The January 2010 edition of National Defense magazine carried an interesting article discussing the Pentagon’s **Industrial Policy Directorate** , and its new emphasis on anticipating financial failures by critical suppliers in its supply base. According to the article, which related an interview with Director of Industrial Policy (IP) Brett Lambert, the IP team “does not plan to be an advocate for industry but rather to engage in a closer dialogue with the private sector so the Pentagon is better informed about the financial health of critical suppliers.” The article reported that Lambert said the new emphasis “will help the Defense Department anticipate ‘points of failure’ in the supplier base and save taxpayer dollars by avoiding costly rescues of failing companies.”

The article reports that, unlike the prior focus on the health of the largest prime contractors, today the Pentagon is concerned about the financial standing of “smaller companies in the lower echelon of the supply chain.” According to

Lambert, "What we are seeing increasingly is that all primes rely on a single source, or point of failure, that is down in the second, third or fourth tier … I believe we don't have adequate insight into those critical subcomponents."

The article notes that "The Pentagon's own contracting databases only capture information about the top-tier industrial base…."

Welcome to the club Mr. Lambert. At Apogee Consulting, Inc., we have been preaching this philosophy for quite some time. Let's restate the issue and our point of view for clarity:

1. In today's aerospace/defense environment, where up to 80 or 90 percent of program execution has been outsourced to external suppliers, program execution risk is found in the supply chain and managing that risk is inextricably tied to managing supplier performance. In other words, 21st century program management is not significantly different from supply chain management.

2. Most primes delegate supply chain management, and supply chain risk management, to a separate silo—the same silo that sources, evaluates, and awards subcontracts. That's a recipe for failure. The skill set in acquisition management is not the same as that necessary for program management. At a minimum, the priorities are different and the technical emphasis is different.

3. Most primes hold their 1st tier subcontractors responsible for lower tier supplier execution. Most 1st tier contractors hold their 2nd tier suppliers responsible for lower tier supplier execution. And so on *ad infinitum*.

This is again a recipe for failure, because execution risk cannot be transferred and always resides, ultimately, with the prime contractor—who is responsible for program execution regardless of what some lawyer thinks.

4. Despite the foregoing, most companies engaged in program management fail to devote sufficient resources and budgets and management attention towards supply chain management. Most companies don't know their program supply chain and, if challenged, cannot produce any written or graphic description of a single program supply chain—let alone map multiple program supply chains to identify where a common supplier exists between programs. Those common suppliers are both opportunities (in terms of establishing long-term alliances) and risks (in terms of single points of failure for multiple programs), yet companies almost invariably have made no effort to identify them.

5. Those critical few suppliers that support multiple programs must be identified, because they represent risk to multiple (and now interdependent) programs. Once identified, they must be evaluated for financial health, and contingency plans must be created so that, if one of those suppliers ends defense production or enters bankruptcy, impacts on the multiple programs will be minimized or mitigated completely. We know of no single company that is making this effort in a rigorous manner that befits the true risk to program execution.

The National Defense article also notes that the Defense IP Directorate is concerned about loss of critical skills during the upcoming defense spending downturn. (About which we've also written about many times.) Lambert is quoted as saying, "we are focused on preserving skills necessary to support our war fighters in the near term and long term." However, he cautions that skills are not jobs, and (according to the article) suggests that "debates about critical skills are biased toward white-collar positions."

As if in evidence of the Defense Department's awareness of the need to preserve critical skills, we noted that on January 15, 2010 a $93.4 million contract was awarded by the Defense Logistics Agency to AM General LLC. The contract was a fixed-price, sole-source award made without competition, and it was awarded to AM General "in support of HMMWV industrial base requirements." In other words, the award was made so that AM General's suppliers would be able to keep their Humvee production lines open and to delay layoffs associated with the declining need for new vehicles.

As the National Defense article reports, "When military orders go down and it becomes unprofitable to make defense-unique components … firms may decide to end production of those items. Other subcontractors may go out of business altogether because of declining orders." Lambert is quoted as saying, "When we terminate programs, the cascading effects on the lower tiers can be catastrophic." And, we would add, because certain lower-tier suppliers supply multiple programs, ending one program may create unintended consequences for many others.

The DOD finally appears to be recognizing some of the risks embedded in its industrial base, and the article reports that "Lambert's office will be reaching out to CFOs of prime contractors to gain access to their subcontractor data." Little does he know that the primes will have little, if any, data to provide his office.

And that fact should frighten many people in the Defense Industrial Policy Directorate.