

Sequestration

How did it happen and what will it mean for defence businesses?

BY LINDA WOLSTENCROFT

By the time you read this, events should have transpired that will set out the near-future terms for the largest defence industry in the world. The fiscal cliff is looming and sequestration is due to arrive. The rhetoric includes doom and gloom over the predicted loss of more than one million jobs, and the cutting back - or even possible loss - of major US defense programs. At the time of this writing in late 2012, uncertainty prevails around the extent that tax increases can protect the industry and this leaves defense firms' planning in disarray.

The stakes are so enormous that it is difficult to fathom that this has happened. How could the world's superpower that has enjoyed massive economic strength and has, by far, the largest defense machine, come to this point? For such a huge problem to occur, the causes must have been complex and critical. Cited causes include the Bush era tax cuts, health care programs, the 2008-09 recession and its ensuing economic stimulus, and the wars in Iraq and Afghanistan.

These are huge, complex issues, but let's look at a small example for perspective. About ten years ago, a company demonstrated to its US military customer the savings that could be realized by changing its aircraft engine R&O process. Significant engine reliability improvements and substantial cost savings would result. But the customer elected to not take advantage of the proposed cost savings, reasoning that if there were too many unserviceable engines they would simply purchase more spares. Could it be that this lackadaisical attitude toward spending was prevalent for many years and helped feed the debt we're facing today?

To understand the thinking that led this to occur, let's contrast how large, unanticipated expenditures are handled in business and personal finances. In the case of a business, when times of emergency arise, such as a market disappearing, the business can also disappear. The Columbus Buggy Company in Columbus, Ohio, went bankrupt in 1913 with the introduction of the automobile. A business can simply declare bankruptcy and cease to exist. An arrangement is made with creditors and everyone moves on to something else. However, with an individual or a family, that is simply not the case; one cannot declare bankruptcy and cease to exist.

So here's the point: when an individual or family faces an unanticipated large expenditure, they would typically recover by having a 'rainy day fund' or 'war chest' that was specifically set aside for such an event. Whether this is a lump of savings, an unused line of credit, or the option to dip into retirement savings, an individual or family has to have some sort of rescue mechanism with only bankruptcy existing as a final resort. While the terms of bankruptcy protection are harsh and the effects are felt for many years, individuals and families must survive it. The point is that people do not cease to exist. This holds true for a nation: a nation such as the United States is a living organism of people and ceasing to exist is not an option in the same way it is for a business. Therefore, maybe it's time to stop comparing running a country to running a business, and start comparing running a country with running a family.

What does this mean for defense businesses? The writing is on the wall. Businesses need to carefully predict what is going to happen to their major markets. Will they stay or will they go? Are there markets that deserve more attention, or less attention? Are there new products or services needed? Will growth be better achieved through international avenues? If so, what are the right international markets to pursue? Do we need to develop a war chest to see us through a downturn? There are many questions, but the bottom line is that in times of external turmoil the best approach is to regroup and determine whether last year's strategy will still be relevant looking forward. With great companies such as Boeing revising their focus (Boeing is shifting its focus to sales in the Middle East, where it expects to double its sales in the next two years), it could be time to follow the leader and review the strategy for your business.



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