

**Remarks by Linda P. Hudson, CEO, BAE Systems,
NCMA World Congress, Denver, Colorado, July 11, 2011**

I'm pleased to have been invited to address this year's NCMA World Congress and exchange views with you.

First of all, I couldn't be more proud that our own Charlie Chadwick is your new president. Charlie's selection is a tremendous tribute to his long and illustrious career and his many accomplishments. He has always been committed to the men and women of our defense and intelligence services and has done his part to see that they get what they need when they need it and ensuring, that as a company, we deliver value to the taxpayers of our nation in the work that we do.

I'm especially proud that BAE Systems is sponsoring the NCMA Women's Forum meeting at this Congress.

I am a strong advocate of the value of diversity and many studies show that diverse companies significantly outperform those with less diversity. When I talk about the need for diversity it is important to note that I don't just mean the expected categories like gender, ethnicity, sexual orientation, veteran status and disability. I also mean diversity of thought, economic status, backgrounds, skills and perspectives. Every organization benefits from different points of view in decision making, action setting and employee motivation. The results speak for themselves.

It's wonderful to see that NCMA shares that commitment to make the contract management corps more diverse. At BAE Systems, we'll continue to be supportive of your efforts.

The contracting management profession is often depicted in a less than flattering manner - banded about in the same unflattering manner as lawyers and used car salesmen. When someone talks about government bureaucracy, it is often the contracting officer that first comes to mind.

Trust me; we defense industry executives sympathize, given our own image problems. We often find ourselves mentioned in concert with crooks and politicians.

But I don't share that negative view of your profession, or mine for that matter. In fact, I see you as just the opposite of red-tape-laying, road-blocking bureaucrats: to me, you are the "can-do" crowd.

You are the pros, on both sides of the table, who get us over the hump and past our differences, and make our businesses and our nation work.

And we really need that can-do attitude and capability today. Because, in the current environment, the defense community now faces a seeming Mission: Impossible.

Our mission, whether or not we choose to accept it, is to help find the additional 400 billion dollars in defense cuts President Obama has called for ... on top of more than 100 billion announced earlier this year by Secretary Gates. On top of this, deficit reduction talks continue and defense is not immune from further cuts.

And we must find them without weakening our security... undermining our ability to achieve current strategies... or compromising the safety and performance of our warfighters... at a time when our country is at war and extraordinary threats exist around the world.

Just how impossible does this mission appear? Even former Defense Secretary Gates warned that cuts of the magnitude called for could erode America's ability to fight two wars simultaneously ... and even threaten the modernization of two of the three legs of our nuclear arsenal.

Gates goes on to say: "Our guiding principle going forward must be to develop technology and field weapons that are affordable, versatile and relevant to the most likely and lethal threats in the decades to come, not just more expensive and exotic versions of what we had in the past."

Outgoing Deputy Defense Secretary Bill Lynn stated the challenge well. And I quote: "For [the Defense Department], how to slow defense spending responsibly while retaining the most effective fighting force in the world is the central task... (and) for industry, how to adjust to a less-robust defense market while maintaining technological prowess. Together we must... accommodate fiscal changes without undercutting our military effectiveness, now or in the future."

That's quite a set of challenges. At BAE Systems, we're determined to apply the same can-do attitude you bring to these difficult balancing acts. We consider delivering versatile capability at lower cost not a Mission: Impossible... but rather a Mission: Imperative.

In fact, the entire defense community is taking extraordinary steps to adjust to the unheard-of phenomenon of declining budgets, not only in the face of rising threats, but at a time of war.

The first step we have taken is ensuring portfolio diversification: shifting our emphasis to the new priorities. More than half – estimates run up to 56 percent – of all procurement is now in services, as opposed to major weapons systems. And a big part of that shift is from kinetic forces to information, communications, intelligence, electronic warfare and cyber security. Demand remains for certain products but there will be fewer new program starts likely resulting in the need for upgrades and increased capability for existing platforms.

A second adjustment is rationalization: getting smaller, more focused and more efficient. That bug has bitten big players from Northrop Grumman, who spun off its ships division; to Lockheed Martin, who announced a voluntary early retirement plan and sold its Pacific Architects & Engineers unit to a private equity firm; to ITT, who is splitting itself into three separate companies.

Everyone, including BAE Systems, is realigning their organizations, reducing staff and challenging long-standing processes. We should all be asking why we do what we do and is it really required to deliver a good product or service to our customers.

A parallel strategy is consolidation: the industry as a whole is getting smaller, so far without appearing to compromise competition. Price Waterhouse Coopers reported 20 billion dollars' worth of merger and acquisition activity last year in this industry, compared to about 10 billion the previous year. And it forecasts a substantial rise in that number in the future. What is yet unclear is whether, like the last defense downturn, we begin to see Tier 1 consolidation.

The DOD has publicly stated its opposition to these big mergers, but I believe market forces will dictate what happens. If there isn't enough work, there will be fewer players.

Then there's globalization: to ensure we can maintain the investment capital needed to fortify our defense industrial base here, contractors are "following the money" to countries with growing defense needs such as Abu Dhabi, Saudi Arabia, India, Canada, Australia and Brazil. Of all the strategies, this entails the highest risk and degree of uncertainty. The activities of the Arab Spring have made it abundantly clear that the world as we know it can change quickly.

But the most important adjustment we all need to make to address the challenge ahead of us must come from both industry and government. Beyond industry moves toward diversification, rationalization, consolidation and globalization, we need collaboration. Partnership between the Government and industry is absolutely essential to preserving our national defense in the face of declining budgets.

And at the heart of this collaboration has to be the contract management process. As the only official link between contractors and the government, you are at the epicenter of the solution. From solicitation to implementation and everywhere in between, there are money-saving and performance-enhancing efficiencies to be found in our departments.

We in industry are doing our part to help find solutions. Both directly, and through the NCMA and other industry organizations, we are reaching out to the government to recommend numerous areas of savings.

These recommendations include the seemingly trivial – like reducing the delivery of documents, presentations and reports ... or addressing the duplication of data calls from multiple sources in the government.

They range to the tactical – like embracing commercial off-the-shelf products, taking steps toward implementing more Value Engineering Change Proposals or eliminating counterproductive and burdensome management system requirements.

And they extend to the highly strategic— like eliminating redundancy within warfighting portfolios; reducing product life cycles by better risk management and concurrency; allowing greater flexibility in determining the need for competition in contracts; taking out solicitation, proposal and negotiation costs through long-term pricing or price-based agreements; or creating more robust and maintainable product designs and more efficient support models.

Clearly, when it comes to collaboration to reduce costs while maintaining capability and performance, the defense industry is putting its money and brain power where its mouth is.

And in many respects, DoD and the rest of the government are responding by saying the right things about collaboration in the contracting process.

To his credit, Under Secretary Ash Carter has sparked a serious look at how we can build greater flexibility into the acquisition process. His initiatives are aimed at everything from incentivizing productivity and innovation to reducing unproductive processes and bureaucracy. More recently, Dan Gordon at the Office of Federal Procurement Policy has issued an important memo aimed at busting myths that stand in the way of good communication.

We're heartened to see the government trying to remove some of the barriers that have had contract managers afraid to do so much as pick up the phone and ask a question. We welcome these efforts and the resulting outreach to industry, and would obviously like to see more of it.

But unfortunately, there's another side to the story. I'm going to be frank, and not everyone here may agree with what I have to say. Because the reality we experience day-to-day is not always matching up with the rhetoric regarding collaboration and flexibility in the contracting process. In fact, some of the rhetoric isn't matching up with the rhetoric.

It's even been suggested by a Senior Defense Department official in public remarks this year that DOD is not a partner with industry... because we have different objectives. It's an understatement to say that this sentiment is not going to go a long way toward fostering the collaboration needed to achieve savings.

But it reflects the attitude we're finding on the front lines, in our day-to-day interfaces with our customers and with senior officials. As often as not, we're still being cast as the enemy, and the government is making the contracting process harder, not easier.

Instead of being more collaborative and promoting greater flexibility, we're finding many agencies becoming even more aloof, promulgating even more regulations and more audits, and prone to be even more punitive on mistakes.

We're encountering a slew of new regulations, rulings and procedures government-wide – that were intended to save costs but are in fact increasing complexity, increasing reporting requirements, increasing costs for contractors and the Department ... and, that appear, taken as a whole, to reflect a deliberate effort to shift risk to, and reduce profits for, contractors.

Like more restrictive, conflicting and harder-biting rules on conflict of interest.

Like the CBCA ruling – based on the "plain meaning" of a standard FAR payment clause that is anything but plain in its language – requiring that subcontract labor on T&M contracts be billed as "material" based on actual cost, not in accordance with their labor category rates, even when utilizing those subcontractors improves responsiveness and performance. That's dramatically reducing profitability on projects with large subcontractor input. That's not an incentive to do things better or cheaper – it will just drive us out of business.

Like the directive that customary progress payments will be the basis of negotiations...even though FASA established performance-based payments as the preferred method of contract financing.

Like lower thresholds, not materiality, for applicability of numerous rules and regulations.

And like the increasing pressure to avoid cost-type contracts when they make perfect sense in favor of fixed-priced contracts where contractors find the risk untenable.

Look, we understand the necessity of an arm's length relationship between buyers and sellers. But maintaining that the government and contractors do not have common goals is just plain not right and it will not get us where we need to be. Trying to create contracting arrangements with unbalanced risk profiles and not allowing profit to be a tool to balance that risk defies basic economic theory.

We acknowledge the need for transparency. But it doesn't make any sense to require the systematic delivery of reams of sensitive, competitive information about our companies and projects, increasing administrative burdens and costs and undermining contractor intellectual property rights... and, as an unintended consequence, creating an online government managed treasure trove of data that could be infiltrated and compromised by our competitors or our enemies.

Yes, we know that oversight is important and necessary when the public money is being spent. But government needs to weigh the benefit against the cost...

And "materiality" needs to be more than an entry in the glossary of contracting terms between "match" and "mentor." Wasteful oversight is still wasteful.

And when we have entire settlements held up because a contractor can't produce a paper copy of a 25,000 dollar invoice for copier paper ... or a contractor threatened with having all future billings prevented under the Business Systems rule because of a harmless billing of two thousand dollars to the wrong contract line ... that's the very definition of wasteful oversight. In fact the entire Business Systems regulation is wasteful no matter how much it was "improved" through multiple comment periods – it's completely redundant to existing rules in every category covered.

We recognize that savings have to be found, revenues recovered and competition maintained. But when we have requirements like the three percent withholding rule, with no relationship to actual taxes owed, that cost more than the revenue recovered, we're barking up the wrong tree.

The danger is that we're going back into the situation we faced in the 1980s. Remember those days? Well, Charlie and I do, anyway. The headlines were replete with tales of 400-dollar hammers and 1000-dollar toilet seats... and the politicized overreaction spilled over into an outright adversarial relationship between the government and contractors.

Defense contractors got the criticism, then as today. But we all know that it was and is really government contracting requirements, ostensibly designed to save costs and protect the taxpayer that drove these high costs.

Back in the 1980s, when I was with another company, I tried to save my Army customer some money by suggesting he buy what they needed at a local hardware store –three, commercially available, standard 50 cent washers. But that didn't provide "mil spec" washers and the quality assurance provisions, certifications and the like that the contract required. He insisted I deliver the washers per the contract – and it cost him about 500 dollars per washer just because we had to create the paper. The washer didn't change; it still cost 50 cents from the supplier.

I want to make sure that we don't return to those days. It would be criminal to go back to situations where we are actually driving costs up with more bureaucracy, more oversight and auditors auditing auditors, with the GAO auditing them.

With our contract managers deathly afraid to make a mistake – and government contract managers afraid to ask a question, worried that the agency's inspector general is the next person on the line – we are heading back to the lunacy of the 80's.

Our rules, regulations and requirements should be designed to drive resources to the so-called pointy end of the spear for the good of the warfighter or the intelligence agent... it is they who will ultimately be deprived of the equipment or capability they need if we can't get our act together.

So let me underscore a couple fundamental truths that shouldn't even be in question any more:

First, businesses, including defense contractors, should – must – make a reasonable return for our efforts, our innovation and our creativity. Because if we don't, we can't sustain our companies, achieve sought-after savings or deliver the capability our warfighters need.

In particular, the government needs to get real about shifting risk. Industry simply can't be expected to invest big over many years to develop new technologies for major products, then sell at margins inadequate to recover the investment and make a return for our investors.

It is even harder because we have limited influence on the demand model. It is subjected to the ever-shifting sands of politics, DoD budget requests and congressional appropriations. This process has worked effectively only when we shared risks, paid fair margins and valued the capability of the industrial base as a partner in national defense.

And second, no matter what you may have heard, we contractors are not the enemy. We can be great allies in finding savings and providing affordable products and services. In fact, we're the major place you can go for savings. Savings will not appear magically from more rules, regulations or bureaucracy. It's that collaboration word again. We have got to do this together.

My company is unique because we have a large global footprint and we serve many countries from indigenous operations. This helps us find value in the global marketplace. For some time we have been diversifying beyond our heritage platform businesses ... growing our electronics business and our service offerings with an increased focus on systems support, intelligence and security.

We know that business is really all about our people and relationships. We are focused on hiring and retaining the very best. We not only look for innovation in our product and service offerings; we are looking for innovative and flexible ways to work. People lead complicated lives today and we want to make it easier for our employees to manage both their business and personal lives.

We continue to make strategic moves by acquiring companies that add key technologies, provide new customer access or strengthen important growth areas to get into what we call the "fast lanes" in this challenging defense market.

And we're competing. We know how to fight for contracts large and small; to maintain our existing businesses and target new ones.

And, yes, we've gotten the message about cost. We've streamlined our organization – taking millions of dollars out of our business by eliminating layers of management and reducing headcount by thousands. We've reduced our G&A costs, harmonized our business processes and implemented shared services. As a result, we are increasing customer intimacy and getting more agile in the process.

And of course, we're committed to collaboration. But we need a partner in the process.

A good example of how it can work is a Performance Based Logistics contract recently renewed by the Naval Inventory Control Point Philadelphia. The contract featured a collaborative team approach between our company and the government that allowed us to invest money in process and product improvements that significantly decreased the cost of execution, which in turn became basis of negotiations for the renewal contract.

All in all, the program increased work scope, raised readiness outcome to 100 percent, expanded Title 10 government industry depot partnerships and resulted in additional savings of more than 12-and-a-half million dollars while accommodating reasonable profit margins.

All of which was confirmed in a deep dive review of the program under the OSD's Project Proof Point, a fact-based, data-driven review of existing PBL programs. This deep dive in itself represented a collaborative effort, because BAE Systems was willing to share actual cost and profit data to help OSD demonstrate to PBL critics that the focus should be on investment and cost reductions, not profits.

Recently, a story came across my desk of one of BAE Systems' own contracting personnel who had previously served as an ACO in the government. During that service, he volunteered to take on a hazardous assignment on the front lines so that he could have, in his words, "the privilege of serving the warfighter directly."

One week later, he was on a C5 bound for Mogadishu, Somalia, where his predecessor had already become a casualty.

While in Somalia, he often challenged the logistics contractor's costs in negotiation, and in some cases disallowed them, but always while explaining himself and working closely with contractors. He found that simply issuing a task order improved the dreadful conditions he observed in one local prison. He engaged foreign counsel to recover hijacked cargo ... doing what needed to be done, and saving millions of dollars in costs. He saw how engagement and action could make a difference; we often forget that in Washington, DC.

But here are the words I want you to hear directly from him:

“During my interviews for the job at BAE... I explained to folks that the ethics and integrity I learned while serving in the Government are the same I would bring to BAE Systems. If that were not acceptable, then I would not be the one they wanted for the team. I’m here, and I’m proud of our company and our commitment to ethical decision-making and integrity.”

He continues: “I am also proud that we strive for partnership and collaboration with our customers and that we don’t lose focus on the collective purpose of our business. We’re about providing the finest equipment and services to our customer so they can carry on the mission.”

And here’s the payoff: “Incidentally, my Son is out there using our equipment. I want him to be proud of this corporate family as we are of him and his brethren.”

Let me repeat something he said: “we strive for partnership and collaboration with our customers and that we don’t lose focus on the collective purpose of our business.”

To us and to you, it’s about the people who use our products and services. Everything we do is done with the end user in mind. If that is not a common purpose I don’t know what is.

And again, for this contract manager and so many others, it’s a commitment that’s not just professional ... it’s personal.

It is personal for me too. As we speak, my own son-in-law is a Marine in Afghanistan on his third deployment in six years. My daughter and three grandchildren are at home in North Carolina, struggling like many others with the challenges of military families with a family member deployed.

And we are just two of many BAE Systems’ employees with personal ties to our military and intelligence services. I’ve spent forty years in this industry, and I know firsthand that organizations perform best when they have this kind of sense of purpose. At BAE Systems we know why we come to work every day, why we do what we do.

In the end, contracts are not just about terms and conditions. They are about getting something important done on time for a fair price. Good contracts feel good for both parties. Inevitable problems are resolved constructively; people are treated with trust and respect. Successes are celebrated; failures provide the basis upon which we learn.

It all comes back to a shared purpose. We have to do this together, respecting our different roles but not losing sight of our common objective. Together we can make our Mission: Impossible into a Mission: Imperative.

I thank you for giving me the opportunity to share some thoughts with you.

I believe the relationships formed at events like this go a long way toward building trust and providing the framework for successful business dealings going forward.

I want to reiterate what I said at the beginning of my remarks, what you do is important. You are the only official link between contractors and the government and you are at the epicenter of the solution to the challenges we have ahead. We have got to get this right – for our taxpayers, for our nation’s economy, for our security and most of all for all the folks like my son-in-law whose lives depend on it.

Thank you very much and I’ll be glad to take your questions.