supply the materiel element of military capability. However, it is important to provide some context. These businesses are themselves different in size scope, capacity and capability. Crucially, they are not all located in the United Kingdom and frequently they service multiple governments. Each business plays a different role in the generation and sustainment of capability. Some of the businesses are entirely focussed on defence whilst others combine defence operations with other commercial activities. Given this varied landscape it appears sensible to adopt appropriate procurement strategies that reflect, as closely as feasible, the nature of the contribution an entity makes to capability. Although some companies service multiple governments, the market for defence products systems and services is, nevertheless, in many ways monopsonistic, with many companies originating and surviving because of a single national customer. For example, there would be no Lockheed Martin without the US Government. The origin and continued existence of most businesses can therefore be traced to a single customer. Whilst in the commercial markets companies can fight for market share as there are multiple customers for the same offering, in defence if a customer does not require a particular product system or service then the business will not retain capability in the hope of some future demand. This makes it important for the customer to understand the industrial impact of procurement decisions. In the United States, the procurement budget is so large, and the understanding of the importance of the industrial base is so clear that this consideration is a key element of the relationship between the buyer and seller. However, in the separate nations of Europe, particularly the UK, the industrial base is treated as a normal commercial market and therefore the generation of military capability and corporate priorities are potentially misaligned.

In the UK the Defence Industrial Base is:

i. Made up of businesses that provide the materiel element of military capability.
ii. International by nature.
iii. Managed by government and businesses to meet commercial outcomes.

2. What is the current state of the UK Defence Industrial Base?

The rapid change in geopolitics, most vividly since the invasion of Ukraine in February 2022, has revealed a series of major deficiencies in UK military capability. The UK's political discourse appears to focus on the percentage of GDP to be spent on defence (i.e., input measures), whilst there is little or no discussion on what an increased input of money will produce (i.e., output measures). How many more people? What mix of materiel?

The DIB that provides the materiel component of UK military capability does not currently have the capacity to generate mass; that is to say, the DIB is unable to produce systems at volume and the demand from the UK alone is unlikely to justify the investment that would deliver such mass. Whilst the UK has hesitated, other nations, notably Germany and Poland, have moved to support investment in new capacity particularly in the land domain. Similarly, whilst there are pockets of technological excellence, once again the demand of the UK alone is unlikely support the investment required to bring these to maturity. Defence exports are often cited as a way of increasing demand to support increased investment. With the exception of some standout programmes this argument is disingenuous for nations such as UK. Defence exports are little more than icing on the cake; they do not provide the consistent demand needed to sustain an effective defence industrial base.

3. How did we get here?

As it stands today, the UK DIB is the result of actions taken since the end of the Cold War. Over a period of thirty years the materiel element of military capability has been placed behind a barrier of procurement processes that focus on financial inputs and value for money rather than outputs, namely the timely delivery of effective military capability. Whilst it is understandable that the provision of military capability should have moved down the list of government and public priorities since the disappearance of the Soviet threat to the UK and Europe, the outcome is that the UK's response to the geopolitical ruptures of the last four years has been, and continues to be, constrained by the absence of effective military capability.

In the post-Cold War period procurement processes have focused on efficiency by reducing inputs and largely ignoring outputs. In response businesses have armed themselves with contract and programme management expertise that is focussed, first on winning the contract and then on winning the ensuing (and inevitable) contractual conflict. The complex procurement process, and its uncompromisingly uniform application, has become a barrier to entry for small and medium sized enterprises while its blanket application and obsession with risk mitigation has stifled innovation at all levels.

Those businesses operating in capital intensive sectors of defence operate on slim margins with high costs of exit. This has, plainly, become an environment that is not been conducive to investment. Meanwhile share prices for many large defence companies have risen sharply since 2022 in anticipation of greater returns; it remains to be seen whether UK procurement will be able to support current valuations.

4. What Defence Industrial Base do we need?

If the UK and indeed Europe is to rearm to deter threats from Russia and to meet other geopolitical challenges, it is clear that the DIB needs to be regenerated. The industrial base should contribute to the generation of military capability that can deploy mass and rapidly adopt new technology to deter and defeat threats. This will require the expansion of those industries that require high levels of capital expenditure and the incubation of new businesses that are able to provide rapid and effective responses to an adversary's capabilities that are as yet unknown and might only emerge in the course of conflict.

The essential performance characteristic and value-determinant of the industrial base has become time. The key measure today and for the foreseeable future will be the timely delivery of materiel rather than the obsessive pursuit and demonstration of 'value for money', which is at best an ill-defined and at worst a meaningless term.

5. How could that be delivered?

The UK DIB is currently waiting for the arrival of yet another acronym – the DIP (or Defence Investment Plan). Apparently a replacement for the UK Defence Equipment Plan, the DIP will set out those elements of materiel that the UK intends to procure. Whilst the delay in the DIP is concerning and is damaging to businesses insofar as it prevents proper planning, unless the plan is accompanied by a paradigm change in procurement and general approach to the DIB, there is a reasonable risk that it will conform to Einstein's dismal prediction: "No problem can be solved from the same level of consciousness that created it."

But in pursuit of a more constructive outcome, I suggest the DIP should address the following themes:

i. **Recognition of the buyer's monopsony responsibility**

In the case of certain sectors of defence materiel, particularly those that generate mass and require high levels of capital expenditure, market forces are only partially effective. In sectors such as shipbuilding, military air and aviation, armoured vehicles and ammunition the industrial base needs constant and coherent activity otherwise the most compelling commercial rationale can only be for the business to exit the sector. The absence of consistent customer support across Europe has driven the fragmentation of the industrial base. The infrastructure required to undertake capital intensive defence projects is to all intents and purposes *national* infrastructure. On that basis it would be appropriate for the customer nations to play a role in how that infrastructure is sustained. As the UK and other European nations move to rearm, the regeneration of the industrial base will be driven by commercial and corporate aims that may not align with military capability outcomes. UK and European allies should therefore play a leading role in the redesign of the defence industrial base; it would be folly to leave this to commercial considerations alone.

ii. **Alignment with European nations**

The fragmentation of the industrial base is a key weakness not only for the UK but also for the rest of Europe. It is important that European nations set aside narrow national or regional interests in the name of national and continental security. The larger aim should be to broaden and deepen the size of the industrial base by common procurement that goes beyond mere interoperability. Some nations may be more obdurate than others in protecting national champions. However, the moment has surely now arrived for national and continental security to take precedence over local economic considerations. In this regard it is vital that the UK DIP should be consistent with the funding and frameworks developed by the European Union. It is in the best interests of all parties that the UK should play a full role in the regeneration of the continental Defence Industrial Base, otherwise the UK risks being pushed further to the margin just as it sees the weakening of the so called 'special relationship' with the USA.

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iii. Appropriate procurement processes

Defence procurement in the UK, as with NHS waiting lists, is a club that is used by media and politicians to beat the government of the day. There have been repeated initiatives to reform defence procurement; most of which are focussed on commercial performance rather than on delivery of materiel. The UK's Defence Equipment and Support (DE&S), the arm's length body that carries out the bulk of UK defence procurement, is a world class organisation for the task that the government asks it to perform. The problem, however, is that DE&S is asked to perform the wrong task; that is to prioritise the demonstration of 'value for money' and achieving total contract compliance above the delivery of the materiel component of military capability. The DIP should shift the focus of DE&S and allow the development of bespoke procurement processes that in turn will support the delivery of military capability and will be appropriate to the materiel being procured. For example, it would be preferable – and it must be possible – for the procurement methodology to differ substantially between the stockpiling of ammunition and the application of artificial intelligence to unmanned systems. The deployment of a variety of procurement processes that are appropriate to the materiel to be delivered would also lower the barrier to entry for businesses new to defence and would support innovation in all sectors.

iv. Change the business relationship

The steps set out above place the onus for delivering an effective DIB on the customer. If it is the case that a large proportion of the DIB base is monopsonistic and given that national security is the much proclaimed 'first responsibility' of any government, then it must be appropriate to place the responsibility for initiating any change in the DIB upon the government. However, businesses – particularly those that may be termed pillar industrial entities – also have a key role to play. The contractors that account for most of the industrial base are in effect pillars around which many other companies orbit. These businesses are custodians of national infrastructure in the form of physical assets and intellectual property.

> These pillar companies have equipped themselves with the resources to manage a contractual relationship based on commercial outcomes for both parties. The 'ammunition' in the battle of the contract is information. DE&S holds information on requirements, financing, and government and military risks. The company holds information on design, manufacture risks and costs. This information is traded within the contractual framework where each party is seeking an advantage.
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> There may be calls in some quarters for nationalisation of these critical businesses. However, this is likely to divert attention and energy into debate on structures and compensation. The relationship would be transformed by transparency and by recognising that the relationship with pillar companies is inevitably long term and dependent on mutual benefit. This transparency would be facilitated by technology that would allow joint consideration of risks and issues and alignment along the supply chain for the timely delivery of military capability. It would also facilitate change. As military capability requirements change – as they inevitably do – these new demands would flow seamlessly into the delivery of materiel. For the companies and their shareholders there would be a strong foundation for long term planning and greater assurance of long-term financial performance. And, importantly, the costs of managing the relationship would be significantly reduced.

In the geopolitical environment that obtained after the Cold War it is probably understandable, albeit deeply regrettable, that the nations of Europe should have allowed the vital resource that is the Defence Industrial Base to wither. As if to correct these past misjudgements, Europe has belatedly decided to acquire the hard power to deter its adversaries and competitors. The UK, however, appears more hesitant than others to match rhetoric with an expanded and enhanced military capability. In any event it is obvious that the UK's defence industrial base is essential to the generation and sustainment of military capability. It would be unwise to embark on the huge and complex endeavour of rebuilding the DIB by deploying the same relationship between government and industry that caused the problem in the first place. The central argument of this essay is that it is perhaps more important for the illness to be recognised and diagnosed before we urgently discuss the details of the prescription that will bring about a cure.

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Paul Hough has over thirty years' experience in the European defence industry. His particular area of interest is how the defence industrial base can be considered a military capability and how that would transform the relationships between Governments and businesses. He is a former member of the House of Commons Defence Committee advisory panel. He is an Honorary Senior Research Fellow at CPUDS and an Associate Fellow of RUSI.

Comment

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