

STRATEGY

It's proved harder than expected for government contractors to pull away from defense accounts and find new ways to save their businesses.



Successful Defense Conversion -- Undertaking a Cultural Proposition

The premise is straightforward. The implementation is not.

Confronted with static or shrinking government sector budgets, aerospace/defense companies pursue alternative ways to grow by converting their best technology and know-how into successful commercial ventures while maintaining their traditional businesses and customers.

But that task has proved daunting. Indeed, a large number of painful, well-publicized failures prompted then Martin Marietta chairman Norman Augustine's now familiar 1989 quote, "The record for defense conversion is unblemished by success." The industry has in fact registered some successes since, but the hurdles remain formidable. Why?

Obvious market implementation pitfalls exist that affect all would-be entrants to commercial markets. Mistargeted products, poor quality, insufficient capital, and similar problems can exact a toll on any fledgling enterprise. At the same time, other tactical hurdles also make entry difficult for a company new to commercial markets. Lack of awareness and credibility in the chosen market segment, or failure to deploy an effective distribution channel strategy, for example, loom as lethal pitfalls that many managers don't recognize until they've already become victims.

Yet, although both difficult and numerous, these issues are not a surprise. Their importance simply demands they be understood and addressed with appropriate expertise and resources.

What, then, makes defense conversion so tough, and what can be done about it?

Three Problems Rooted in Culture

The extraordinary difficulty of defense conversion traces to three root problems that are cultural in nature -- wrapped in semantics, tradition and corporate socio-politics. Each problem is complex, highly abstract and generally resistant to self-diagnosis. At the same time, these problems often seem intuitive and readily visible to the outsider, or to the would-be corporate entrepreneur trying to pilot a commercial initiative. They are also serious. Any one of the three can waylay an otherwise sound defense conversion initiative.

The first problem is being technology- and product-driven rather than embracing a true customer orientation -- the cultural barrier to commercial marketing. So what's new here? Being customer-driven is certainly accepted in principle, to the point, unfortunately, of having become a cliché. It's part of many if not most corporate mission statements. Yet it remains poorly implemented in practice -- a disastrous shortcoming in technology markets.

While "customer first" sloganism commands great lip service, the idea behind it is frequently stifled by traditional management inside-out thinking. Such thinking regards customers

impersonally, as opposed to considering them, the product and the application together in real-life scenario terms. Not listening to and understanding the target customer results in failing to grasp this customer-product-application scenario and the insights it provides. Those insights include the nature and perception of the problem/application and the importance and appeal of the solution that the product offers, all described in customer terms and language.

Aerospace/defense managers can find themselves particularly susceptible to believing that customers will value an arbitrary, company-driven list of seemingly attractive features and benefits in a given product. They are used to dealing with government customers who evaluate competing products and systems by RFP compliance criteria rather than by the product's net impact on the problem or application. But those customers themselves are now changing. The U.S. Government and its agencies have started to behave more like commercial customers, often preferring, for example, standard value-priced commercial off-the-shelf hardware to high-priced customized, proprietary hardware.

The second problem is a rigid disposition toward selling projects rather than products -- the cultural barrier to commercial business economics. The economies-of-scale benefits of selling standardized products and services to general markets once again seem obvious. Yet they are considered impractical and risky by companies used to the unique investment expectations of rapid cost reimbursement and almost guaranteed profitability benefits generated by billing time and materials against an awarded contract.

This tendency to think of business as a series of discrete projects is perhaps the toughest mindset to break. Such a project orientation is valid for a commercial venture only if it's within a custom professional services setting. The reason is simple. Technology projects -- the focus of most defense companies trying to enter commercial markets -- consist mostly of hourly-rated labor, primarily engineering time. Such professional time in the defense model, from an economic perspective, is a fixed-price commodity to be budgeted and sold on a cost-plus basis. Growth using this model requires selling more and more direct time, as opposed to marketing the value-added solution that the time itself delivers. The concept of highly trained and specialized people reselling standardized service solutions -- performing well-defined, high value, and thus high-margin professional services to solve similar problems -- is too frequently a foreign one.

The third problem is an inability to shed the millstone of administrative and procedural overhead -- the cultural barrier to commercial business management and organization. Arbitrary imposition of doing business "the company way" appears to have doomed commercial ventures at almost every defense/aerospace corporation at one time or another.

Though widely assailed, administrative overhead is not always bad. Indirect activities such as structured contract administration, layered procedural guidelines and detailed cost accounting practices prove useful tools for managing and controlling complex projects requiring close oversight. But small, focused commercial ventures beg for relief. Here such organizational structure eradicates any time/cost efficiencies by adding valueless overhead where it was designed to achieve just the opposite. Similarly, it tends to inhibit creativity, motivation and balanced risk/reward decisions by virtually eliminating incentives while retaining rigorous accountability. Yet most aerospace/defense companies still impose such overhead on all their operations, ostensibly in the interests of efficiency, consistency and stability.

Six Steps Toward Adopting A Commercial Market Culture

Success in commercial markets demands fundamentally different philosophies -- both procedural and behavioral -- from those expected, even required, to do business with the Department of Defense. While neither easy nor simple, following six basic guidelines can help defense conversion efforts bridge this cultural chasm:

Step One: First recognize that such conflicts of culture exist. The issue here is one of open-mindedness and objectivity on the part of upper management. Leadership must acknowledge that defense and commercial businesses within a corporation are fundamentally different, each deserving objective consideration and almost always a distinct management approach.

Philosophies and traditions of doing business in a uniform, corporate way die hard in the defense/aerospace community. Yet they don't necessarily have to die. They just need be confined to their own traditional sphere of influence rather than imposed as blanket policy. Without due recognition as distinctly different businesses driven by different sets of rules (see charts), commercial ventures often become fodder for management turf battles (e.g., key personnel allocation) and destructive micromanagement.

GE and TRW are two of several major defense/aerospace players that have had the foresight to separate their commercial businesses cleanly from their traditional businesses at the group executive level. New or acquired commercial entities are run autonomously by managers experienced in their respective industries and technologies.

Step Two: Adopt a true customer-driven culture, especially in product definition and development. Defense market veterans must at last resign themselves to acknowledging that commercial customers generally care little about the technical elegance or one-upmanship specifications of a given product. Bottom line: To be successful, a commercial product must meet clear, acknowledged market needs. That begins with defining such products in the customer's own context of perceptions, language, issues and priorities.

Accordingly, the objective should be to interact and partner with customers to understand problems and applications and to help visualize products and services to address them. Take steps, at the same time, to discern which customer issues and requirements are representative of the market as a whole, and which aren't.

The net customer value that a product provides, above all else, should drive product development decisions. Does it in fact make customers' lives and jobs easier or more effective through a competitively superior approach to a given problem, task or service?

Step Three: Create a strategic product/service model that emphasizes and exploits reusable, value-added technology and expertise for common sets of customer applications. Rather than simply marketing and selling engineering time in one-time projects, leverage expertise through "standardized" products and services. Resell the same solutions to similar, carefully targeted customers and applications at prices determined by value delivered. This is what the EDS's and CSC's of the world do so well, but what equally talented defense-oriented systems integrators so frequently fail at.

Defense conversion would-be's, however, are now getting more successful market models to emulate. Ascent Logic, Inc., a systems requirements planning and project management software company out of San Jose, CA, has successfully applied its methodologies to manage complex manufacturing and deployment programs for large military projects to the commercial marketplace. Ascent has taken itself from total reliance on the defense/aerospace market as recently as two years ago to forecasting some 50 percent of its revenues this year from commercial customers such as Motorola and Chrysler.

Step Four: Understand the key differences between the economics of commercial and defense businesses -- particularly anticipated return on investment over time -- and manage expectations accordingly. Perhaps the most frequent reason that promising commercial business initiatives fail to win management approval to go forward is because they cannot guarantee zero risk or immediate profitability.

Aerospace/defense managers, whose traditional businesses are characterized by unusually low investment needs and relatively quick financial payback, tend to project similar expectations on new commercial ventures that they undertake. At some point, however, they recognize that an investment framework calibrated and sized for defense businesses cannot support otherwise analogous commercial businesses. They begin to understand this dilemma too late to reset expectations and usually wind up pulling the plug on the commercial business to maximize near-term division ROI.

In the aerospace/defense arena, good project planning and solid proposals win contracts and assure cash flow and profitability from the outset. Similar slam dunks, however, are rare in the commercial world. There a more directly proportional relationship between risk and reward normally determines potential profitability while timely, effective product development and marketing determine actual profitability.

Managers need to balance risk by providing commercial initiatives with an enabling environment, adequate time and capital resources, and proper incentives. Equally important, the investment resources to support such ventures need to be separately budgeted and dedicated, immune from end-of-budget-period discretionary reallocation.

Such nurturing pays off. The financial performance of a nimble, aggressive, customer-driven commercial business can in time dwarf that of a defense-oriented enterprise that's much larger. Without support and incentives, however, champions of commercial initiatives within a corporation tend to leave the company and build the businesses on their own. In almost legendary style, Texas Instruments spawned many such entrepreneurial successes outside its walls rather than within during the seventies and eighties for those very reasons.

Step Five: Separate the commercial enterprise physically, functionally and culturally from the defense-oriented parent. Let competitive market forces, not rigid company policy, shape and drive the commercial initiative. But such separation often proves difficult to achieve. Aerospace managers, usually having risen through the ranks of program management, place a very high value on control. Accordingly, sufficient autonomy or flexibility may only be possible by spinning the unit off as a start-up.

Step Six: Acquire the necessary commercial market skill sets and experience to fill the cultural voids via well-defined personnel hires, acquisitions and alliances with strong industry partners. The maxim "Stick with what you do well" has an equally valuable corollary: "Recognize and get help with what you don't do well."

In a global business climate that stresses alliances and partnerships, defense companies trying to bring products and services to new commercial markets should be at the head of the line in seeking strong partners. An understanding of, and preferably direct experience with, commercial markets should be reflected across all functional areas of a commercial business initiative -- from distribution channels to finance to manufacturing.

A scarred veteran of many commercialization attempts, Dallas-based E-Systems is increasingly using partnerships to accomplish diversification. Large deals often serve to leverage core technologies, such as its co-founding of the commercial imaging satellite company Space Imaging Inc. with Lockheed Martin. Other partnerships enable small, specialized companies to better commercialize the various derivative technologies that E-Systems has developed on its government contracts.

Equal Rights for Commercial Business Units

These issues of culture and the steps to address them should not be construed as an indictment of the aerospace/defense industry. Its policies usually represent years of continual revision to help

companies deal best with their traditional government customers. But if not confined to defense-oriented businesses, these same policies represent real and intimidating barriers to commercial defense conversion ventures within the company.

Although successful defense conversion is a complex task, dealing with the three cultural barriers give such initiatives a fighting chance. Once addressed, they afford the parent company a manageable process for growth in both the aerospace/defense and commercial sectors, each operating according to equal but separate models.

To realize what true “customer orientation” is all about, try the day-in-a-life scenario -- putting yourself in your customers’ shoes to role play a typical day in their work lives, in the process identifying with their problems, perceptions, and issues, both large and small.

James R. Helbig is president of Marketing & Management Resources, Inc., a Dallas-based consulting firm to technology-based businesses.

Michael L. Capps is manager of business planning at Raytheon E-Systems, Garland Division, a defense electronics and systems integration company.

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