

The Corporate Experience: Lessons for the Military

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This chapter examines the corporate experience in adjusting to globalization and implications that are relevant for the Armed Forces. The analysis draws heavily on interviews with corporate executives. It examines the topic from two perspectives: how changes within multinational corporations in response to globalization may offer lessons for military departments and how government policies and globalization affect the supplier companies that are integral to a strong defense.

The business experience is directly relevant to current challenges facing the services. The U.S. military has undertaken to transform itself through a revolution in military affairs strategy that calls for new investments of about \$60 billion a year to modernize equipment. In his introduction to *Mind the Gap*, former Deputy Secretary of Defense John White points out that the U.S. Congress will be reluctant to approve these new expenditures “unless DOD [Department of Defense] streamlines its support structure to yield \$15 to \$20 billion in annual savings. In other words, we need a revolution in business affairs (RBA) to accompany the [revolution in military affairs (RMA)].”

As the services seek appropriate paths for adjustment to globalization, they can learn important lessons from business. Business has been the front line of globalization—it has shaped and accelerated the process and, in turn, has had to reshape itself to meet the challenges created. Corporations have downsized, reorganized, combined, spun off, reinvented management, and done many other things to promote competitiveness and profitability, and to attain the overriding objective of increased shareholder value. The military services are clearly not businesses, and their mission and motivations are quite different from those driving the private sector. The services should not and cannot copy business, but they can learn some successful techniques and some pitfalls from examining the corporate experience. The pages that follow outline some of the lessons to be learned.

Equally important for defense planners is to understand how the defense industry is affected by current conditions and the magnitude of the change that it is experiencing. Because the industry is a partner of DOD and the services in protecting U.S. national security, its experiences are important for reasons beyond just the techniques of adjust-

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ing to change. Its health, its ability to change and innovate, and its profitability matter to DOD because the services depend on the vitality of corporate contractors. Major defense companies are struggling to reshape their business strategies in light of changing economics and national security needs. Planners need to understand how globalization affects major DOD suppliers and contractors and to adopt policies to ensure that cooperation and partnership will be strong and effective in the future. This chapter suggests some approaches to help build that cooperation as a partnership.

Corporations and Globalization: Dynamics and Trends

Corporations have been profoundly affected by globalization, and they have adapted to meet many new challenges: the integration of the global economy, the information and communications revolutions, the new character and demands of stock and financial markets, the diversity of the labor force and the ever-changing needs for new skills, and the incessant pressure for new markets and financial results. For companies, restructuring has become a way of life. Continual organizational restructuring is demanded by the intensity of global competition, advances in communications and information technology, and changing consumer preferences. Different companies take different roads, but most successful corporations today are constantly seeking ways to improve competitiveness and corporate performance. Common elements and objectives of their programs include:

- Cut costs
- Improve productivity
- Promote flexibility
- Improve morale and motivate employees
- Build and train a skilled workforce
- Make the most of new technologies
- Improve internal communications and coordination of activities
- Encourage innovation
- Build and maintain a sense of teamwork and a meaningful corporate culture
- Adopt effective methods of management and leadership.

Approach to Restructure: Case Studies

At base, what corporations are trying to do is to retool to meet the fast-paced changes that are characteristic of globalization. They seek to become more responsive to customer needs, reduce overhead and management costs, improve organizational flexibility, simplify and accelerate decisionmaking processes, strengthen core competencies, and improve innovation. Often, this has involved decentralizing decisionmaking, developing integrated information systems, building teamwork, and finding new ways to motivate and reward personnel.

The following examples illustrate the spirit of change in three major American corporations.

IBM. In the mid-1990s, the IBM information technology management system did not support the company's strategic vision—that is, IBM found that it was not practicing what it was preaching. Its strategy was to approach the marketplace as a single, unified, global team—yet its information technology infrastructure was fragmented among hundreds of local geographies and inconsistent from one business unit to the next. IBM was not achieving the short-term cost and expense reductions needed to fund its investments in re-engineering and e-commerce. IBM—like many of its customers—had a dual challenge: managing information technology to derive maximum cost efficiencies and improving the effectiveness of application development and the speed of supporting infrastructure deployment.

Management identified an urgent need for action. A wholly new framework was developed for managing, deploying, and operating end-to-end information systems. A worldwide information technology management system was put in place to improve the effectiveness of information resources, generate a higher return on global information technology investment, and enable employees to become more productive and better able to serve customers.

The IBM transformation plan resulted in a savings of more than \$12 billion over 6 years. The savings came in two areas—information technology cost avoidance and line-of-business efficiencies. IBM information technology expenditures as a percentage of total revenue decreased by almost 25 percent. This was made possible through the implementation of a common, worldwide information technology infrastructure that was acquired and deployed through an outsourcing arrangement with IBM Global Services.

Raytheon. The adjustment to globalization has not been easy for Raytheon. Changes and difficulties at this major defense contractor are illustrated in the Winter 1999/2000 issue of *Viewpoints*, the company's employee magazine. Chief Executive Officer Dan Burnham started his opening letter by saying, "I know all of us look forward to a better year for Raytheon in 2000." He went on to say, "I think there's a perception, which I certainly don't want to encourage, that we're putting cash before people. The fact is that without cash, in time there would be no business. . . . [W]e took it on the chin from Wall Street. Thank you for staying focused despite the distractions."

Burnham's direct admission of the company's problems is consistent with Raytheon's efforts to improve communications throughout the company and become "an employer of choice." In 1999, Raytheon made its businesses more efficient, streamlined reporting relationships, and refocused its commercial electronics division. It also launched "Raytheon Six Sigma," a program successfully used by Motorola and General Electric to promote a "zero defects" approach to production, excellence throughout the production process, and the elimination of inefficiencies. Raytheon invited tens of thousands of employees to awareness training about the program. It conducted its first companywide employee survey. It implemented new human resource initiatives to attract and retain talent, to improve the performance evaluation process, and to encourage and draw upon the strength of diversity.

The employee survey was used as a baseline for a continuous process of improvement. Employees now have the opportunity to participate in feedback sessions

to learn about survey results, discuss strengths and areas of concern, and identify issues for action. Raytheon also planned about 200 action workshops involving more than 2,000 employees and aimed at developing specific action plans to implement recommendations for improvement. To build on the baseline survey, quarterly sample surveys are planned, followed by a comprehensive, all-employee survey every 2 years to get feedback on actions that are implemented. "We will be a great company," Burnham told his employees. "Your involvement will get us there."

Rockwell Collins. Rockwell Collins wants to be the most trusted source in the aviation electronics field. To increase its competitive advantage in the marketplace, the company has adopted an enterprisewide "Lean Electronics" concept that focuses on eliminating waste and maximizing cost efficiency and a "Best Place to Work" process that gives employees voice and feedback in establishing a "Best Place to Work" environment.

Both programs rely on employee involvement, ideas, and interaction. For the "Lean" program, each business unit has an identified "Lean" director who helps his or her unit work toward financial targets and culture changes in day-to-day work routines. Program goals are a 50 percent reduction in cycle time, a 25 percent reduction in floor space, a 50 percent reduction in inventories, and a 35 percent improvement in productivity. To help meet these goals, approximately 400 workshops were planned in 2000.

Challenges of Restructure: The Defense Industry

Corporations will continue to have experiences such as those just illustrated. The processes of globalization and change are not slowing. Competitive pressures are relentless and often unanticipated. Time horizons for technology grow shorter. Innovation and flexibility will be in demand, and adjustment to change will always be necessary and will frequently be painful. Successful companies will address the problems head-on and develop targeted programs to tackle them. Change will be constant, and the strategies for reacting to it will change, too. What worked last year may not work next year, but corporate leadership is learning that two elements must be constant: continuing reevaluation of approach and methodology, and a dedication to involvement of personnel in the change process.

The challenges of adjustment have been particularly difficult for the U.S. defense industry. The industry has shrunk, markets have shrunk, and financial health is imperiled. Former Lockheed Martin Chief Executive Norman Augustine has illustrated the problem by showing how the market value of defense firms stacks up against some of the in-vogue "new economy" companies. Calculating the market value of the seven major defense firms against that of the newly merged AOL-Time Warner, Augustine found that the defense sector was worth just one-quarter of the value of the new company—just one-eighth if Boeing were not included in the comparison.

Why has this happened? It has happened because the Cold War is over, and ever higher defense budgets are over. The industry has had to consolidate and to shrink. Unlike other industries, however, defense firms cannot "globalize" quickly. They do not operate in a pure market economy; instead, the market is controlled. Defense companies are constrained by government, laws, technology transfer restrictions, and

shrinking world markets. The U.S. Government appears to want industry to globalize and to become more commercial, recognizing that this is the only way that the firms can remain competitive and innovative; however, for often understandable reasons, government policies do not always keep up with this objective.

Where there was once overcapacity in the U.S. defense sector, today the industry has been shrunk through mergers and acquisitions. The mergers have proved more difficult to manage than might have been expected, and the pressures on corporate bottom lines and raising money for investment are serious. The U.S. defense industry is severely constrained in terms of investing and growing on its own. The industry gets most of its research-and-development monies from DOD, but the private sector also needs to do its own investment. Cash is short. Management problems are many. The same management techniques that worked in a \$5- to \$10-billion defense corporation are not necessarily transferable to a \$20-billion merged giant. Today and for the foreseeable future, the defense industry and the U.S. Government that effectively regulates it will face major business and policy challenges as the industry tries to retain its leading-edge position in the world of globalization.

Impact on International Politics and Security Affairs

The U.S. leadership position in international political and security affairs depends on this country's strength in militarily relevant technology, a superior military, a strong U.S. economy, and a healthy defense industry. All of these elements are affected by globalization and the adjustments involved. The following are relevant observations from the *1999 Final Report, Premises for Policy: Maintaining Military Superiority in the 21st Century*, produced by the Secretary of Defense Strategic Studies Group IV:

[*On technology*] The U.S. lead in militarily relevant technology may be shrinking, or may no longer exist at all. . . . Although the U.S. does not lead in all technology areas, it has a unique ability to combine individual technologies or systems of technologies into larger systems. How well we field integrated systems ultimately will determine U.S. military advantage. Since technology diffusion cannot be prevented over time, leadership in system integration capabilities can offset a potential adversary's unique technological advantages. Attaining the primary military advantage of system integration requires cultural and educational qualities underpinning industry's—and the military's—integration ability to be identified, nurtured, and protected.

[*On the military*] It is imperative that DOD shift its emphasis from a strategy that lost its relevance at the end of the Cold War, to one that capitalizes on the advantages and avoids the risks inherent in accelerating globalization of industry and the ongoing transformation of business practices in the Information Age, [and] people are the key to continued U.S. military superiority.

[*On the economy*] The U.S. economy is expected to remain strong, in light of lowered trade barriers and an increasing flow of global capital to areas of greatest opportunity or least risk. U.S. businesses have adapted well to the

rigors of a global marketplace, and remain the prime force as the engine of global economic growth.

[On the defense industry] In the absence of an effective methodology to define clearly a short list of key military capabilities that should be developed and protected, the tendency has been to overprotect. This . . . approach limits the ability of U.S. industry to pursue market leadership in selective military and dual-use technologies. DOD strategies must evolve to account for the technology leveling that will occur as a result of globalization, and apply greater attention to the importance of U.S. economic vitality and diversity in the global marketplace. The combined impact of globalization and commercialization suggests the need for a new partnership between government and industry.

Thus, as a result of globalization, the corporate experience in building competitiveness has become highly relevant to the military establishment and to U.S. Government policies. Military planners recognize the need to change. Globalization has given the military a broader mission—peacekeeping, peacemaking, education, even government creation—and globalization means that many new and different challenges can converge at once. Technology, planning, leadership, training, and personnel recruitment and retention pose new issues for the military, as they do for corporations. At the same time, the military knows that its decisionmaking processes are different from those of the private sector. The military has no profit motive to spur efficiency and productivity, yet it must rely on an industry that is more and more driven by requirements of innovation and profitability. Two major challenges of globalization for the military are to adopt relevant features of the corporate experience and to do what it can to help its corporate partners be as strong and effective as possible.

Implications for U.S. Interests, Strategies, Policies, and Goals

To maintain the Nation's security and military strength, the U.S. armed services must seek to manage the adjustments of the globalization process with maximum efficiency and effectiveness. They must work with the private sector to share experiences, to maximize the opportunities of technology and communications, and to bring new ideas into the military system. The discussion that follows is based on interviews with business executives; students of and veterans of the U.S. military services; leaders in government, industry, and academia; and relevant studies and papers. It has two themes:

- What can the services learn from corporate experiences and techniques?
- What should the services understand about the impact of globalization on defense industries? How does the “business side” of the defense industry affect the defense mission?

Learning from Corporate Experiences and Techniques

Before looking at some lessons that may be applicable to the service experience, it is helpful to point out what to avoid. Two clear messages emerged from the interview group regarding adjustment and change:

- Do not let cost cutting overwhelm the mission.
- Do not reorganize too fast.

The corporate world has done a great deal right in the steps it has taken to become lean and mean, improve profitability and productivity, and otherwise meet the challenges of global competition. This process, however, has involved heavy costs—most notably, extreme downsizing, personnel layoffs, insecurity about continued employment, loss of loyalty to the corporation, and a general decline in motivation and morale. Some of the organizational changes have been drastic and sudden, and in some cases, they have to be reversed. For example, a company might decentralize one year and implement a new reporting hierarchy the next. The military is cautioned to move with care and deliberate speed. It is also cautioned to be open and direct about the pressures that it is facing from competing demands: how can it cut costs and be more productive at the same time that it is expected to expand its mission and take on more responsibilities? The military can “do more with less,” but when the demands become too many and clearly outweigh the resources, the military has to stand up and say, “We can’t do that.”

As we approach the positive side of the corporate experience, it is important for the military to expect that some change in the military mindset may be necessary. As more demands are placed on military personnel, the services must do more to acknowledge how central and valuable good people are to its mission. It *is* possible to do more with less: for example, the Navy is already operating combatant ships with crews of fewer than 100 instead of 400, and the military is using force multipliers everywhere from new paints to new communications equipment. At the same time, cost cutting should not be allowed to undermine morale and overwhelm mission. One former naval officer and current business executive interviewed for this report suggested that military leaders must begin to see leadership as meaning “deal with” rather than “dictate to” (skippers are tempered today by accountability to crew, political leaders, and even the media); that the era of people as “expendable assets” is over; and that the expanded mission of the service requires its leaders to have a broader understanding of different cultures, history, and technology than ever before.

The military’s interest in learning from the corporate world has been demonstrated most effectively through the establishment of the Secretary of Defense Corporate Fellows Program (SDCFP) in 1994. Under the program, the Secretary selects annually one or two military officers from each service for a 10-month assignment working with SDCFP. Corporate Fellows spend a year working with leading-edge American businesses in order to glean the best of change, innovation, and emerging business practices. They are then expected to bring that experience back and use it to help transform the services. During their fellowship year, they continually update the

Deputy Secretary on progress made and on occasion have working sessions with him. At the conclusion of the assignment, each fellow submits a final report to the Secretary of Defense, and the group as a whole provides a common report. Each member also provides a formal briefing to the Secretary, Deputy Secretary, Chairman, Joint Chiefs, service secretaries and chiefs, and other senior officials.¹

Corporate Fellows also prepare individual reports on their experiences, and the individual presentations are aggregated to suggest general recommendations. These suggestions, made by officers in pay grades of O5 or O6 who have demonstrated high flag or general officer potential, speak directly and with great authority to the question of what the services can learn from corporate techniques and methodologies. Some of the major conclusions of the program participants from the 1997–1998 and the 1998–1999 program years are summarized in the following discussion.

SDCFP Conclusions

One objective of SDCFP is to take lessons from businesses and see how best business practices might apply to DOD, particularly infrastructure programs, which make up two-thirds of the department's budget. Those in the SDCFP see businesses outside DOD as successful in adapting to the changing global environment, exploiting the Information Revolution, structural reshaping and reorganizing, and developing innovative practices. A second program objective is to build a cadre of future leaders who understand more than the profession of arms—that is, who understand adaptive business culture, recognize organizational and operational opportunities, understand skills required to implement change, and will motivate innovative changes throughout their careers.

The 1997–1998 and 1998–1999 fellows offered observations and recommendations on a wide range of subjects, including organization and structure, planning and budgeting, human resources, and outsourcing.

Change Management

- Planning is a must. The first step is to determine actual processes.
- The second step is to educate and empower employees to effect change.
- Continuity of leadership is critical. Change is a multiyear process.
- Active top-level leadership is a must. No transformation occurs without it.

Culture

- Partnerships and teaming are important.
- Trust and sharing are objectives and motivators.
- Culture should not be adversarial; when working with partners, the goal should be to create “win-win” and long-term relationships, not a sense of constant recompetition.
- Business allies should have greater access to information.

Information Technology

- Enterprisewide architecture and protocols are a must, as are a common operating environment, authority granted to the chief information officer, and money to enforce information decisions.
- Seamless DOD-wide Intranet access is needed.
- Full implementation of information technology potential is a strategic-level leadership issue.
- DOD requires enterprise resource planning (ERP) systems.
- Lease rather than buy, when possible, to maintain state-of-the-art capability.
- Strive for paperless/deskless/virtual systems when sensible.
- Fully utilize high-technology collaboration potential throughout DOD, with “best practices” in accessible archives, video/chat meetings and decisionmaking forums, online professional news, and education.
- Use information technology more effectively for common administrative functions.
- Introduce automated shared support services (for example, pay, travel, legal, information technology) with single-point access by user.
- Professionalize DOD administration systems and not as a collateral duty.

Innovation

- Corporations take risks and expect that some experiments will fail. Such failures are not career-threatening events.

Organization and Structure

- Agility is the single most important attribute.
- Successful companies have flexible and dynamic structures.
- Collaboration and teaming are important and effective, with information technology as the enabler.
- Task-organized, rather than hierarchical, structures contribute to flexibility.
- Decisionmaking in agile firms is often decentralized.

Outsourcing

- A company must be certain of its core competencies and businesses. These should not be outsourced.
- Partnership is an alternative.

Personnel Incentives and Motivation

- Fear is not enough. Incentives are an absolute requirement for change. The benefits of change must be shared.
- There is a real workforce shortage. As a result, the military faces growing competition from the private sector for skilled employees.

- Added and high value from employees must be rewarded; a “one-size-fits-all” approach is not effective.
- DOD must rethink paradigms that limit its ability to fill gaps, rather than moving personnel only from the bottom up.
- Human resources is a profession, not a collateral duty.
- Incentives for recruitment and retention must be adapted so that DOD can compete in the marketplace. The total benefits package, not just salary, is critical.
- New incentive combinations might be considered, including compensation above basic pay for performance, flex-time, and a strong health plan.

Planning

- The time frame for fiscal planning should be 18 to 36 months or 12 to 24 months.
- Budget building and approval processes could be shortened.
- Financial reviews should be held throughout the year; at the “business-unit” level, savings should be plowed back, not taken away.
- Strategic planning should be “top down,” not “bottom up.”
- Strategic planning should be broad and general, with a time horizon of 1 to 5 years out. The rapid pace of change and need for agility make longer range planning outmoded.

SDCFP Recommendations

In reviewing the SDCFP conclusions and recommendations, several items stand out.

The new challenges for military leadership and the potential for learning from the private sector. There are new ways of looking at strategic planning, motivation of personnel, and technology that can perhaps help military leaders cope with their increasingly complex responsibilities.

Today’s military leaders have a much broader and more subtle mandate than did their predecessors. The responsibilities of leadership are made quantitatively more difficult by the realities of globalization and the two-way communication that changes the dynamics of on-the-scene leadership. The traditional mission of the commander—“Go forth and act in the nation’s best interest”—does not mean the same thing to a commander today as it did in the days before instant international communication. Then, the commander had more latitude and discretion. Today, decisions are instantly communicated to superiors, who can applaud, question, or reverse what is done by the on-site commander. A major question for leadership is, “How can we use technologies to communicate decisions and give a better picture of what is going on in the field?” Another question is, “How can leadership be made more sensitive to the complex realities of the global world, not just the military situation?” Decisionmaking today needs an informed consensus. It needs well-educated, well-rounded leaders who can “cross-fertilize” ideas and deal with different cultures (for example, in Kosovo, in Lebanon) and who are flexible enough to take on projects that have not been anticipated and that they have not been fully trained to do. Coping with these demands requires flexibility and agility—qualities that are encouraged in

the private sector but that are sometimes difficult to nurture in a culture where hierarchy and rules predominate.

The need for the military to address issues of recruitment, retention, and reward of personnel. The military faces serious motivation and morale problems if more attention is not paid to recruiting good people and keeping them satisfied with their work.

The military may not be fully aware of how serious the war for talent is in this period of workforce shortages. Corporations are competing with each other for talent, and they are coming after good people from the military. Taking a “commodity approach” (“There are more people where the ones we have come from”) is not satisfactory in a competitive market. Pay is not the only consideration. The military can learn from the private sector about competing for people and about the incentives and lifestyle accommodations that corporations make to keep and attract good people. Consideration should be given to relieving the pressure of long hours, long periods of time out of port, and the low ratio of money earned to hours worked. Working conditions, too, can be a major morale factor—for example, excessive bureaucracy, paperwork, insufficient personnel, lack of choice and opportunity for input for officers in the personnel selection process, and lack of spare parts. The military can also consider how the private sector rewards excellence and achievement. In the services, there is little individuality of reward, performance bonuses, or additional pay for extra skills.

The need for top-level attention to making the most of technology. Private sector corporations have learned that to maximize technology and communications, the whole company must be networked and data must be integrated to improve communications and coordination. In effective ERP systems, all functions are linked, software is integrated, and comprehensive data systems are developed. There would be significant up-front costs involved, but over time, the dollar savings and efficiencies generated would be very valuable to the services. DOD needs networked systems for traditional business applications (such as payroll and inventory) and for warfare. DOD has identified “information superiority” as the primary enabler for *Joint Vision 2020*; this demands that information be managed in a timely manner and that DOD have the correct technology mix and a top-of-the-line conceptual framework. The Department and the services should be able to obtain the same type of productivity gains and efficiencies in its overall business systems performance that the private sector is enjoying as a result of the application of networked information technology.

The need to review planning and budget cycles. Private sector firms are often criticized for being too “short-term” in their horizons, but there are advantages to a shorter planning time line: agility and flexibility are among them. Defense planners routinely look out 6 years and sometimes 20 years; businesses, by contrast, generally operate in 1- to 3-year planning periods. Long time lines mean very long research-and-development cycles. Military budgets take 2 full years to plan and have much more detail than private sector budgets do. These differences make the services less flexible than business and may hamper their ability to respond to current and future developments in technology, economics, and politics.

The need to nurture a “culture of trust” that affects internal service morale, relations with contractors, and government-industry relations. In the corporate world, the

processes of “empowerment” and decentralization have included giving more responsibility to employees at every level (for example, decisionmaking responsibility, risk-taking) and more weight to the assumption that employees are basically honest and competent. Big bureaucracies in all organizations develop huge operations for audits, contract management, expense reporting, and the like. Sometimes, the costs outweigh the direct dollar savings, and the negative message of “We think you might have done something wrong” can undermine collegiality and trust in the workplace. The services might evaluate how things have changed in corporations. Says John Naland in his September 1999 *Foreign Service Journal* article “Reinventing State: Lessons from U.S. Business”: “Despite a strong focus on the financial bottom line, Caterpillar does not stand over employees’ shoulders when they make long-distance calls (for example, no phone logs) or travel (compare a 5x7-inch reimbursement form with a multi-page voucher).” Trust is fundamental to teamwork inside an organization, and to working with partners outside. The services and DOD should seek ways to make trust a stronger part of their management and administrative cultures.

The Impact of Globalization on Defense Industries

DOD is already sensitive to the changes in the U.S. defense industries and the resulting significant effects on the defense industrial base. The 1999 *Final Report of the Defense Science Board Task Force on Globalization and Security* says:

Globalization affects DOD in two distinct, overlapping ways. First, it is altering the composition of DOD’s supporting industrial base. In just a few short years, DOD has gone from relying almost exclusively on a captive U.S. defense industry to depending more on the commercial market, both domestic and international. Second, and perhaps more significantly, globalization is reshaping the environment in which DOD must compete. The international military-technological playing field is being leveled by a range of trends, including: an increasingly permissive and sophisticated conventional arms market, the diffusion of advanced dual-use technology, the commercialization of formerly military technology, the increasing reliance of militaries worldwide on commercially-developed technology, and the declining effectiveness of export controls. Thus, all states—not just the United States and its allies—will eventually share access to a majority of the technology underpinning the modern military.

Globalization means that the defense business world has become commercialized. This changes the way that companies do business, and it changes the pressures that they face. It means, as discussed earlier, more pressures on the bottom line, more pressures for cost cutting, for profits, and for cash. It means looking for new customers, finding new ways of doing business and of raising money, and facing a whole new set of business problems.

One of the major manifestations of globalization has been the movement away from the foreign military sales (FMS) contract approach, under which the U.S. Government sells products to the government of another country, to a direct contract approach, in which a defense company contracts directly with a foreign government.

This has been a huge change for defense firms. One major defense contractor interviewed for this report said that about a decade ago, 70 to 80 percent of his firm's international defense business was done on an FMS basis. Today, it is only 40 percent FMS, and the expectation is that this number will go down to 20 to 30 percent. This change creates a whole series of adjustments in the way that business is done. Under the FMS system, when the sale is made through the U.S. Government, the rules of business are pretty much the same, regardless of the final customer. When sales are made through direct contracts, by contrast, countries negotiate and defense firms tailor their activities to meet their requests. Some typical provisions and results:

- The foreign buyer wants the seller to work with industry in the customer country. Many teaming and joint venture arrangements come about through this request.
- The seller is often required to establish in-country operations to support the product being sold. There are complicated legal, tax, labor, and finance issues associated with establishing an off-shore operation.
- Defense firms have to deal with more than one contract and procurement system. Under the FMS system, the U.S. Government standardized these. Now, a company may have to manage 60 to 80 different systems. Some countries have vague rules. Some customers reinterpret the rules as they go along. In some countries, written contracts are the beginning of a negotiation. Getting paid can be a problem if the contracts are not clearly written and understood by both sides. The implication: a great deal of up-front analysis is being done to qualify opportunities and detail what is involved.
- Export licensing is more complex and difficult. There are frequently export-licensing questions involved in government-to-government sales, but the U.S. Government is more comfortable with these FMS transactions and more willing to cooperate.
- More work with foreign consultants and agents is required. Companies work to find honest consultants and are very strict on ethical issues.
- Offset requirements have become increasingly costly and more difficult, with countries making conditions harder to fulfill. More costly indirect offset is replacing direct offset.
- Financing can be a major problem. Many countries say, "Find us the money, and we'll buy your product." This puts the seller on the spot to arrange off-balance-sheet financing with countries that are reluctant to commit a sovereign guarantee. These same countries do not want to pay the cost of such financing.
- Foreign exchange issues are risky and difficult. Under the FMS system, contracting firms are always paid in U.S. dollars. Now, currencies come in all colors and in varying values, and sometimes there is risk around being paid at all.
- Tax planning has become more important for defense firms. Every country's tax system and rules are different, and all can cause financial troubles if business is not set up in the most advantageous way. Tax gains and losses can often overshadow the operating profits from a program.

- Accounting and bookkeeping have become very difficult. Foreign entities must be set up to collect the financial data needed for taxes and other financial matters in a manner consistent with local accounting practices. Currency issues complicate the job: for example, on some projects, a firm may buy in one currency, sell in another, and do its financial reports in a third.
- Putting people overseas and hiring local residents raise complicated and time-consuming issues. All countries have their own labor laws and employment contracts. Expatriate administration, immigration and business visas, and security clearance issues take a good deal of corporate staff time. Training of personnel is a problem, too. As the business issues change and grow more complex, it is more necessary than ever. In reality, however, training is often sacrificed to the press of time.

Two themes are consistently articulated by companies facing the challenges of globalization and commercialization in the defense field. One theme is the need for a spirit of partnership, cooperation, and support in the area of commercial sales. The second is the problems that companies face because of U.S. Government policies and procedures on technology transfer.

A Partnership Approach on Foreign Sales

There is a sense in industry that the services are so concerned about the release of technology that they are sometimes reluctant to work in partnership with American industry on commercial direct sales. The services and DOD, it is said, do not like the trend toward commercial sales and away from the FMS system; thus, they shy away from helping industry in the international arena. When defense firms do procurement in the United States, there is an arm's-length relationship with the services. At the international level, circumstances and objectives are different. Both industry and the military services are trying to help U.S. national security and the national interest. In the words of one industry representative: "It should be a team, an arm-in-arm relationship. We have to be on the team with FMS. They should be on the team for commercial."

Technology Transfer

Export control and technology transfer issues have caused problems between industry and government for many years, but industry representatives believe that these problems are more serious than ever in a world where markets are shrinking and export sales are increasingly important to corporate financial health. Some industry representatives told us that the technology transfer control is the chief inhibitor to their success in global markets. Fellows in the 1998–1999 SDCFP concluded that the technology transfer approval process is "inconsistent and glacial. A new process is needed for deciding what to protect."

Certain technologies (for example, stealth technology and sophisticated information systems) understandably need to be tightly controlled; however, many other technologies may not merit such protection. The government mentality with respect to this matter, it is believed, is still shaped by the Cold War and does not give foreign

competitors their due. The result is to handicap American industry in export strategies and to slow the rate of American technological innovation. It is suggested that government undertake a significant national policy review, identifying truly “critical technologies,” update the Military Critical Technologies List, and revise the International Traffic in Arms Regulations to make it a dynamic entity.

Apart from the substance of the restrictions and controls, export license processing continues to cause delays and obstacles for the defense exporters. A review of the process, as well as the substance, is highly recommended. Finally, it is suggested that somewhere in the system there should be a point of advocacy for exports, someone who looks at the technology with a different set of objectives than “Let’s stop it.”

The need for reform of technology transfer restrictions and export controls has been acknowledged and endorsed by recent DOD studies such as the following:

The Department of Defense should engage the Department of State to jointly modernize the regulatory regime and associated administrative processes affecting the export of U.S. defense articles.

— *Defense Science Board Task Force on Globalization and Security* (December 1999)

In an era when: industry is globalized, the U.S. lead in militarily relevant technology may be shrinking, or may no longer exist at all; the U.S. military relies increasingly upon commercial technologies and products, and product-introduction cycles grow increasingly shorter; DOD must be selective in the technologies it chooses to protect.

— *Secretary of Defense Strategic Studies Group IV, 1999 Final Report*

Because of the continuation of outmoded export control policies and practices, defense industries in both the United States and allied European and Asian countries have attempted to remain autarkic—a self-sufficiency that is counter to the needs of coalition warfare and industrial globalization.

— *Jacques Gansler, “The Defense Industrial Structure in the 21st Century,” AIAA Acquisition Reform Conference* (January 21, 2000)

The difficulties in moving forward on these observations are themselves illustrative of the challenges of leadership and the problems of bureaucratic guidance in this complicated age. Industry generally welcomes the Defense Security Trade Initiative announced on May 24, 2000, but few believe this program will solve all the problems. Technology changes rapidly, and the process of evaluating technology transfer restrictions should be a constant high priority for government policymakers.

Conclusions and Key Recommendations

Globalization offers the opportunity for business, DOD, and the military services to renew and recenter their relationships, to learn from each other, and to move forward in a spirit of partnership and teamwork to meet the national security challenges of the new era. Specifically:

- The military should undertake a focused effort to analyze the corporate experience of adjustment to globalization and to assess what is and what is not relevant to the challenges that it seeks to address.
- The U.S. military should learn from the experience of corporations and try to think “out of the box.” Like the private sector, the military needs to promote agility, flexibility, and creativity. Military leadership needs these attributes as it adapts to ever-changing and more complex challenges.
- The military must take steps to ensure that it has the highest class, most comprehensive, and integrated information technology systems available and that these systems are suited to its many needs.
- The military should give special attention to its personnel requirements and its corporate culture. New ideas for incentives and rewards should be encouraged, as should more traditional benefits such as significant pay increases, which would enhance recruitment and retention efforts.
- DOD and the military services should work in partnership to help the defense industry adjust to globalization. Specifically, DOD cooperation with industry commercial efforts should be encouraged, and technology transfer and export control policy and procedures should be reevaluated and reformed.
- The intensity and pace of global change demand that organizational reevaluation and restructuring be a continual process. Industry, DOD, and the services should work together in this process—promoting mutual feedback, questioning, and teamwork for change. 🌐

Notes

¹ To date, Corporate Fellows have spent time with such diverse and important businesses as Andersen Consulting, Boeing, Caterpillar, Cisco, CNN, Citicorp, Coopers and Lybrand, DirecTV, FedEx, Hewlett-Packard, Lockheed Martin, Microsoft, Mobil, Netscape, Northrup Grumman, Oracle, Raytheon Systems, Sarnoff Labs, Sears, and Southern Company.