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POLITICSNATIONAL SECURITY

Lagging Arms Production Makes Pentagon Wary of Further Industry Consolidation

Defense Department, antitrust officials want to boost competition and manufacturing to arm Ukraine



The Pentagon's operations leave less room for multiple contractors, with Lockheed's F-35 jet fighter meant to replace many types of aircraft.

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By *Doug Cameron* [Follow](#)

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U.S. defense companies are finding it tough to quickly replenish weaponry such as missiles and artillery shells for Ukraine, leading Pentagon officials to revisit whether industry consolidation has gone too far.

Two decades of mergers and acquisitions have left the top six contractors to share the majority of Pentagon spending on military equipment. In the 1990s, some 50 firms vied for big contracts.

The largest defense companies, like auto makers, manufacture fewer things themselves than they used to and rely more on subcontracting. The broader defense industrial base shrank to 55,000 vendors in 2021 from 69,000 in 2016, and those smaller companies have become a choke point as shortages of labor, chips, rocket motors and other components are hobbling efforts to boost arms

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The Pentagon “is increasingly reliant on a smaller number of contractors for these critical capabilities,” Halimah Najieb-Locke, deputy assistant secretary of defense in charge of industrial-base issues, said at a recent seminar on consolidation hosted by George Mason University. “That impacts everybody’s ability to ramp production.”

Pentagon and antitrust officials have for a decade discouraged further mergers among the six prime contractors while approving most involving the next tier of suppliers. That has started to change.

Last year, the Justice Department tried to stop a combination between two cybersecurity firms, though a judge in October declined to block the merger.

The Federal Trade Commission last January sued to block plans by Lockheed Martin Corp., the world’s biggest defense company, to buy rocket maker Aerojet Rocketdyne Holdings Inc. for \$4.4 billion. Lockheed dropped the deal.



The Pentagon faces the challenge of measuring the potential impact of defense-industry deals.

PHOTO: JOSHUA ROBERTS/REUTERS

Aerojet is an example of a small but crucial cog in the defense industry. Labor and supplier issues have delayed its deliveries of rocket motors, which are used in the Javelin and Stinger missiles deployed in Ukraine.

Aerojet Chief Executive Eileen Drake said in November that a fire at a supplier

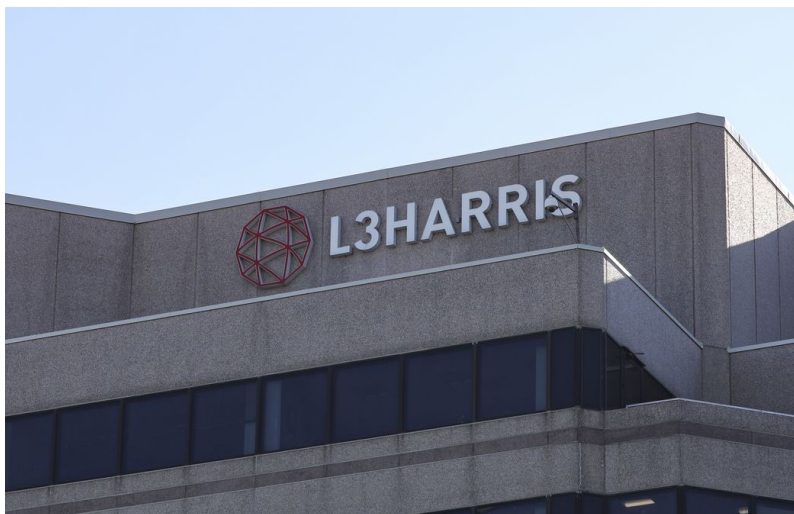
disrupted production, but that the company had stood up a new manufacturing plant, improved hiring and bolstered its own supply chain.

Raytheon Technologies Corp., which makes the Javelin along with Lockheed, said it will be 2024 before Aerojet catches up with engine orders.

A boardroom battle emerged after the collapse of Aerojet's sale to Lockheed, and the company was again put up for sale, culminating in last month's \$4.7 billion bid by L3Harris Technologies Inc., the smallest of the six prime U.S. defense companies by sales.

That deal is also subject to shareholder and regulatory antitrust approval, giving the Pentagon, the Justice Department and the FTC a chance to include the lessons learned from almost 12 months of conflict in Ukraine in their analysis.

A challenge for the Pentagon and antitrust enforcers is how to measure the potential impact of defense-industry deals. There has been relatively little academic work in the defense sector, in contrast with industries such as healthcare, in part because of a lack of available data and the difficulty of measuring outcomes.



Buying Aerojet would cement L3Harris's role as one of the Pentagon's prime defense contractors.

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In the health field, for example, a better outcome might be lower mortality, but the military lacks an agreed metric for success.

"It's kind of shocking to me that there's been so little work by economists," said

Mark Duggan, a professor at Stanford University and the co-author of a 2020 study on defense-industry competition.

That study didn't turn up any evidence that consolidation led to a significant increase in what the Pentagon pays for weapons, but couldn't determine whether quality and availability had been affected.

The Pentagon's Ms. Najieb-Locke said the department is working to commission more academic work on the sector and improve the available data to help its analysis of deals.

"We are closely reviewing M&A that could further consolidate the [defense industrial base] and hurt competition," she said.

The review of the L3Harris bid to acquire Aerojet will provide a test of whether a deal that makes a company better able to produce more outweighs any anticompetitive effects, said analysts and legal experts, most of whom expect it to be approved.

"We don't see regulatory hurdles to an L3Harris-Aerojet deal as there are no vertical integration issues, and the resulting company is still smaller than several larger primes," said Byron Callan, a defense analyst at Capital Alpha Partners LLC.



Lockheed is the owner of the Sikorsky helicopter business.

PHOTO: CHRISTIAN MURDOCK/THE GAZETTE/ASSOCIATED PRESS

L3Harris, like Lockheed before it, said being part of a larger group would help Aerojet resolve its challenges and invest in future products. L3Harris said it

Aerojet resolve its challenges and invest in future products. LEMARRIS said it would apply its “knowledge to drive both recovery and growth for the business.”

While the Pentagon will consider whether an acquisition would help a company’s ability to meet production goals, that is unlikely to be sufficient to approve transactions that are found to reduce competition, said Jeff Bialos, a partner at Eversheds Sutherland LLP and a former industrial-affairs chief at the Pentagon.

El Segundo, Calif.-based Aerojet’s importance to national security was highlighted when the Pentagon in February issued an update on the state of defense suppliers, noting the rocket-motor sector as an area of concern. The Pentagon said the shrinking number of providers could stifle innovation and price competition, and leave the military vulnerable to supply disruptions.

Whatever decision the Pentagon makes on future acquisitions, it will be tough to reverse years of consolidation. The number of big producers of aircraft, ships and missiles has shrunk to two or three in each category.

The Pentagon has also streamlined military operations in ways that have left less room for multiple contractors. Lockheed Martin’s F-35 jet fighter, for instance, is meant to replace many other types of aircraft.

Similarly, there are only two big shipbuilders, General Dynamics Corp. and Huntington Ingalls Industries Inc. At most three companies typically submit bids for most big defense contracts.

“It’s pretty hard to have competition for something like an aircraft carrier when only one facility is able to build it,” said David Berteau, president of the Professional Services Council, a trade group, and a former Pentagon acquisition official.

Pentagon officials have expressed concern that bigger companies wield so much political clout that, without competition, investment decisions can be distorted and taxpayers end up spending more on defense equipment.

Before helping to quash Lockheed’s planned takeover of Aerojet, the Defense Department hadn’t challenged a big industry deal since 2015 when Lockheed bought the Sikorsky helicopter business from United Technologies Corp.—now

part of Raytheon.

That acquisition, then the first big defense merger in a decade, prompted the Pentagon to take a closer role in advising the Justice Department and the FTC on defense deals. It approved the transaction because Lockheed at the time didn't make helicopters.

Now, Lockheed is the Pentagon's largest helicopter provider, a position it is trying to extend by protesting its loss to Textron Inc. of a deal worth up to \$80 billion to provide hundreds or even thousands of new choppers for the Army.

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