



# Survival of the Fittest in the Industrial Base

The drumbeat from Wall Street analysts has been pretty consistent on the defense industry: Top Pentagon contractors have weathered the post-war slump remarkably well, and their financial performance in fact has exceeded expectations.

But down in the lower echelons of the military supplier chain, the mood is not quite as upbeat. There has been no soft landing for many of the small and mid-size companies that sell equipment to the military, and the downturn has been especially tough on contractors whose livelihood for years was tied to war spending.

"It's a cold business," says Stephen Speakes, president and CEO of industrial equipment manufacturer Kalmar Rough Terrain Center, near San Antonio, Texas. A retired Army lieutenant general, Speakes oversaw military procurements during the war buildup and was hired by Kalmar in 2011, "when the good times were over."

The company is the U.S. subsidiary of Sweden's Kalmar. The Texas plant opened in 2009 to support the Army's gargantuan demand for forklifts and other specialized logistics vehicles to move cargo containers into warzones. Kalmar built about 1,000 "rough terrain container handlers" — nicknamed the "wretch" — that the Army ordered at a cost of nearly a billion dollars. Then, one day, sales stopped, and the company has struggled to stay afloat, Speakes tells National Defense. "We are trying to remake ourselves for the future. We tried to commercialize, but it's not easy."

It's always a bad day for a CEO when he has to let employees go, and Speakes has had many such days over the past year. A workforce of 200 is now down to 130, and more layoffs could follow if military contracts keep drying up.

Speakes was in Washington recently trying to convince Army leaders that they should allocate funds for repairs and upkeep of the wretch fleet so vehicles are ready for service if needed. The response from Army officials: We agree, but we have no money.

The idea that the Army would spend a billion bucks on new vehicles but not have the money to maintain them for later use baffles the mind of anyone who is unfamiliar with the ways of Pentagon procurements. And it illustrates the chaotic nature of war buildups. When contingency operations budgets topped \$150 billion a year, the Army ordered all the hardware it needed to supply troops at war. Since 2008, spending on equipment has plunged about 74 percent. Over the past five years, the Army also has had to absorb steep cuts in personnel and training. In today's environment, problems like the condition of the wretch fleet don't enter the radar. So what if the fleet is not maintained and, a decade from now, another war breaks out? Overwhelmed by bigger concerns, these are not questions the Army wants to have to answer right now. In the meantime, suppliers like Kalmar have to find another way to survive.

"When your product stops being procured, you depend on mods," Speakes says. "The M1 Abrams tank has survived that

way since the 1970s." Logistics vehicles, he laments, don't get that level of attention. "We buy them, use them and throw them away."

Speakes, nonetheless, insists he is hopeful. He believes the Army will come to its senses and put money into the wretch fleet. "It's too expensive to throw away. We could remake like new for \$150,000 to \$250,000 each, over 10 years, and extend the life of the fleet for 30 more years."

Another subtext to this discussion is the question of whether the Army, when not at war, should be concerned about the health of its suppliers. These industrial base hypotheticals spark much debate in Washington, and lawmakers occasionally bring up the subject during hearings when they become aware that jobs in their districts might be on the line.

Army leaders recently testified about the service's procurement programs. They laid out the wretched state of the service's finances, no pun intended.

"Due to resource constraints, we simply cannot modernize the entire force with the most modern equipment," Lt. Gen. Michael Williamson, principal military deputy for acquisitions, tells the Senate Armed Services Committee. To reduce expenses, he says, "we're divesting excess equipment across the entire Army to reduce and eliminate sustainment costs."

A shrinking modernization account, Williamson says, "continues to present significant challenges for the defense industrial base including our own organic industrial base."

The Army is trying to stay attuned to the state of the industry, Williamson assures lawmakers. "We're continuing to engage with our vendors on the aviation side as well as on the combat vehicle side. We are trying to give indications of what goes beyond '17 so that they can think through not only their workforce but also things like capital investment for their plant and for their facilities and also for their machinery. It is not something that we've taken lightly."

For companies like Kalmar, the end of massive war spending is hitting home. With no funding for the wretch in the latest Pentagon budget, the company is in a fight for survival. It is now competing for upcoming Army orders for up to 5,000 small forklifts that go inside shipping containers to grab items. The company also is investing in next-generation technology like software that can turn a conventional vehicle into an autonomous robot. "Metal is metal," Speakes says. "The real innovation is in the software design."

Defense Secretary Ashton Carter wants to partner with Silicon Valley, "but there's a lot of innovative companies and a heck of a lot of talent in America's heartland that do not get recognition from DoD leaders," says Speakes. "We are clinging to a fragile existence. That encourages innovation in a different way. For large companies, innovation is theoretical. We had to lay off 21 workers the day before Christmas. That's the reality."

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