

EXECUTIVE SUMMARY: Target Industry and Strategic Recommendations

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Introduction

This report, *Strategic Recommendations*, provides the State of North Carolina with a set of priority actions for developing its defense industry. As the final report of the study, it is the culmination of significant research, public input, and strategic meetings. The strategic recommendations aim to bridge the gap between North Carolina's strong military assets and its moderate, but growing, private sector defense industry.

This report is part of a broader study, the *North Carolina Military Business & Resource Gap Analysis*.

In January 2005, the North Carolina Military Business Center selected the consulting team of AngelouEconomics and Jane's Information Group to conduct this study. The goal of this study directly supports the mission of the North Carolina Military Business Center:

To leverage military business opportunities to promote economic development and quality of life in North Carolina.

The goal of a stronger state defense initiative is clear: ***to bring more jobs and revenue to North Carolina.***

This study was performed for the North Carolina Military Business Center, a component of the North Carolina Community College System, headquartered at Fayetteville Technical Community College. Many organizations and groups were interviewed throughout AngelouEconomics' assessment and preparation of this report:

- North Carolina Department of Commerce
- North Carolina Community College System
- Fayetteville Technical Community College
- Research Triangle Park Foundation
- Research Triangle Institute
- Economic Development Regional Partnerships
- Chambers of Commerce
- North Carolina League of Municipalities
- Small Business and Technology Development Center
- North Carolina University System
- Military Officials from North Carolina bases
- North Carolina Economic Developers Association
- North Carolina Association of County Commissioners

We thank each of them for their participation.

The economic impact of successfully implementing this Plan is clear: more jobs, more income, and more tax revenue. Success will be measured by the expansion of Department of Defense procurement from companies located in North Carolina. If the state can grow its share of U.S. defense procurement from its current 1% of U.S. total to 1.5% (a reasonable “fair share” goal) by 2010, **North Carolina would earn \$1.7 billion in defense contracts each year**. AngelouEconomics estimates that these new contracts would support the **permanent** creation of 30,000 jobs and \$150 million in new annual state and local tax revenue.

Clearly, the stakes are high in today’s defense sector, and our success will be dependent on the state and local partnerships we create. We look forward to your comments on these recommendations and your future participation in this joint effort.



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Review of the Process

Specifically, the study was designed to result in the:

- Identification of specific sectors of the defense industry that are expected to experience the highest demand and business growth in the next 5-10 years
- Assessment of North Carolina's capacity to support new military-related businesses and future product demand
- Identification of specific industries and companies that should be targeted for North Carolina relocation and/or expansion
- Creation of an action plan containing community development and marketing strategies aimed at growing North Carolina's defense industry

Study Process

TASK ONE:
Project Set Up

TASK TWO:
Analyze national and North Carolina defense industry

TASK THREE:
Compare North Carolina resources to recruitment needs

TASK FOUR:
Identify target audiences for marketing

TASK FIVE:
Create a business recruitment strategy

Four reports were prepared for this project:

1. **Defense Industry Demand Analysis**
2. **North Carolina Resource Analysis**
3. **Target Industry Recommendations**
4. **Strategic Recommendations**

A clear distinction was made in this study between the "Military" (base assets) and the "Defense Industry" (private companies). North Carolina is strong in its military assets, but few companies are large suppliers to the U.S. Department of Defense. For the purpose of this study, we define the "Defense Industry" as the *private sector companies or research organizations that sell goods to or perform a service for the U.S. military.*

Review of Assessment

The *Defense Industry Demand Analysis* was led by Jane's Information Group with assistance from AngelouEconomics. The report analyzed national and state trends in military procurement:

- An overview of national security issues driving military spending
- A look at operational shifts within the Department of Defense
- Discussion of short-term and long-term military procurement trends
- Detailed analysis of specific military weapons and communications platforms

The report revealed that not only is military spending rising rapidly but that military contracting, the value of goods and services purchased by the DoD, is accounting for an increasing share of that spending. The Defense

Department currently spends over half of its budget in the private sector, accounting for 1.3% of private sector output. The Defense Department spent \$231 billion with the private sector in 2004.

Nationally, North Carolina supplies only a moderate value of goods and services to the military. Only \$2.2 billion, less than 1% of the total, of DoD spending took place in North Carolina. Of the \$231 billion, only \$1.6 billion went to North Carolina companies. Out-of-state construction firms performing work on North Carolina bases account for much of the gap between the two figures.

Specific to military installations located in the state, the picture does not get much brighter. Of the \$2.4 billion in contracts awarded by military installations in the state in 2004, only \$460 million went to state firms.

The *North Carolina Resource Analysis* examined aspects of North Carolina that are important to defense businesses. Key data were developed for 21 factors on workforce, education, business climate, sites and infrastructure, and economic development efforts. The report presents a benchmark analysis comparing North Carolina to key defense industry competitors, as well as specific datapoints on the seven Economic Development Partnership Regions. The report was developed **through the eyes of a business executive or a site selector** that might be considering the area for a relocation or expansion, and analyzes state and regional strengths and weaknesses from that point of view. The data was analyzed with the broader defense industry in mind.

North Carolina has several strengths it can utilize to develop and attract defense companies:

- An affordable, family-oriented quality of life that will be an attractive feature to target industries and workers, including an affordable cost of living
- A trainable, educated, affordable workforce
- Strong, reliable infrastructure, including excellent air service and utilities
- A low overall cost of doing business
- Strong academic institutions

The report also highlights the weaker areas that North Carolina must address to move forward in its recruitment of defense companies:

- A lack of statewide entrepreneurial resources
- The need for strong external marketing efforts
- A need for improvement in secondary education

The *North Carolina Resource Analysis* demonstrated that North Carolina's assets and strength far outweigh its weaknesses.

Summary of Target Industry Recommendations

Based upon the results of the *Defense Industry Demand Analysis* and *North Carolina Resource Analysis*, AngelouEconomics developed a list of target industries for North Carolina.

While the primary goal of this study is to determine defense targets for recruitment to North Carolina, we identify both recruitment and expansion targets:

1. **Recruitment targets:** Companies or industries that should be the focus of a marketing effort to recruit them to North Carolina
2. **Expansion targets:** Industries currently found in North Carolina that can sell more to the Department of Defense or large defense contractors

The distinction between a recruitment target and an expansion target is often less than precise: some targets will be both, and the expansion of an industry from within North Carolina will naturally increase the state's attractiveness for relocations.

Issues unique to the defense industry are keenly important to understand, from privatization and outsourcing to competition among today's military suppliers, not only for determining a target, but also in determining whether to pursue internal growth or external recruitment. An excellent example is the current competitiveness that exists in military procurement. Many established industries and suppliers are no longer subject to competitive bids due to a number of factors: a dearth of companies able to supply the good or service, industry consolidation, or existing relationships with the Defense Department. Many of these non-competitive contracts are in high growth industries, so North Carolina will need to focus on recruitment of these companies rather than internal expansion.

Specifically, AngelouEconomics employed a combination of quantitative and qualitative analysis in selecting the target industries for North Carolina. In determining the best defense targets for North Carolina, AngelouEconomics answered the following five questions:

1. **Which industries will benefit most from the Defense Department's transformation?**
Immediate and obvious target candidates are those experiencing growth nationally in the near-term. Development of new defense systems are a long-term opportunity and large scale transformation programs, such as the Army's Future Combat Systems, should be closely monitored.
2. **Which industries are most "open" to new suppliers, or most interested in relocation for strategic or cost reasons?**
Many sectors of DoD contracting are no longer competitive, with some areas having less than 25% of contracting opportunities bid out competitively. Many companies in these industries produce a proprietary good or service that the military considers unique to the company. As such, the industry is an unlikely candidate for expansion or development in North Carolina. These industries will be identified as recruitment targets where appropriate.
3. **Do gaps currently exist in North Carolina industries' DoD procurement nationally?**
In several instances, North Carolina fails to supply goods and services to the military in industries that constitute the state's core strengths. These gaps provide near-term opportunities for North Carolina firms to enter the military procurement market and win new market share.

4. Do gaps currently exist in North Carolina industries' DoD procurement to state military installations?

The percentage of North Carolina base contracting performed in North Carolina or by North Carolina companies is declining. Similar to the national procurement, gaps exist in industries strong in North Carolina.

5. Are there local assets that give North Carolina a competitive edge in expanding the defense industry? What local weaknesses or barriers will limit industry growth?

Communities are as unique as people. Each one has strengths that companies can leverage to create competitive advantages. These strengths can include such things as workforce skills, tax structure, infrastructure, research universities, or market proximity. Our challenge is to identify the key assets in a state or region that will support growth in a wide range of defense-related industries, and to identify specific ways to continuously improve the community "product" (e.g. workforce skills or infrastructure).

AngelouEconomics recommends targeting 23 specific industries for development under four broad target industry categories. These targets best utilize state and local assets and promise new opportunities for growth in jobs, wages, and economic advancement.

The recommended target industries for North Carolina are:

- ⇒ **Defense Technologies (Manufacturing, Research, and Services):** North Carolina should target traditional arms and equipment manufacturing, related research and development, as well as military services.
- ⇒ **Defense Consumables (Textiles, Food, Printing, & Distribution):** The defense industry is a microcosm of the national economy in many ways. The DoD requires vast sums of everyday goods and services to keep bases running and soldiers clothed and feed.
- ⇒ **Base Construction:** Hundreds of millions of dollars is earmarked for construction on North Carolina military installations in 2006 alone. In recent years less than 10% of prime contracts for major base construction were awarded to North Carolina firms.
- ⇒ **Base Support Services:** With over 100,000 soldiers and support personnel located in North Carolina bases need a vast sum of support services ranging from engineering and IT work to food and laundry preparation.

Specific sectors within each target category are detailed in the following table:

Defense Target	Niche	Defense Target	Niche	
Defense Technologies (Manufacturing, Research, and Services)	333	Machinery Mfg	311	Food Mfg
	334	Computer and Electronic Mfg	312	Beverage Product Mfg
	335	Electrical Equipment Mfg	313	Textile Mills
	336	Transportation Equipment Mfg	314	Textile Product Mills
	541	Technical Svcs	315	Apparel Mfg
	927	Space Research	316	Leather and Allied Product Mfg
	541	Professional and Technical Svcs	323	Printing
	551	Management Svcs	493	Warehousing and Storage
Base Construction	233	General Contracting	561	Administrative and Support Svcs
	234	Heavy Construction	722	Food Svcs
	235	Special Trade Contractors	811	Repair and Maintenance
Defense Consumables Textiles, Food, Printing, & Distribution			812	Personal and Laundry Svcs
Base Support Services				

Many of the underlying industries have a “high-tech” component, and the jobs they create will require more technical skills than these industries have required in the past. They will require a highly skilled, educated workforce. As the *North Carolina Resource Analysis* shows, high value-added businesses require a workforce that is well educated. As the defense industry continues to transition to new weapon platforms the importance of the skill levels of the workforce will only continue to grow.

Summary of Strategic Recommendations

AngelouEconomics and the North Carolina Military Business Center began the study with the full understanding that the ultimate implementation of this Plan would require the participation of many of the state’s existing organizations. We hope that this report will be a new tool for state and local agencies seeking to improve the economic development potential of the state. Many of these organizations have completed or are currently undergoing their own assessments of issues that relate to the defense industry. Some of the recommendations in this report will no doubt overlap with existing efforts. Our intent for this report is to assemble a complete range of actions for state and local agencies in five major areas:

1. **Information**
2. **Marketing**
3. **Entrepreneurship & Research**
4. **Infrastructure**
5. **Organization**

As such, this report aims to be an aggregator of the many productive efforts currently underway. Through it, we seek to support these efforts and enhance the collaborative environment for defense issues. Finally, this report should serve as a Living Plan for the state’s defense sector – one that continues to evolve as the market changes, new government efforts are undertaken, and new private sector participants join in.

In the world of economic development promotion, information is increasingly the “head-start” for successful efforts. AngelouEconomics and the North Carolina Military Business Center know of no other competing effort in the U.S.

Defense policies are common throughout the U.S. as they relate to military bases and the Base Realignment and Closure (BRAC) process, but no state has assembled a cross-agency collaborative effort to grow and attract defense companies.

This plan will provide a roadmap to guide future economic development activities related to defense industry development in North Carolina. We outline the consultant recommendations in each of the 5 topic areas:

Information Strategy

Military contracting is a complicated and confusing process for any small business. A key issue uncovered in our work with current and hopeful DoD suppliers was a lack of pertinent information. With the right information we believe businesses in North Carolina will be more willing to actively pursue military contracting and more successful. Recommendations to improve information flow and availability are as follows;

1. **The NCMBC should develop an information portal.** NCMBC's website should become an Information Portal for pursuing contracting with the military. A guide to pursuing work with the DoD should be developed as well as information on subcontracting opportunities. An interactive section that provides networking for North Carolina companies should also be developed.
2. **Create and support a defense enterprise team within the Department of Commerce.** An enterprise team should be created within the department's existing framework.
3. **Establish an annual defense contracting conference.** NCMBC should hold an annual conference on defense industry opportunities.
4. **Perform a State Defense Asset Inventory.** Develop an asset inventory and set of analytical tools to be maintained by the Policy, Research, and Strategic Planning Division at the Department of Commerce.

Marketing Strategy

In economic development image and perception are paramount. Creating and sustaining a positive image for North Carolina with defense industry executives and site selectors will put the state top of mind when expansion and relocation decisions are made. While securing military contracts for existing North Carolina companies is a central tenant of the NCMBC, large companies such as Boeing and Lockheed Martin dominate many areas of contracting. For these non-competitive areas recruitment will be important in developing the cluster locally. Recommendations to improve state marketing are as follows:

5. **Expand external marketing campaigns.** Conduct a campaign to enhance external perceptions of North Carolina and to persuade target industry executives to consider North Carolina for expansion and relocation.
6. **Make marketing website improvements to the Commerce website.** Create a defense industry section on the Department of Commerce website that highlights state assets relevant to the defense industry.

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7. **Attend national defense conferences.** DOC and NCMBC staff should attend trade shows and conferences featuring target defense sectors identified in this plan.
 8. **Marketing and informational visits to defense clusters.** State defense specialists should coordinate marketing trips to specific defense regions to visit with large defense contractors, research institutions, and federal facilities.
 9. **Market development trips to defense contractors.** NCMBC defense specialists should coordinate marketing trips to specific defense regions to visit with large defense contractors.
 10. **Include foreign defense companies as top targets.** North Carolina should target European companies aggressively pursuing DoD projects that will require a U.S. manufacturing facility, research and development operation, or regional headquarters.

Entrepreneurship/Research Strategy

DoD transformation includes a shift away from large-scale weapon platforms towards light, mobile systems. These new programs are more diverse and offer new opportunities for entrepreneurs and small business. For example, the Air Force is only buying two types of fighters over the next two decades, but over a dozen Unmanned Aerial Vehicles. More platforms, smaller platforms, and a desire to move systems to the field quickly open doors for new companies. Recommendations to facilitate entrepreneurship and improve research are as follows;

11. **Launch an annual North Carolina SBIR conference.** SBTDC, NCMBC, state universities, and NCCCS should organize an expanded annual SBIR conference to educate North Carolina companies about the opportunities to receive federal grant money for research and development.
12. **Create an SBIR matching fund.** Support defense technology entrepreneurs with state-level funding to leverage the SBIR research grants won by North Carolina companies.
13. **Create a North Carolina defense technology fund.** North Carolina should increase assistance to state universities in securing DoD research contracts.
14. **Fund a defense technology commercialization fellowship program.** The fellowship program envisioned by RTI is a national best practice.

Infrastructure Strategy

State and local infrastructure is very important to defense companies and their suppliers. Fortunately, North Carolina's infrastructure is nearly ideal for recruiting and developing this industry. The state offers excellent transportation access, including road, rail, air, and sea, and an ideal location. The state's utility infrastructure is reliable and affordable, including electric rates, which are key for many manufacturers. North Carolina's public sector assets, federal and state, such as bases, research universities, and small business support services are also well above average. Recommendations relating to state infrastructure are tied to supporting existing assets.

15. **Support existing state defense assets.** North Carolina should continue to support and market unique programs and assets. For example, the Army Research Office is located in the Research

Triangle Park. This office is an enormous asset to the state and is unfortunately threatened by the BRAC process. Depending on the outcome of the current BRAC process the state should consider developing a new facility for ARO and offer some degree of subsidization.

Organization Strategy

Successful economic development depends heavily on close coordination, strong organization, and following a plan. If local economic development officials, state agencies, the community college system, and the NCMBC work together to further these recommendations, the plan will be successful. Recommendations improve state and local organization are as follows:

16. **Designate “Defense” as a target industry for the state.** The State should adopt and identify “Defense” or “Defense Technologies” as a target industry for promotion by state agencies.
17. **Integrate this military gap analysis into the economic development plan for the State.** The State should adopt this plan and prioritize the recommendations.
18. **Designate a defense cluster specialist.** North Carolina should designate a specific Defense Cluster Specialist inside NCMBC or the Department of Commerce to drive the strategic elements of this plan.
19. **Integrate local economic development efforts into this plan.** Local economic developers will play an important role in expanding the state’s defense sector.
20. **Existing state contractor annual visits.** Local economic developers should assist NCMBC by committing to visit with each Defense contractor in their region each year.
21. **Create targeted incentives for defense contractors.** As a primary target of the state for recruitment and expansions, defense contractors should benefit from their own set of tax incentives.
22. **Create a marketing funds 401c6 for NCMBC.** Economic development efforts such as those of the Military Business Center can expect to receive some private sector assistance for marketing.
23. **Expand and coordinate federal lobbying efforts.** The State should coordinate with its Washington delegation for an expanded lobbying effort.

We encourage North Carolina businesses, citizens, and leaders to participate in the North Carolina Military Business Center’s initiatives. More information can be found on the website, www.ncmbc.us. Feedback on this report is welcome, so please contact AngelouEconomics or the North Carolina Military Business Center to provide your comments or suggestions.

We look forward to your continued participation in the state’s economic development efforts.