

**9 November 2010**  
*Private and Confidential*

# Macro Market Trends

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Prepared for:

**2010 Defense Outlook Forum**

**Bank of America Merrill Lynch**



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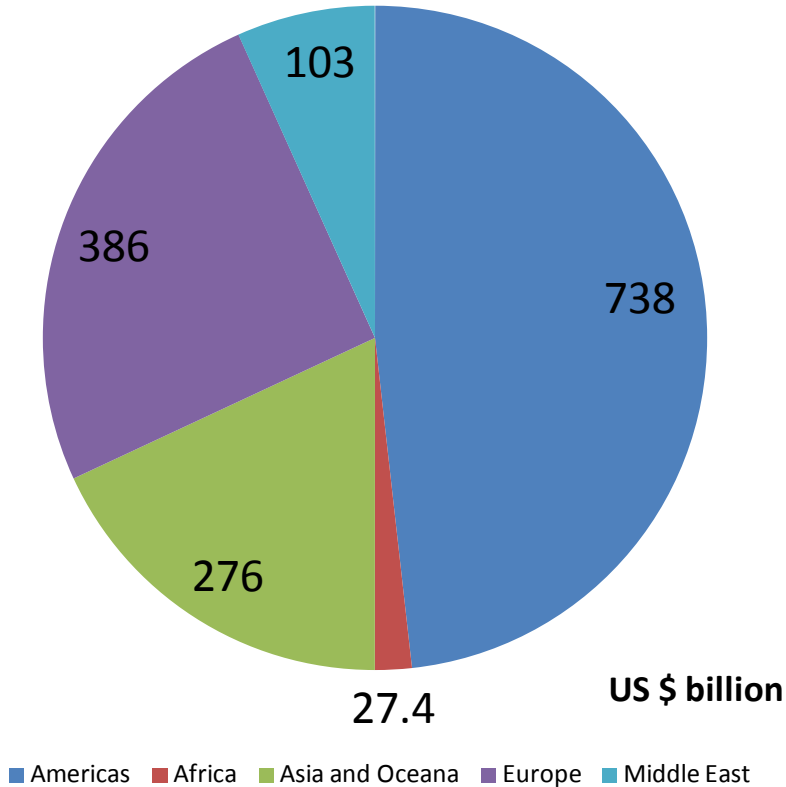
- Review of Global Defense Spending
- Global Trends

Theme 1 – conflict between jobs/national industrial base and efficiencies possible with multi-national collaboration and industry structure

- U.S. Defense Spending
- Acquisition Reform in the United States

Theme 2 – conflict in “acquisition reform” history between desire for efficiencies and prevention of any notion of fraud or abuse

Military Expenditure by Region  
\$1531 billion in 2009



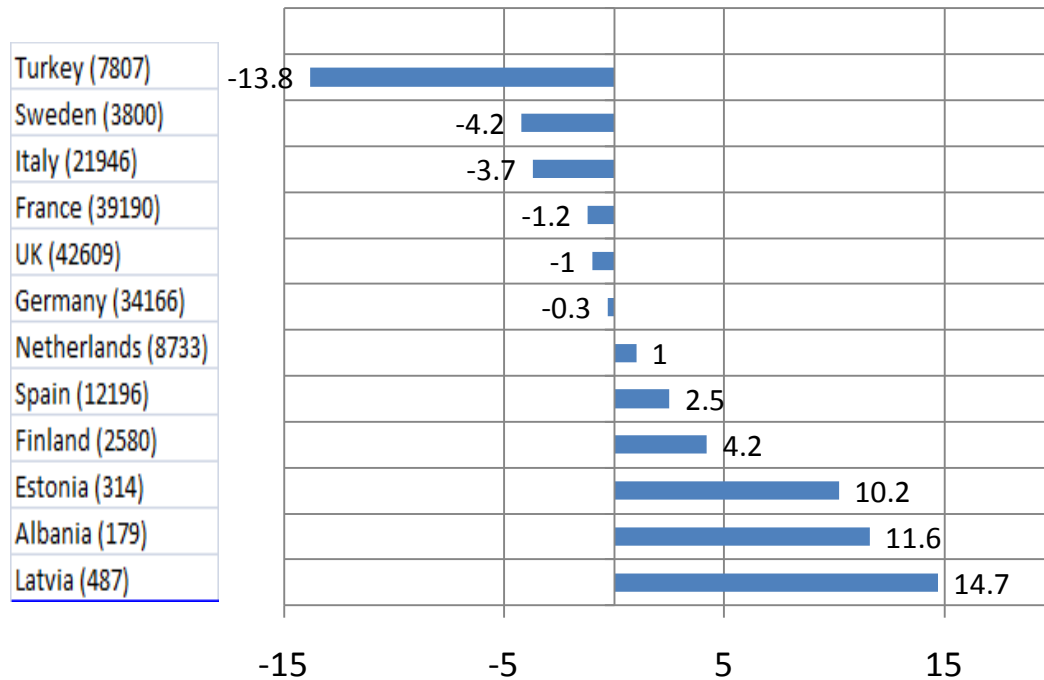
- Represents 2.7% of Global GDP in 2009
- Increase of 6% in real terms from 2008
- Increase of 49% since 2000

Country	Spending \$b	Share
USA	661	43
China*	100	6.8
France	63.9	4.2
UK	58.3	3.8
Russia*	53.3	3.5
Japan	51	3.3
Germany	45.6	3.0
Saudi Arabia	41.3	2.4
India	36.3	2.4
Italy	35.8	2.3

*\*SIPRI Estimates*

**Representative European Defense Spending**

01-'09 CAGR



Constant FY'09 Euros millions – Figures next to countries represent the nations defense expenditures in 2009.

- Real European Defense spending had a negative 1.8% compound annual growth rate over the period
- End Strength declined faster than defense spending
- 2009 – only four European nations exceeded NATO goal of 2% of GDP
- Trend for defense spending in real euros over decade peaked in:
  - Turkey in 2001
  - Italy in 2003
  - France in 2006
  - UK in 2007

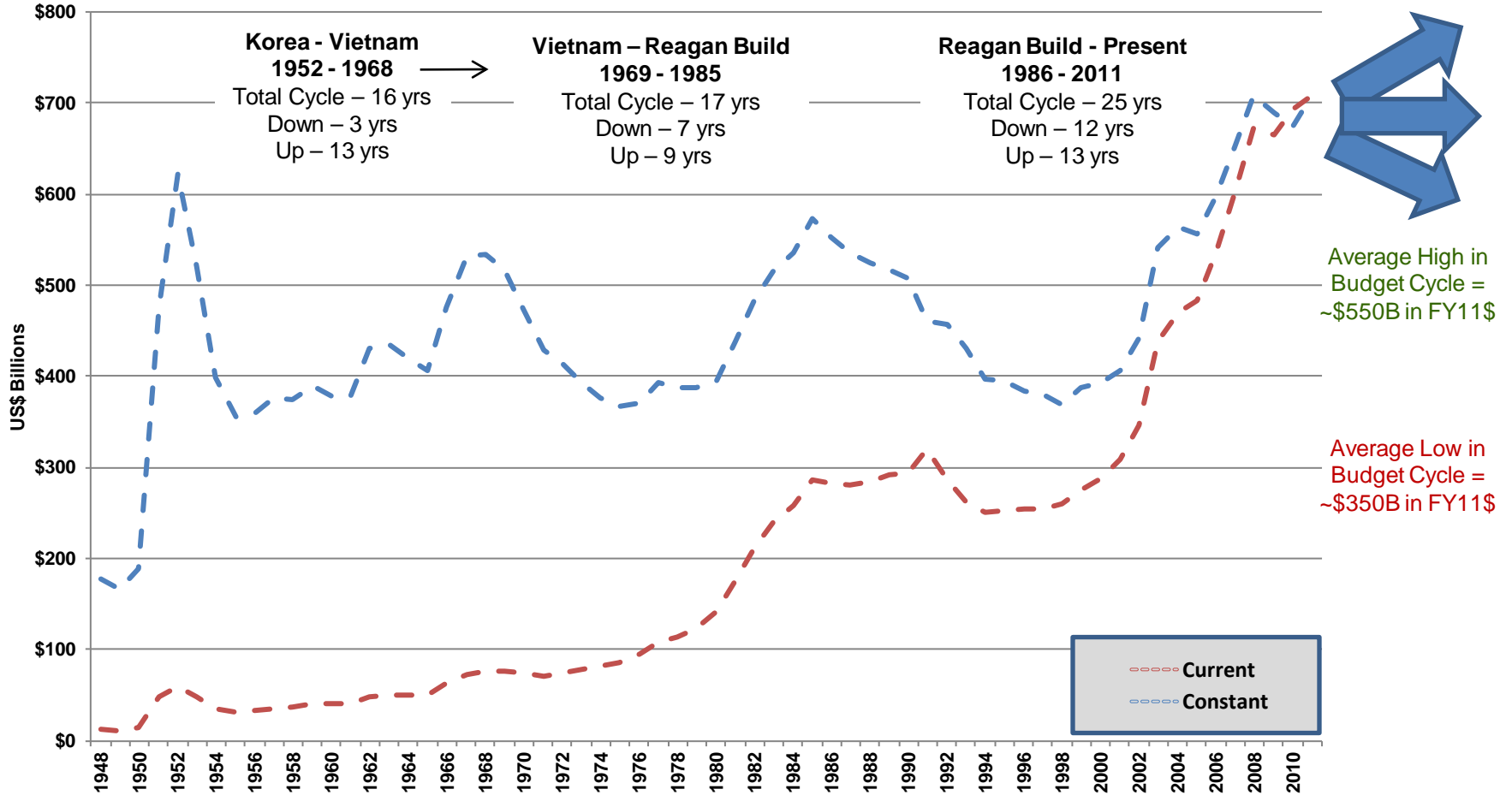
- Efforts at greater collaboration in producing nations ... but...
  - US export controls review and new treaties
  - European efforts at market reform
  - Capability sharing
- Downward budget pressure in Western Nations
  - Debt servicing
  - Entitlements/Social Structure
- Global demand shifting
  - Likely growth in Middle East, India, Asia
  - Challenge of offsets to build indigenous capability
  - Some of these markets are slow to close
- Growing markets will be challenged to compensate for declines in Western Nations
- Markets will be highly sought after, but not always easiest to serve

- Waning public interest
  - American public priorities
- Waxing public debt
  - Effects of radically increased public leverage on the Federal Budget
- Shifting political landscape
  - Cloudy Crystal Ball

*Source: RSAdvisors analysis*

# US Department of Defense Total Spending, 1948-2011

Budget Authority Including Supplementals/OCO



Source: RSAdivisors analysis

- Threats Have Shifted and Unlikely that World Will Appear Peaceful
  - Forces likely to stay busy
    - Different scale
    - Different ways
- Very Different Industrial Sector
  - Consolidation of the Primes
  - Rise of Services
  - Nature of R&D Cycle
  - Conventional Wisdom on Contractors
- Customer Environment Shifting
  - Gates Imperative
    - Rebalancing Capability
    - Efficiencies Initiative
  - Carter Guidance
    - Target Affordability and Control Cost Growth
    - Incentivize Productivity and Innovation in Industry
    - Promote Real Competition
    - Improve Tradecraft in Services Acquisition
    - Reduce Non-Productive Processes and Bureaucracy
  - Need for Growing Capabilities at the Traditional Seams
    - Information, Knowledge, Speed
    - Advancing and Protecting Networks
    - Growing capability of existing platforms and forces

*Source: RSAdvisors analysis*

- Target Affordability and Control Cost Growth
  - Mandate affordability as a requirement
  - Drive productivity through will cost/should cost management
  - Eliminate redundancy in portfolios
  - Make production rates economical and hold them
- Incentivize Productivity and Innovation in Industry
  - Incentivize supply chain management and indirect expense management
  - Adjust progress payments to incent performance
- Promote Real Competition
  - Competitive acquisition strategy at each milestone
  - Require open systems architecture and set rules for acquisition of tech data
- Improve Tradecraft in Services Acquisition
  - Senior official in charge, common taxonomy and better define requirements
  - Limit time and materials and award fee contracts
- Reduce Non-Productive Processes and Bureaucracy

*Source: RSA advisors analysis*

# Questions?

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