



The State of Investment in Defense

Unlocking Growth

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The State of Investment in Defense

Foreward

Private investment in defense capabilities is a critical element of national security. Healthy capital markets fuel the innovation, production capacity, and technological advantage needed to ensure warfighters are equipped to achieve their mission. As defense requirements increase and technology accelerates, prior planning assumptions, funding models, and production methods must adapt.

“Previous investment and business models must adapt for the new environment. Investment growth of all kinds is required to address capacity and innovation constraints—and that growth will occur when all stakeholders work in tandem.”

—MICHAEL SION, AEROSPACE AND DEFENSE PARTNER, BAIN & COMPANY

There are signs of positive change. Investors have committed more capital. Budgets have increased, and novel procurement pathways are growing. Industry has increased investment in new facilities, workforce development, and innovation across the defense ecosystem. The market is now at a turning point. Significant work remains to further increase levels of private investment.

“Across the defense industrial base, companies are investing billions in new facilities, production capacity, workforce development, and innovation to meet the nation’s security needs and deliver capabilities to the warfighter. Continued investment at that scale depends on a healthy capital environment, predictable demand, and policies that give businesses the confidence to invest for the long term.”

—ERIC FANNING, PRESIDENT AND CEO, AEROSPACE INDUSTRIES ASSOCIATION (AIA)

The central finding of this report is simple: Defense does not face a shortage of capital. It faces barriers that make expanded investment, particularly in critical bottleneck areas, more difficult. The challenge is creating the conditions that allow capital to flow to the facilities, technologies, workforce, and production

The State of Investment in Defense

capacity needed to strengthen the defense industrial base and deliver for the warfighter. Partnership between government, industry, and investors is key to achieving these goals.

AIA asked Bain & Company to survey the current landscape and seek views on ways to increase private investment. As part of the research, we conducted 50 stakeholder interviews with large prime integrators, new entrants, mid-tier suppliers, venture capital and private-equity investors, institutional investors, investment banks, customers, and industry thought leaders. These interviews were supplemented with an AIA member survey and data analysis.

This report will be updated in future years to assess developments in private investment and industrial base capacity.

The State of Investment in Defense

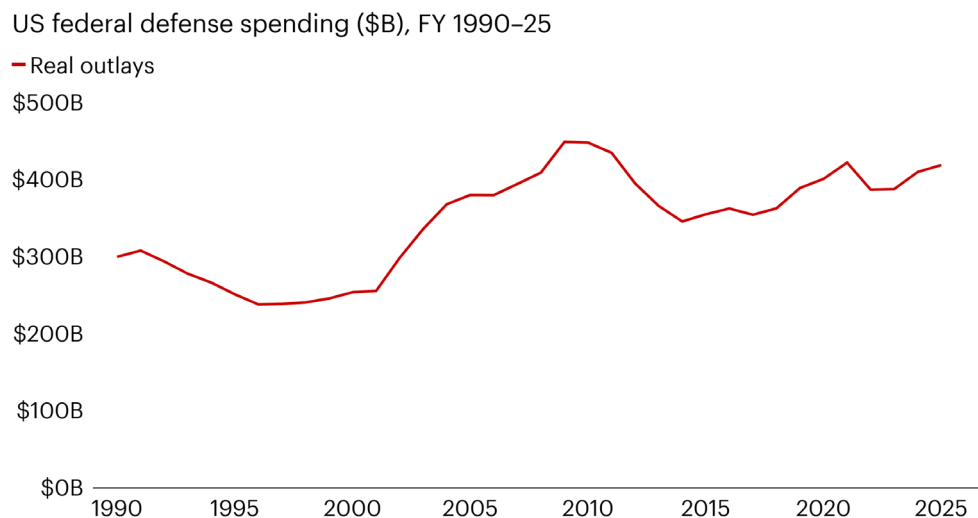
Introduction: Increasing threats, rapid technology change, and funding gaps

The gap between US defense requirements and budgets is accelerating. This creates an enormous need for increased private (non-government) investment, lower product costs, and increased speed of product delivery—outcomes that would enhance national security and potentially improve affordability for taxpayers. Despite signs of progress, existing private investment, business, and acquisition models could all improve.

Global threats continue to grow in scale and complexity.¹ At the same time, there is growing demand for both a greater volume of conventional systems—for example, FY2027 requests for three major munitions programs were more than 800% higher vs. the previous year²—and emerging capabilities such as uncrewed systems. Likewise, demand for advanced software and artificial intelligence capabilities has grown as planners seek more scalable and cost-effective ways to address emerging threats.

Within this dynamic, the US military's purchasing power has not kept pace with the expanding set of demands placed upon it. Defense spending has declined relative to the size of the US economy, from roughly 6% of gross domestic product (GDP) in 1985 to roughly 3% in 2025.³ Adjusted for inflation, defense outlays are equivalent to levels in 2008 (see *Figure 1*).⁴ This spending pattern has also been unpredictable; temporary funding through continuing resolutions has occurred often over this period, which makes business cases for investment even harder to close.

Figure 1: US defense spending, adjusted for inflation, is at 2008 levels



Notes: FRED PPI for government-purchased defense applied to 2015–25, and total manufacturing PPI to 1990–15; includes defense spending outside of DOD
Source: FRED, OMB Table 8.1

1. Current State of the Defense Industrial Base

The Defense Industrial Base (DIB) is critical to US national security. Partnership between the defense community, financial institutions, and industry has been a driving force for innovation and capability for decades. Yet major challenges remain.

Limits on manufacturing capacity

Advanced US equipment such as fifth-generation fighters and missile defense systems are cornerstones of US defense capability and enjoy substantial international demand.⁵ But drawdowns of supplies are outpacing production in some areas.⁶ The capacity challenges are system-wide, and at current production rates, gaps will continue to grow.

Supply chains, the backbone of the DIB, are complex, fragmented, and accustomed to gradual increases in production rates rather than sharp surges. In a recent Bain study of production challenges on 15 defense programs, companies cited supply-chain constraints more consistently than labor, engineering, or capital equipment shortfalls.⁷

“The supply chain is brittle. Sole sources are everywhere, and it will take time to address.”

—DEFENSE PRIME LEADER

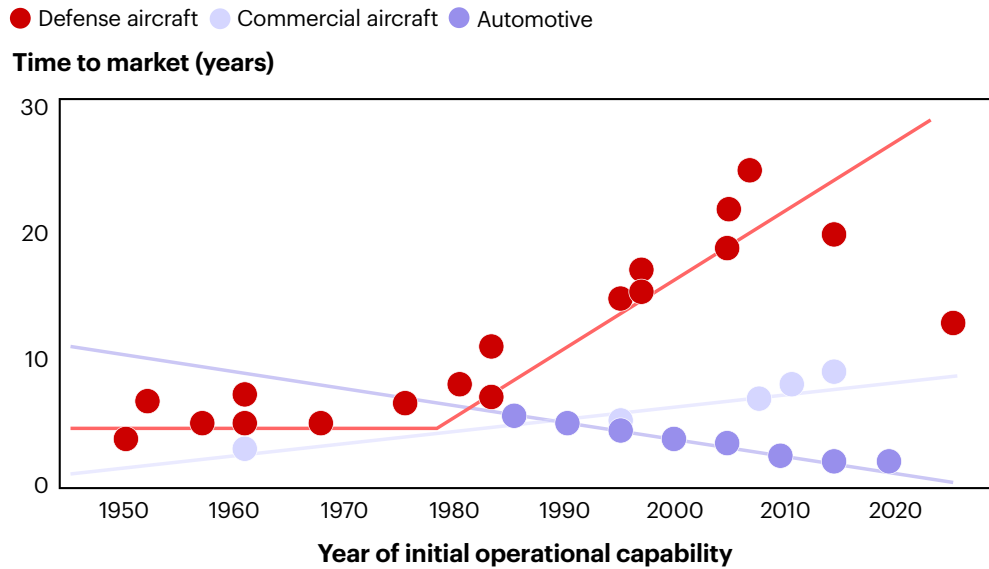
Many mechanical and electronic components are in short supply, both globally and domestically, either because they serve defense-specific needs or face competing demand from other industries. Even when production is carried out domestically, key machines often use parts sourced from overseas.

Persistent delays and cost issues

As demand has increased, the DIB has faced additional pressure to field new capabilities quickly and to deliver programs on schedule and at planned cost.

Yet the time it takes to develop and produce new systems has grown, with the average major defense program taking more than 12 years to deliver an initial capability. Defense aircraft, for example, currently take more than 10 years to get to market (see Figure 2).⁸ Additionally, the Government Accountability Office (GAO) found that major programs can be structured to “fail slow,” with success measured by money spent rather than capability delivered.⁹

The State of Investment in Defense

Figure 2: Each generation of aircraft is taking longer to build

Sources: Defense Advanced Research Projects Agency (DARPA)/Tactical Technology Office time-to-market study; Bain analysis

Delays in a program mean increased reliance on aging, less-capable equipment. In a period when threats can develop over months, a system that takes more than a decade to reach the field risks arriving after the need for it has moved on.

Programs running over budget are also a significant issue. The GAO tracked 30 programs in two consecutive years, when the combined cost estimates rose by \$49.3bn.¹⁰ Development delays, fixed requirements, inflation, and supply-chain constraints are some of the underlying drivers.¹¹ Most of this sits in a small number of difficult programs rather than across the whole portfolio, but it is proving hard to reverse.

Recent progress

Against this challenging backdrop, some notable improvements have occurred across several major programs. Company investments in capacity have grown both as a percentage of revenue and in absolute terms.¹² As examples, Advanced Medium-Range, Air-to-Air Missile (AMRAAM) production nearly doubled between 2024 and 2025,¹³ and deliveries of the PAC-3 MSE interceptor rose by more than 20%.¹⁴ New multiyear framework agreements signed in 2026 aim to significantly strengthen demand signals, though finalized contracting is still a challenge.¹⁵

Efforts to strengthen supply-chain resilience and domestic production capacity, including localization, supplier diversification, and selective vertical integration, have been made. Likewise, defense companies have launched efforts to improve talent pipelines with programmatic initiatives and school partnerships.

The State of Investment in Defense

The government has announced policy changes with the stated intent of attracting further private investment, including the November 2025 Acquisition Transformation Strategy.¹⁶ Implementation of these authorities has varied across programs and agencies, and stakeholders noted that policy intent and contracting practice do not always align.

2. How Defense Investment Works

All companies—in any industry—must decide whether to build facilities, hire workers, fund research and development (R&D), carry inventory, and scale production. Investors and lenders must decide whether to supply the capital that permits companies to do those things. To do that, they follow a simple rule: Capital flows when expected returns justify the risk.

Capital follows risk-adjusted returns

Investors fund company growth through equity (an ownership stake in the company) and debt (a loan that has to be repaid with interest). Each of these carries risk: Equity exposes investors to the company's future gains or losses; debt provides lenders with interest payments but exposes them to the risk that the company can't pay back the loan.

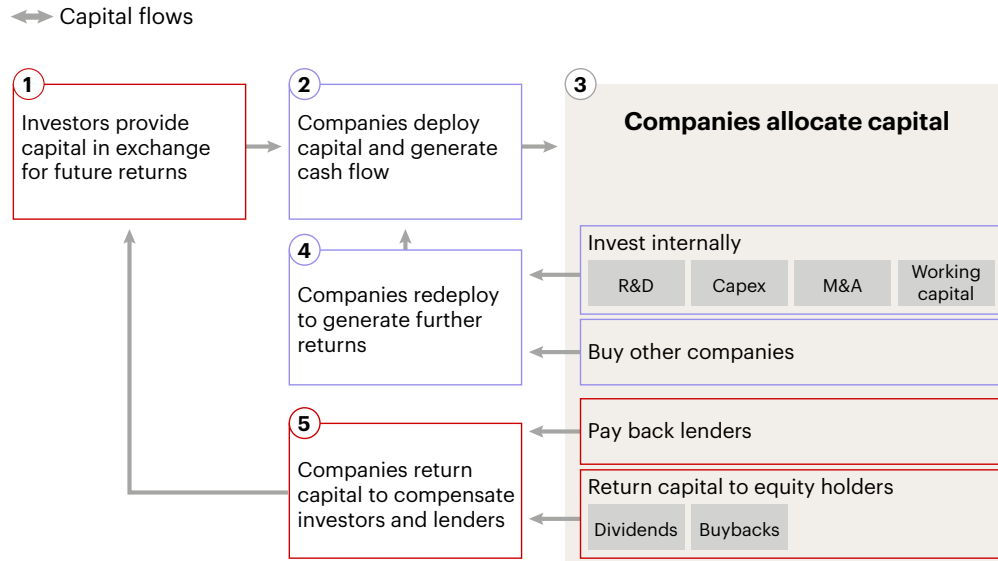
All companies—in any industry—must decide whether to build facilities, hire workers, fund research and development (R&D), carry inventory, and scale production. Investors and lenders must decide whether to supply the capital that permits companies to do those things.

Companies use cash they generate from operations to repay debt, compensate equity investors with dividends or share repurchases, or to reinvest in operations such as research and development efforts, new buildings, or an acquisition (see *Figure 3*).

Every investor requires a return that compensates for the risk that they will lose money (see *Figure 4*). A company or investor takes more risk when the expected return justifies it. If they think an investment opportunity won't compensate them for the risk fairly, they will take their money elsewhere.

This lost investment is “unseen” but felt acutely. One example is new, more efficient facilities that don't get built when they won't generate enough profit to justify the expense—or, equally, when the *risk* that they won't do so is perceived as too high.

The State of Investment in Defense

Figure 3: Investment growth requires a mutually reinforcing cycle of risk and return

Source: Bain & Company

Figure 4: How, when, and why a company allocates capital differently

	Reinvest in operations	Return capital to investors
How you do it	Build a facility or equipment, design a product, buy a company, etc.	Provide dividends, buy back stock
Why you do it	To generate a future return for the company for a given amount of risk	To provide a return now to investors
When you do it	When there are strong business cases for reinvestment that will generate positive returns	When reinvestment business cases are weak and don't justify the risk

Source: Bain & Company

The State of Investment in Defense

A company could make the investment anyway, but if it fails to deliver sufficient returns, demand for the company's equity will decrease, and shareholders, such as pension funds and retail investors, will lose out.

The demand signal is critical

The strength of a demand signal is the foundation of any investment decision. Companies use the demand signal to raise funds, hire people, plan R&D, and build production capacity. When the signal is strong, consistent, and clearly connected to observable underlying needs and funded demand, an ecosystem invests with confidence. When it is unstable or ambiguous, risk becomes harder to price, and capital stays on the sidelines.

Routes to market matter

When companies produce a defense product or service, two contracting decisions shape the investment case. The first is how the product or service is bought; for example, through a traditional negotiated contract subject to strict regulation, or through an alternative procurement pathway such as a commercial purchase, an Other Transaction Authority (OTA), or a Commercial Solutions Opening (CSO). The second is how the contract allocates risk and reward; cost reimbursement (where companies pass on changes in cost and therefore bear less risk), fixed price (where companies take on more of the risk or reward of changes in cost), or hybrid structures.

Those choices matter because they influence the shape of returns. For example, if the contracting approach sets hard or soft caps on profit margins, it can constrain a company's ability to generate the returns that might be needed to justify an investment in additional capacity. Many contracts limit available upside even if they may later require significant investment and risk.

The type of investor and their needs matter

"Investor" can mean many things. The most important distinction is between an investor who provides their own money and bears most of the risk (a principal) and the party to which they delegate management of their money (an agent). The principals consist of pension funds, insurance companies, foundations, family offices, endowments, and retail investors (often via retirement accounts). The agents consist of mutual funds, hedge funds, private-equity funds, venture capital funds, or other asset managers that make investment decisions on behalf of others. These investor types play different roles in the ecosystem given the diverse needs (e.g., desired growth, risk they are comfortable with, need for liquidity) of the investing public (see *Figure 5*).

The State of Investment in Defense

Figure 5: Types of investors and their approach

	Venture capital	Private equity	Asset managers	Retail investors	Lenders
What they invest in	Equity in early-stage private companies	Equity primarily in mature private companies	Stocks (equity) and bonds for all types of companies	Stocks (equity) and bonds, primarily mature companies	Loans for credit-worthy companies
Who invests in them	Institutions (pensions, insurance companies, foundations)	Institutions (pensions, insurance companies, foundations)	Institutions (pensions, insurance companies, foundations) Individuals	Individuals	Depositors Bond market participants
How they invest	Minority equity in early rounds	Controlling equity	Passive equity	Passive equity	Non-dilutive (no ownership stake)
Type of risk they take	High upside potential and downside risk Returns driven by a few outsized “winners”	Moderate upside with downside risk protection Returns (and risk) magnified by use of debt to finance purchase	Variable depending on strategy	Variable depending on strategy	Generally lower upside, lower risk
Return target	20%–30%	15%–25%	Varies	Varies	5%–10%

Note: Excludes growth equity, infrastructure, sovereign wealth, and other smaller investor types
Source: Bain & Company

3. Defense Investment Trends

Private investment augments public spending by creating value for warfighters and, in a healthy capital market, drives the capital efficiency of each budgeted dollar spent.

Importantly, private capital is not scarce in aggregate for the defense ecosystem as it exists today. Investment in aerospace and defense stocks has grown.¹⁷ However, private capital is distributed unevenly, and there are often “unseen” gaps.¹⁸ In some instances, business cases that might close under different circumstances are never pursued because the risk is too great or the expected returns insufficient.

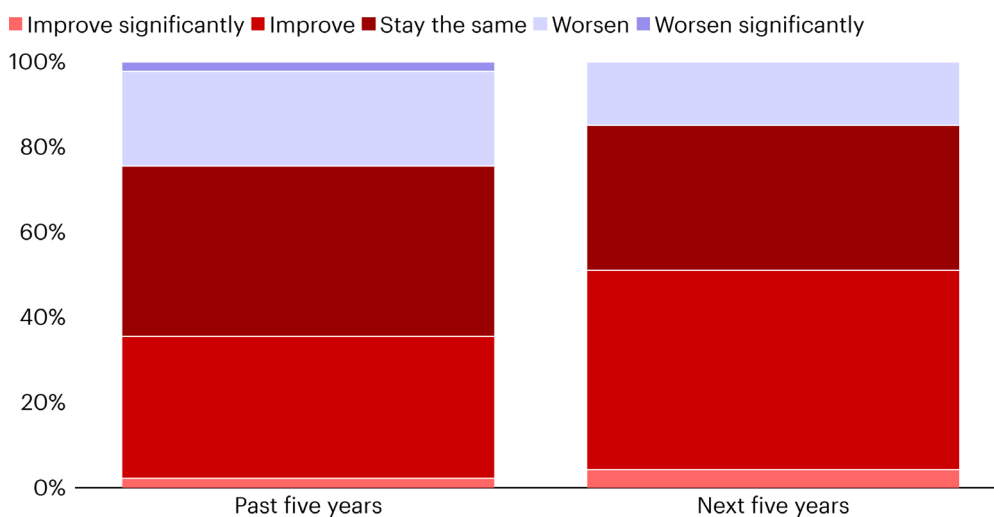
There is significant stakeholder optimism

All stakeholder groups interviewed as part of this research are broadly positive about the defense market outlook (see Figure 6). Reasons they gave for optimism include strengthened demand signals, the need

The State of Investment in Defense

Figure 6: Stakeholders are growing more optimistic about the defense industry outlook

Respondents' view of defense industry attractiveness for investment



Sources: Industry participant interviews; AIA Defense Industrial Base Investment Trends Survey 2026 (n=47)

to refill stockpiles, and the potential for acquisition reform. These underlying conditions have spurred growth in capital inflows across investment categories.¹⁹

Public markets are repricing defense

The overwhelming majority of private investment in defense comes from the public markets, which contribute a significantly larger share than defense venture capital (VC) and private equity (PE) combined (see Figure 7).²⁰ Public-equity markets enable pension and retirement funds, insurance companies, retail investors, and others to buy common stock in defense companies.

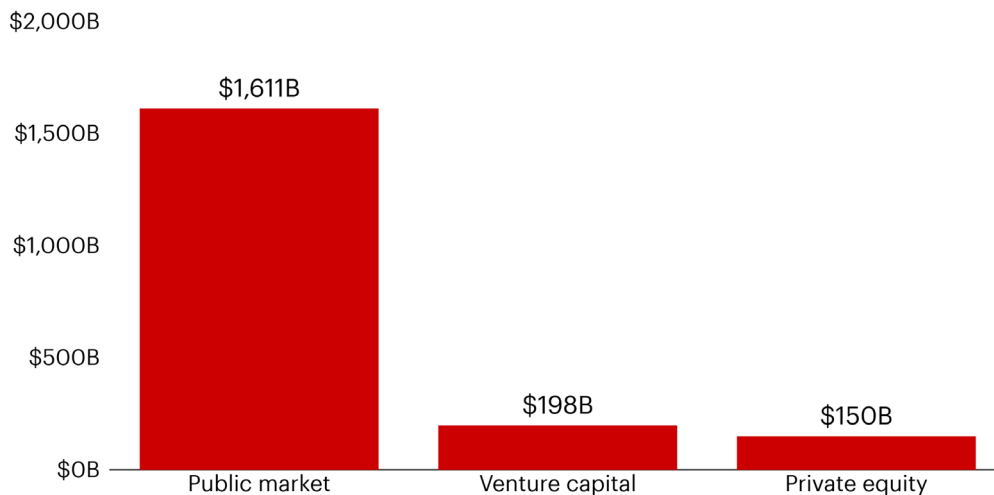
Large defense-focused public equities have traditionally attracted investors who want stable and predictable cash flows as well as up-front capital investments that are directly linked to government funding. This profile offers stability for companies and investors but can make it hard for companies to take on more risk. As evidence, large defense company EV/EBITDA multiples, an indication of growth expectations, are similar to those of utilities—in other words, lower risk with stable rewards (see Figure 8).

In recent years, stock market investors have assigned greater value to defense companies and their potential future growth. The market capitalization of publicly traded US aerospace and defense companies (which includes some companies partly or majority focused on commercial markets) reached

The State of Investment in Defense

Figure 7: The majority of aerospace and defense company value is owned in the stock market

Approximate market valuation by investment category, 2025

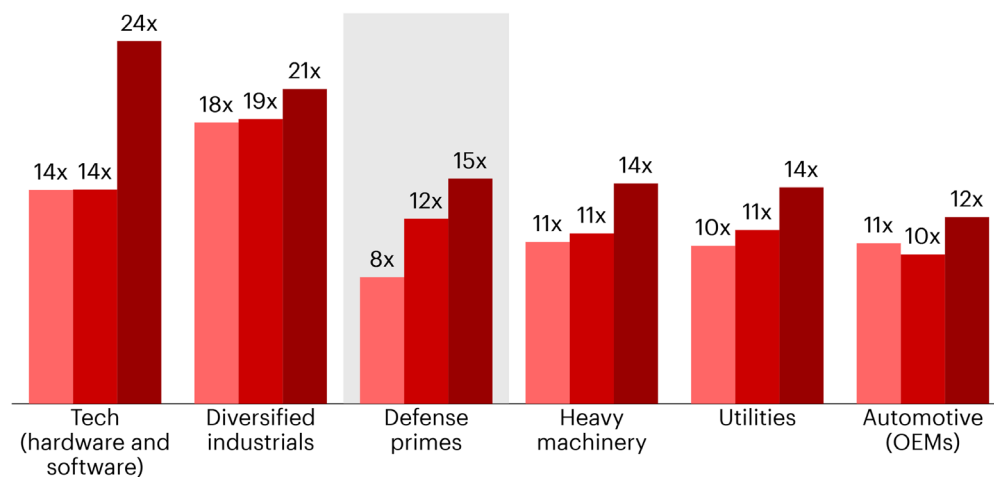


Note: Values are approximated based on Bain analysis of public filings of aerospace and defense (including commercial) companies via S&P Capital IQ, reported PE aerospace and defense (including commercial), and VC majority-defense transactions via Pitchbook and SPS deal data
Sources: S&P Capital IQ; Pitchbook; SPS Deal Database

Figure 8: Defense multiples are below tech and diversified industrials

Average EV/EBITDA multiple by industry segment and period

■ 2000–12 ■ 2012–19 ■ 2019–25



Note: OEMs are original equipment manufacturers
Sources: S&P Capital IQ; Bain analysis

The State of Investment in Defense

about \$1.6tn in 2025, nearly double its 2019 level.²¹ Higher stock prices reflect investor belief in accelerating future earnings growth and enable companies to raise capital for viable investment opportunities more easily.

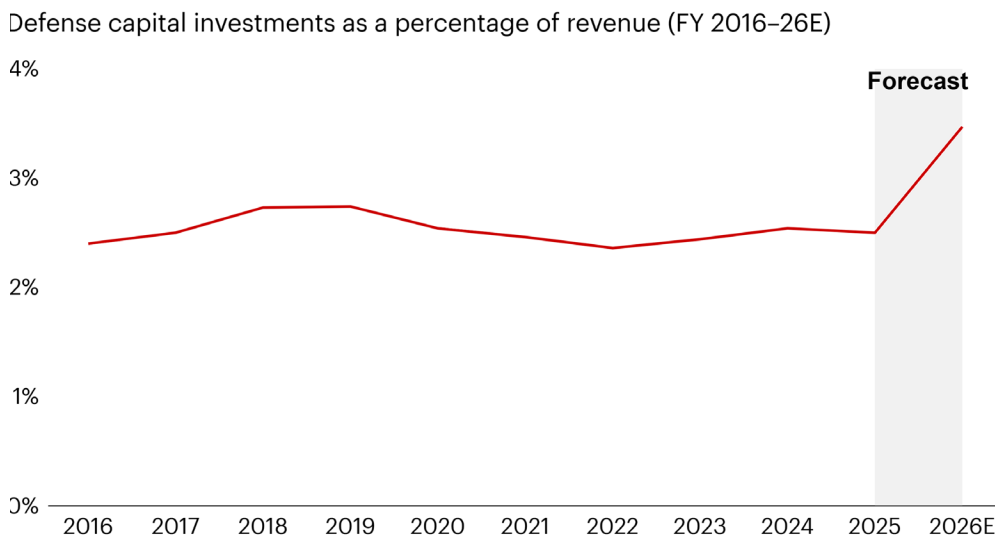
Public-equity market entry has also increased. The number of listed US aerospace and defense companies increased from 71 in 2010 to 102 in 2025.²² And the pace of entry has accelerated in recent years: 19 aerospace and defense companies entered public markets between 2021 and 2025, compared with four between 2016 and 2020 and six between 2011 and 2015.²³ Public offerings like these offer a critical exit path for VC and PE investors. Without a healthy market for public offerings, such investors will be more hesitant to invest.

Retail investor participation has grown as well: Assets in defense-focused global exchange-traded funds (ETFs) increased from about \$300m in 2010 to roughly \$34bn in 2025.²⁴

Public defense company investment ratios have been flat but are rising

Finally, another sign of confidence is that large public defense companies are investing more in their own businesses. Investments in capacity have grown both as a percentage of revenue and in absolute terms—a sign that business cases have become more viable (see *Figure 9*).²⁵ Investment in R&D, meanwhile, has remained largely steady (see *Figure 10*).

Figure 9: Defense capital investments have been flat since 2017 but are expected to increase this year



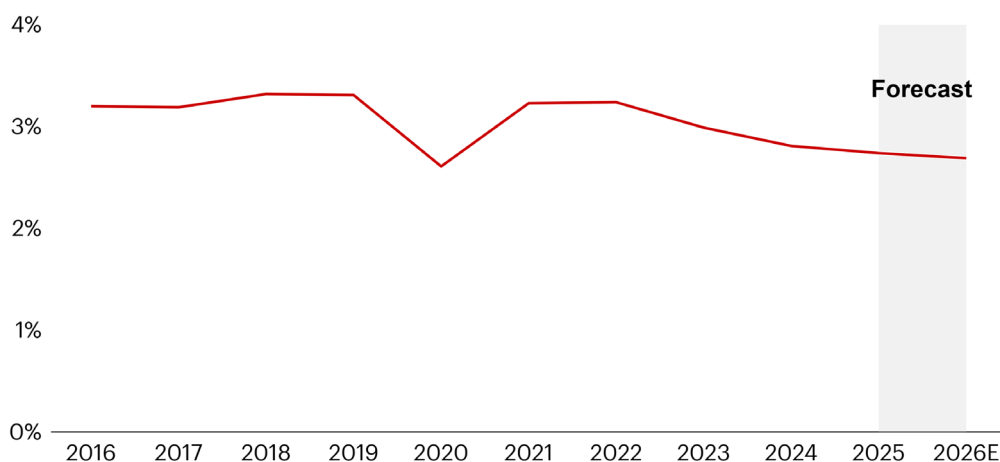
Notes: Reflects public filings from defense Tier 1/2/3 suppliers, weighted by revenue; 2016–17 only reflects Tier 1 data because Tier 2/3 capex as a percentage of revenue was not reported for those years; 2026 estimate is from JP Morgan

Sources: Company filings via S&P Capital IQ; JP Morgan

The State of Investment in Defense

Figure 10: Defense R&D investments have been around 3% of revenue

Defense research and development investments as a percentage of revenue
(FY 2016–26E)



Notes: Excludes customer-funded R&D; values are revenue-weighted averages
Sources: Bain analysis of public filings via S&P Capital IQ; JP Morgan

Venture capital has grown significantly

US venture capital investment in defense is low relative to the technology sector and overall venture investment. Total US venture capital (VC) investment was \$339bn in 2025, with AI making up roughly 65%.²⁶ But, in the same year, only 5–6% of global venture capital funds went to defense companies.²⁷ Government R&D funding augments private venture financing, but total levels are small relative to commercial technology early-stage investments.

However, defense-related venture capital investment dollars have grown from roughly \$1bn in 2019 to around \$10bn in 2025 (see *Figure 11*).²⁸

In our interviews, VC investors highlighted software and AI adoption, the need for disruption, acquisition reform momentum, and the successful examples of SpaceX and Palantir as key reasons for growing investment. Investments to date, which have been concentrated in space, software, AI, autonomy, uncrewed systems, and other similar technologies, back this up.²⁹ Defense-focused venture funds have also emerged, a sign of excitement about the sector.³⁰

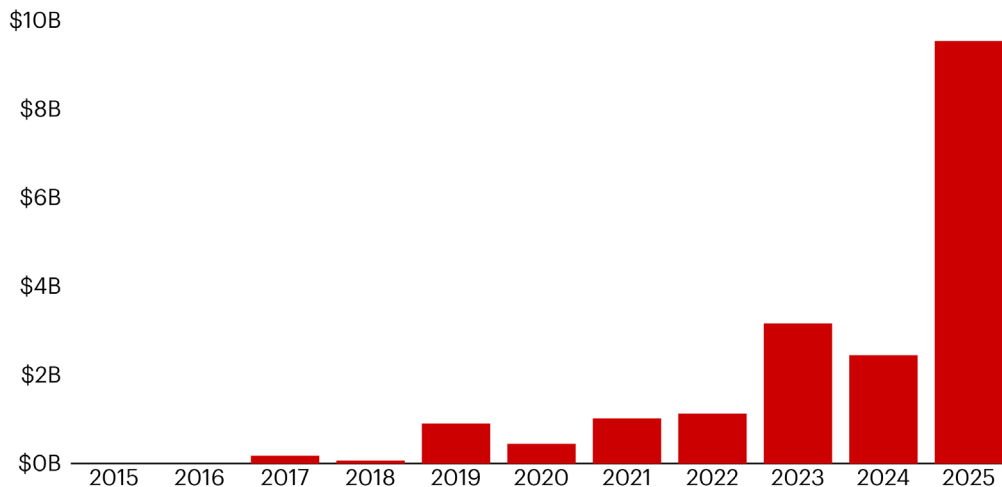
Private equity remains very small

Private-equity participation in majority defense-exposed businesses is still small, despite some evidence of increased interest in and comfort with the sector (see *Figure 12*).³¹ Defense-focused buyout volume has generally remained at around \$1bn to \$3bn annually, which is small relative to the level of investment in

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Figure 11: Defense venture capital has grown substantially

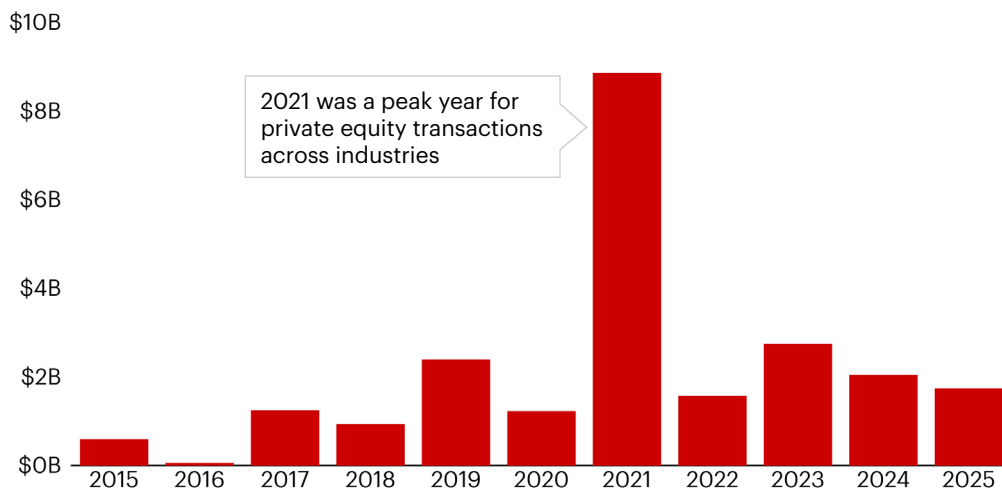
Venture capital investments in defense-focused companies, excluding space and dual-use (North America, 2015–25)



Notes: Reflects reported deal values for majority-defense companies; excludes space-focused and majority-commercial companies; excludes pre-VC (e.g., seed, angel) funding
Source: Pitchbook

Figure 12: PE majority-defense investments have been \$2 billion to \$3 billion annually since a one-time spike in 2021

PE capital investments in defense-related companies, excluding space and dual-use (North America, 2015–25)



Notes: Reflects majority-defense investments; excludes majority-space or majority-commercial investments
Sources: SPS; Pitchbook; Bain & Company deal database

The State of Investment in Defense

defense-industry public equities.³² Most private-equity exposure to defense demand is via investments in majority commercial-market exposed companies that sell into commercial aerospace or broader industrials markets.

Private equity focuses on established businesses with predictable cash flows, operational improvement potential, and clear exit paths.³³ The most attractive investments therefore have predictable future volumes that can be forecast with confidence using rich and reliable data.³⁴ Historically, defense opportunities have often not met these criteria. But many private-equity leaders interviewed suggest that is changing because of market growth and acquisition reforms.³⁵

“It’s harder to get through investment committee [which approves investments] ... is it even investable [given our investing goals]? Profitability is capped.”

—PRIVATE-EQUITY INVESTOR

Debt financing availability

Additionally, debt financing remains a supporting source of private capital, predominantly to companies with stable contracted revenue, long program timelines, and large backlogs.³⁶ Large defense companies typically have strong credit ratings and low spreads. The story is different for mid-tier suppliers and new entrants, where debt is more expensive and harder to come by. Mid-tier suppliers typically face borrowing costs that are approximately one percentage point higher than those of large prime contractors.³⁷

The lack of non-dilutive capital for earlier-stage companies is a common gap cited by venture capital investors in interviews. Less established suppliers and new entrants, whose revenue is harder to forecast, remain more dependent on equity and government funding until contracts become sufficiently predictable to support borrowing.

New capital sources are emerging

A common challenge for traditional financing sources is timing. These sources work best once a company already holds a contract. Borrowing to build capacity before an award, when money is often most needed, is still difficult because there is no contracted revenue to lend against.

New private capital platforms are beginning to form that could address these limits. In October 2025, JPMorganChase announced a 10-year, \$1.5tn Security and Resiliency Initiative covering four critical industries including defense.³⁸ Most of that figure is financing the bank expects to arrange rather than money it puts at risk, and it includes up to \$10bn of direct investment.

The State of Investment in Defense

There are also defense-focused funds that are oriented toward new defense technologies and defense suppliers—including the Cerberus Supply Chain³⁹ and Opportunities Fund and The Carlyle Group’s newly announced Defense and Reindustrialization Fund.⁴⁰

Others are more specialized. Erebor Bank, chartered in early 2026, has been built to serve sectors including defense and advanced manufacturing start-ups,⁴¹ and firms such as Leonid Capital Partners also lend against signed government contracts.⁴²

4. Critical Investment Bottlenecks in the Industrial Base

The main challenge for the DIB is uneven capital flows that leave some strategic areas underserved. Capital moves more readily to places that offer large addressable markets, technologies undergoing rapid adoption, short development cycles, and stable businesses with secure cash flows—each of which appeals to specific investor needs. Areas without those features face potential bottlenecks and capital constraints. Our interviews and survey responses identified four key areas where more capital is needed to address bottlenecks, as follows:

Critical inputs and raw materials

The US is fully reliant on imports for 16 critical minerals,⁴³ and foreign export controls on gallium, germanium, antimony, and rare earth-related materials have highlighted this vulnerability.⁴⁴

Critical inputs and raw materials, including critical minerals, create hard constraints because they sit upstream of almost every advanced defense system.⁴⁵ Aircraft, ships, weapons systems, satellites, and other defense systems require myriad inputs including precision components, microelectronics, and chemicals, among many others. These can only be bought from a qualified supplier and are certified for specific platform variants.⁴⁶ Any missing input, no matter how small, risks holding back the entire production process. Approval timelines for domestic critical minerals projects, meanwhile, can take at least 10 years.⁴⁷

Refining for critical minerals used in radar, satellites, magnets, missiles, armor-piercing rounds, and thermal imaging is also an acute exposure because most is not carried out domestically.⁴⁸ Mining and processing are also capital-intensive and subject to global commodity price fluctuations, while some important machinery is produced abroad. These dynamics give investors pause. Recent policies have increased focus on critical input challenges,⁴⁹ but projects remain long-cycle and high risk.

“Investors ask questions around what domestic share will be, what premium will be put on US goods. In light of those variables, with just equity, there isn’t enough juice in their model to get the required return.”

—INDUSTRY LEADER

The State of Investment in Defense

Sub-tier manufacturing

Stakeholders interviewed flagged major constraints in manufacturing of castings and forgings, advanced semiconductors, energetics, solid rocket motors, sub-tier precision components, and sensors (see Figure 13). In some of these areas, defense needs compete with commercial ones. Suppliers who produce both commercial aerospace and defense components can choose where to use their capacity.

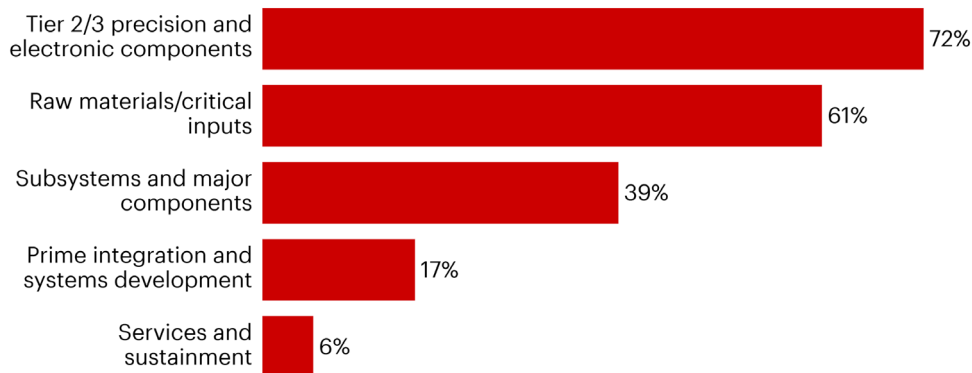
Supply-chain *visibility* adds to the challenge. Over 6,000 global vendors—many small businesses with uneven access to capital—and 150,000 parts make up the F-35 program, for example.⁵⁰

Rapid increases in production, as envisioned by recently announced munitions framework agreements,⁵¹ require new facilities and equipment, more engineers, and more skilled labor. In some component categories, the industrial base has too few qualified suppliers to provide surge capacity and, in some cases, relies on a single supplier with a limited number of facilities.⁵² Any supplier that can't make these investments, or that can but fails to convert the investment into high-quality, on-time production capacity, risks the entire program.

Smaller suppliers can find rapid increases in demand particularly challenging. Their access to capital is lower given their size, especially without a firm order or signed contract. They often also lack the infrastructure to rapidly hire and train employees, especially when located in less densely populated geographies.

Figure 13: Stakeholders are most concerned with investment in the middle of the supply chain

At which level of the defense value chain is non-government investment most scarce or expensive relative to strategic need? (Select up to 2)

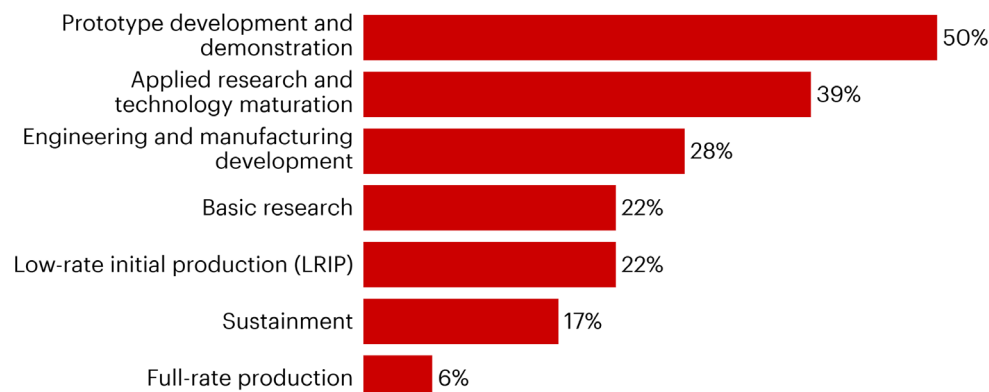
Percentage of respondents

Source: AIA Defense Industrial Base Investment Trends Survey 2026

The State of Investment in Defense

Figure 14: Prototype-to-production is a key stage where investment is scarce

At which defense development stages is non-government investment most scarce or expensive relative to strategic need? (Select up to 2)

Percentage of respondents

Source: AIA Defense Industrial Base Investment Trends Survey 2026

Technology transition and production scaling

Venture capital investors and new entrants point overwhelmingly to transition funding as a constraint.

In the research and prototyping stage of a program or technology, companies attract private venture investment because their high risk profile, with the potential for a large exit multiple, matches VC investment models. In the mature production phase, programs attract institutional capital for the same reason—this time because of the lower risk profile.

There is no “fit-for-purpose” investment model for the space in between—when a promising technology has not yet been demonstrated and produced (*see Figure 14*).

“There are all these great mechanisms to fund early venture tech ideas, but there isn’t [yet] a good mechanism to help with the transition from prototype to scaled product.”

—VENTURE INVESTOR

The State of Investment in Defense

Promising technologies can stall not because they failed technically, but because the risk of failed transition is deemed too great for investors and customers. This challenge can be seen at a macro level in funding gaps for early-stage companies. The Silicon Valley Defense Group's NatSec100 report tracks funding and federal obligations for the top 100 venture-backed, dual-use, and defense technology companies. There is a growing gap between private capital raised by these companies (\$118bn from 2020 to 2025, excluding OpenAI) and funding commitments for the same companies (\$16bn total lifetime federal obligations as of FY25). This trend further underscores the challenges associated with transitioning early innovation momentum into mature solutions.⁵³

“We hear it all the time. New companies want production orders when all they have is a prototype. They need to take risk and be ready to produce.”

—CUSTOMER

Defense prime R&D and capex investment

Additional investment by established companies is one of the most important levers for improving capacity and innovation. These companies have hard-to-replicate national assets: top engineers, process and design intellectual property (IP) built over decades, customer relationships, and scaled manufacturing facilities and supply chains.

Publicly traded large defense companies invest in research and production capacity at ratios to revenue and earnings that have been largely stable. Across the large contractor set, independent R&D (IR&D) and capital expenditure (capex) generally remain within the same 2%–3% of revenue and 30%–40% of EBITDA (earnings before interest, taxes, depreciation, and amortization).⁵⁴ Tier 2 and Tier 3 suppliers invest slightly more in research and capital expenses as a share of revenue (*see Figure 15*).⁵⁵

By comparison, large-cap technology companies generally invest in the range of 10%–20% of revenue in R&D.⁵⁶ Software companies invest in the 15%–20% of revenue range.⁵⁷ Manufacturer John Deere, a closer analog to defense hardware companies, consistently invests 4%–5% of revenue in R&D, none of it reimbursable directly by customers.⁵⁸

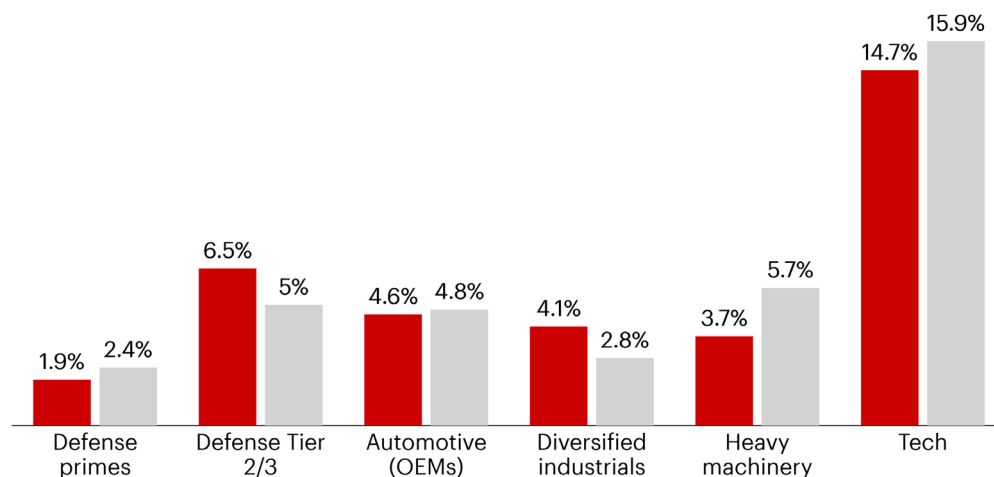
For production capacity, the clearest evidence of investment constraint is the lack of surge capacity to support higher demand. Manufacturing capacity has contracted in some critical areas. For shipbuilding, US Maritime Administration reports show that new build and major maintenance facilities decreased by around 25% (from 25 to 19 and from 30 to 22, respectively) between 2001 and 2025.⁵⁹

The State of Investment in Defense

Figure 15: Defense lags other industries in R&D and capex investment

R&D and capex spending as a percentage of revenue by industry (FY 2025)

■ R&D ■ Capex



Notes: Total fiscal year internal research and development (IR&D) spending, inclusive of all divisions and sectors; IR&D expense includes internally funded research and excludes externally (e.g., DOD) funded research
 Sources: S&P Capital IQ; JP Morgan

5. Root Causes Constraining Investment

There is no single root cause for these bottlenecks. The following underlying issues were identified in our interviews and survey as the most important for stakeholders to address:

Lower program volumes limit scale benefits

In most commercial markets, demand is a function of needs across a large and broad group of distinct customers. The US defense market size, by contrast, is set by appropriations—the budget allocations US government departments get each year—and reflects trade-offs across programs within a budget envelope.

Defense systems are also typically customized and highly capable—and therefore often expensive. As a result, volumes are relatively low compared to commercial aircraft programs. The commercial aerospace industry has produced more than 23,000 narrowbody planes across just two families of aircraft,⁶⁰ but even the largest fixed-wing defense aircraft programs deliver only a fraction of this number of units over their lifetimes.⁶¹ The most expensive defense aircraft systems deliver far lower volumes.⁶² This math may change for lower-cost systems like small, unmanned aircraft, but is unlikely to do so for high-end systems that are the backbone of US defense capabilities.

Lower volumes, the risk of program size reductions, and related lower capital efficiency all make investment cases tougher. Up-front spending on facilities, qualification, and supplier development must

The State of Investment in Defense

be amortized over fewer units and often within a contract lifespan. Companies also have fewer opportunities to drive productivity benefits, raising the return required to justify investment.

Defense demand signals are hard to price

Investors and companies look for hard evidence of demand to invest against. Higher-quality evidence results in stronger business cases and reduced uncertainty. When evidence of demand is either lacking or points to high levels of volatility, uncertainty grows.

Appropriations are a key demand signal. Most defense funding is allocated in annual increments, while many investment decisions require confidence over a long period of time, which makes business cases challenging to construct.

The defense budget was roughly \$870bn in the fiscal year 2025, up more than \$300bn from a decade earlier in nominal terms.⁶³ However, adjusted for inflation, funding was roughly in line with levels seen around 2008.⁶⁴ Spending is likely to increase in FY27 in the US, and there is significant growth anticipated in Europe.⁶⁵ Those outlooks contribute to investor optimism, though higher interest rates and inflation could be countervailing headwinds.

Investor confidence in defense stocks, as measured by earnings multiples, has historically tracked nominal budget growth. That relationship is complicated by continuing resolutions, which freeze new starts, limit production increases, and delay contract actions—and which have occurred in 37 of the past 49 fiscal years.⁶⁶

“Uncertainty kills capital.”

—PRIVATE-EQUITY INVESTOR

Suppliers and investors interviewed pointed repeatedly to the demand signal as a key issue in investment decision-making (see *Figure 16*).

Simultaneously, government stakeholders interviewed say that the demand signal is more than strong enough ahead of awards, and suppliers need to be bolder to reap downstream rewards. Narrowing this gap in viewpoints will be important to unlocking more private investment.

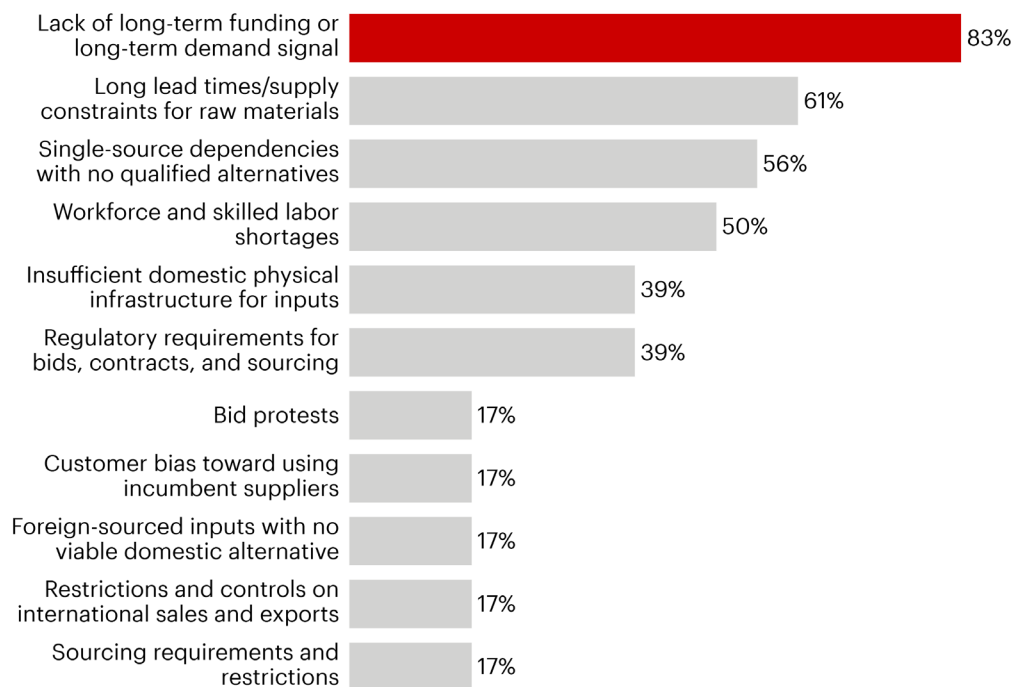
Margins are explicitly or implicitly capped

Contract structures define how risk and reward are shared between customers and suppliers. Key terms in defense driving the risk/reward equation include price, the mechanisms that determine this, and disclosure requirements.

The State of Investment in Defense

Figure 16: The demand signal is the largest constraint to investment

What are the most critical constraints preventing capacity expansion for the US Defense Industrial Base? (Select up to 5)

Percentage of respondents

Sources: Industry participant interviews; AIA Defense Industrial Base Investment Trends Survey 2026

Profit margins for defense companies are among the lowest of US large capital goods industries.⁶⁷ These margins form part of the returns that investors expect for taking risk.

Contract types

In a **cost-plus contract**, the profit margin a supplier earns is fixed based on the disclosed cost of providing services plus a fee.

In a **fixed-price contract**, the profit margin is not fixed explicitly—but is often capped **implicitly** in negotiations and by regulation.⁶⁸ Significant cost transparency is used to negotiate a price and margin.

The State of Investment in Defense

However, the effect of capping profit margins is that it can lower expected returns and restrict the amount of private investment a company can undertake. When expected returns are lower, risky investments never happen. If a company can earn at most 8%-12% returns on capital, then any project that requires higher returns on capital to offset higher risk *does not take place*. In other words, returns must exceed a company's cost of capital. A rational company cannot undertake projects that don't deliver a high enough expected return to offset estimated risk—if it did, it would eventually be valued less by investors and further lose its capacity to make needed investments.

“What other product or service is contracted on margin while ignoring capital and risk?”

—INDUSTRY ANALYST

Ultimately, this misalignment restricts the total amount of investment and associated benefits in the defense market. The Pentagon recently announced its intent to initiate rulemaking so that “negotiated margins reflect value delivered, risk carried, and private capital invested.”⁶⁹ That rulemaking and its implementation could help address the challenge of risk/reward misalignment.

Weakened incentives

When projects are high risk or long duration, and therefore more difficult to fund privately, the government often helps with financing. This approach can drive good outcomes for income-focused investors in defense companies, who value the strong cash profile of such a model. At the same time, it weakens the incentive to put private capital against such investments—key income-oriented investors may prefer higher cash flows and lower risk.

Another key incentive challenge is that many costs are reimbursable by the government via contracting mechanisms. These mechanisms reduce risk for defense companies but also reduce the rewards for higher-risk investments in efficiency and productivity.⁷⁰

Timelines are misaligned

Private capital investors typically need to generate cash returns in a specific window so they can return capital to investors—for private equity, this is often within five to seven years.⁷¹ Venture investors require a strong revenue trajectory and path to exit within the fund's lifecycle—often six to eight years from initial investment—a timeline that creates structural tension with defense hardware development cycles.⁷² This mismatch pushes venture capital toward software, autonomy, attritable systems, and other shorter-cycle opportunities.⁷³

The State of Investment in Defense

“Acquisition cycles can’t match the speed of the capital deployment cycle and defense technology development cycle.”

—FOUNDER

Many new entrants are seeking to break dependence on customer fundings with large-scale, up-front investment in new technology and business models.⁷⁴ A key open question is whether new company revenue trajectories will meet venture investor needs.

“There is surplus of investment capital in early-stage companies and a shortage in [DOD] customer revenue [needed to provide returns on that capital].”

—VENTURE CAPITAL INVESTOR

For public-equity investors, the problem is that requirements are set far in advance, contract timelines are often short, and appropriations are made annually. Large-scale investments have a long payback period and a commensurate need for confidence in future-year contracts and appropriations that are inherently uncertain. The bar for large-scale investment in hard capacity is higher as a result.

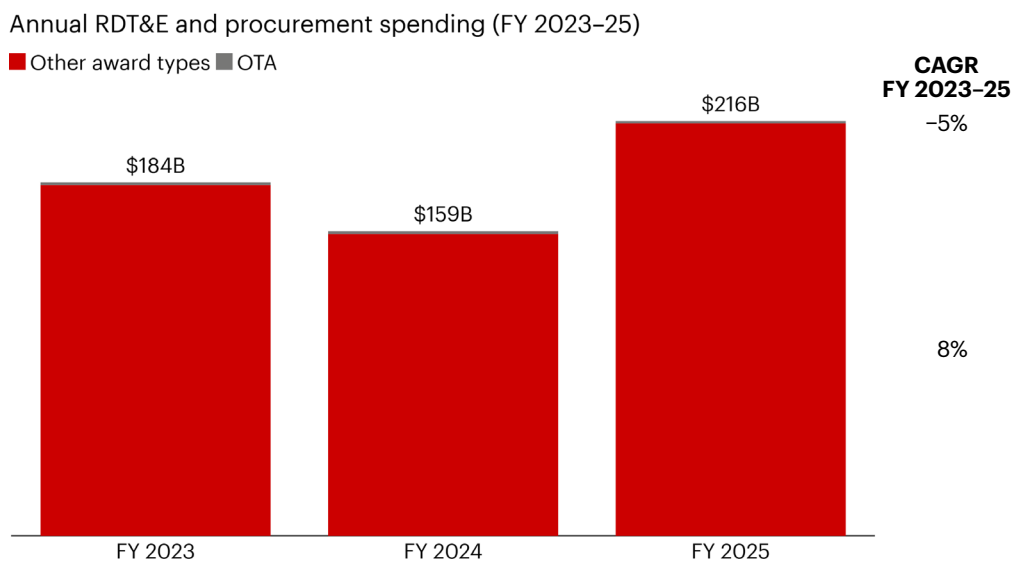
“You can’t set requirements and then buy 15 years later—you won’t have cutting-edge technology.”

—PRIVATE EQUITY INVESTOR

Too much friction and complexity in capability procurement

Process friction remains a persistent challenge, adding cost and time. Significant resources are devoted to contracting, accounting, compliance, legal review, audits, reporting, and oversight. Much of this activity is

The State of Investment in Defense

Figure 17: OTAs are a small fraction of spending

Notes: Excludes services spending; OTA is Other Transaction Authority; RDT&E is research, development, test, and evaluation
 Sources: USAspending.gov; DACIS

essential for ensuring accountability and fairness. However, the cumulative burden of these requirements also slows programs, raises overhead, discourages new entrants, chases away talent, reduces competition, and makes capital deployment harder to justify.⁷⁵

Stakeholders interviewed consistently stated that the cost of friction can sometimes exceed the benefits. OTAs are cited as a lower-friction procurement pathway—but there are divergent views on the benefits of their use, and they make up a very small proportion of overall procurement spending (see Figure 17).⁷⁶

The complexity is further exacerbated by differing definitions of the term “commercial.” Friction and uncertainty increase when clarity about the eligibility of a product or company for a given designation is lacking.

Potential lack of exit infrastructure for early-stage companies

Early-stage investors need a way to return capital to their investors on the timelines promised when they were raising funds. That usually requires a liquidity event such as an acquisition, growth equity recapitalization, secondary sale, or initial public offering (IPO). Despite the rapid growth in venture investing in defense, that exit infrastructure is uncertain.

The State of Investment in Defense

“There’s nobody waiting to buy. Combination of reasons they aren’t going public. And primes won’t pay for 100x revenue.”

—VENTURE CAPITAL INVESTOR

Furthermore, the traditional private-equity model is not well-suited to maturing defense technology companies with concentrated exposure and choppy volumes—the cash-flow profile and downside risk are at odds with higher leverage. And overall private-equity exposure to majority defense businesses, as noted above, is low.

“PE investment in defense-only businesses is a big problem—they are a critical part of the exit infrastructure for earlier-stage investors.”

—VENTURE CAPITAL INVESTOR

Without viable exit pathways, the attractiveness of defense for further venture investing will decline.

Lack of shared visibility and understanding

Program managers, companies, suppliers, and investors evaluate the same opportunities through different information sets. This challenge is particularly acute in the supply chain, where fragmentation makes production constraints hard to see. Investors were direct in our interviews: Lack of data makes investment decisions harder—and results in capital staying on the sidelines or going to more data-rich markets.

6. Ways to Encourage Investment

Our research with stakeholders points to six priorities to address funding gaps, make defense investment more sustainable, drive faster, higher quality, and lower cost capability for warfighters.

1. Back clear priorities with funding

In our interviews, new entrants pointed repeatedly to the need for “proof points” that risk will be rewarded with production contracts. Government stakeholders, meanwhile, persistently pointed to the need for early-stage companies to prove they can produce effectively. Similarly, established defense companies

The State of Investment in Defense

need confidence that long-term agreements will be funded. Government stakeholders say that the demand signal is overwhelmingly strong already.

Stakeholders we interviewed suggested a variety of measures to help address these tensions, including:

- long-term contracts for enduring needs that increase affordable capability for customers and drive supplier investment and productivity;
- awards for worthy new entrants that send signals to investors and founders that risk-taking will be rewarded when a company can demonstrate operational effectiveness *and* production capability; and
- meaningful new industry capacity and R&D commitments that demonstrate a desire to do business differently.

Importantly, many stakeholders interviewed stressed that funded commitments should not reward poor performance. When failure to perform results in an identifiable market consequence (e.g., lower profitability, a lost contract, a reduction to future win rates), it sends a signal to all suppliers that they will best reward investors by improving performance. These kinds of consequences are a feature, not a bug, of properly functioning incentives.

2. Directly link risk and reward

When companies invest ahead of demand, retain technical risk, or build proprietary technology, their investors expect a return commensurate with that risk. Defense margins are, on average, lower than in comparable industries⁷⁷ and lower margins often mean lower returns, which means less investment ahead of demand.

In analogous commercial markets, IP ownership and aftermarket parts and services are used to offset at-risk investment in new technology and equipment. In lieu of such a model, other means of rewarding successful up-front investment would be needed to see it increase.

Software needs a different model and rhythm. Capabilities in AI, autonomy, cyber, and command-and-control improve through updates, user feedback, data, and iteration. Improvement at commercial speed requires modularity, recurring upgrades, and continuous progress.

To develop aligned incentive structures, stakeholders we interviewed suggested:

- fit-for-purpose acquisition and contracting that, where appropriate, better aligns risk and reward; and
- internal company incentives that better reward risk-taking, speed, execution, and efficiency and provide differentiated rewards for teams that deliver on customer needs.

The State of Investment in Defense

3. Reduce buying and selling friction

Multiple stakeholders interviewed pointed to the substantial administrative burden in procurement and contracting. They also said that existing authorities permit substantial reductions in friction and that flexible procurement pathways can lower costs and increase speed.

Stakeholders pointed to the clear need for more agile and results-oriented companies. They stated that defense companies are often complex, use dated technology, are slow to shift priorities, and are reactive rather than proactively investing against underlying customer needs. The culture and operating model of many defense suppliers will need to transform to better serve the warfighter.

Stakeholders offered multiple suggestions for reducing buying and selling friction, including:

- increased use of flexible procurement pathways and clearly defined commercial buying processes and terms;
- clearer workforce playbooks, stronger leadership support, and better incentives for fit-for-purpose contracting; and
- faster company operating models with reduced internal complexity, simplified decision making, and increased company employee incentives for speed.

4. Grow market volumes

The larger the market, the more investment cases will close. The benefit for companies and taxpayers is twofold: Greater volume over which to amortize up-front costs and greater scale benefits that can reduce unit costs over time.

Stakeholders we interviewed listed the following as potential ways to grow market volume:

- increased international sales via highly competitive products and expanded pathways to market;
- production mix shift to lower-cost systems, modularity, common inputs, dual-use, and increased total unit counts; and
- strong company infrastructures to sell to, serve, and sustain allied customers effectively.

5. Develop flexible sources of capital

Existing investment models could be better adapted to the unique profile of the defense companies of the future. Exit infrastructure for promising new companies will ensure future entrepreneurs are attracted to the defense market.

The State of Investment in Defense

Stakeholders identified the following as among the ways to adapt existing investment models:

- defense company partnerships with more flexible private capital to increase the breadth of viable technology and capacity investments;
- expanded flows to defense-oriented growth equity and infrastructure funds that are better suited to constrained parts of defense company lifecycles;
- private credit platforms with novel structures that support the flexibility and speed needed for growing defense companies;⁷⁸ and
- increased defense specialization on private capital investing and operational teams.

6. Improve performance

Suppliers must devote more time, energy, and resources to improving schedule, quality, and cost performance. When delivery, quality, or affordability fall short, the government naturally responds with measures that protect it from risk. That negative cycle adds friction, delays, and cost.

If there is a significant reward for improved cost, schedule, and quality, as well as credible downsides from failing to do those things, companies will spend time, energy, and capital getting it right. A market that rewards performance and creates consequences for underperformance would reinforce the incentives needed for sustained improvement.

Stakeholders offered the following suggestions for improving performance:

- incumbent supplier capacity investments deeper in the supply chain; multiyear forecasts, supplier qualification support, and targeted capital and technical assistance for constrained suppliers;
- new entrant operational testing, production readiness, and cost discipline that help turn technology promise into procurement confidence; and
- training programs, school partnerships, trade partnerships, apprenticeships, and more diversified manufacturing footprints.

The State of Investment in Defense

Conclusion

No single intervention will close these gaps. The demand signal can strengthen, but industry must invest against it. Industry can increase reinvestment, but returns must justify the risk. Investors can create longer-horizon capital, but they need companies with credible paths to production. The greatest impact comes when stakeholders move together.

The defense investment gap will not close through enthusiasm alone. It will close when business-case conditions make private investment rational. That is a solvable problem—and when alignment is strong, the defense industrial base can deliver extraordinary outcomes.

Methodology note

Aerospace and Defense is a large and diversified industry, spanning commercial aviation, space exploration, and all aspects of the defense industry. Unless otherwise noted, this document focuses on the US defense industry specifically and excludes where possible commercial aerospace, space, and non-defense federal government services-exposed companies. For public equities market analysis, we focus on majority-defense businesses and exclude where possible commercial aerospace or industrial business segments. For private market analysis, we identify investments in majority-defense companies and exclude companies whose primary business focus is non-defense markets.

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The State of Investment in Defense

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