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Securing strategic advantage for defense companies

International Defense Insight Report

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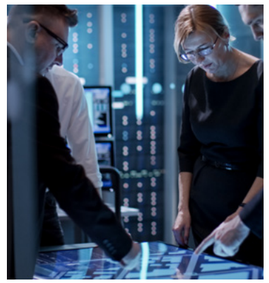
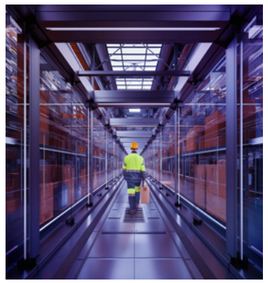




Tech, tactics and tenacity in a shifting global landscape

Defense market dynamics shifting at an unprecedented pace

The global defense market is witnessing significant shifts. Ongoing conflicts and heightened geopolitical tensions have propelled international defense spending to a record high, reaching $2.4T in 2023.[1] From combat aircraft to space-based assets to surveillance systems, the defense industrial base has witnessed robust order growth over the past six months. At the same time, emerging technologies such as artificial intelligence (AI), automation and robotization are transforming how defense businesses operate and creating new pathways for improved performance.

Yet, supply chains remain strained after the pandemic. Talent and raw material shortages, coupled with longer lead times for critical components like semiconductors, persist due to active conflicts and political tensions. On top of that, established businesses face growing competition from new market entrants capable of delivering advanced defense systems at competitive prices—a challenge further compounded by rising calls for localization.

The defense industry is navigating a complex landscape, with positive prospects and pressing issues in similar measure. Executives at defense companies told us that they have observed key trends in the market that are likely to continue over the next six to 24 months:

- **Regional demand is set to grow:** Asia Pacific (APAC), Europe and Middle East and North Africa (MENA) are expected to see significant growth in defense procurement both in the short and long term. Each region has unique capability needs, ranging from air and missile defense, air superiority and spectrum dominance to cyber defense and Intelligence, Surveillance and Reconnaissance (ISR).
- **Disruptive tech is gaining ground:** AI is recognized as a pivotal disruptor across regions. Ongoing defense uncertainties highlight the increasing importance of AI-fueled intelligence platforms and unmanned and direct energy systems, underscoring the need for a region-specific approach to technology adoption.
- **Competition is heating up:** With new market entrants posing a stiff challenge, established defense manufacturers are prioritizing cost efficiency to remain competitive. Other strategies include enhancing product technological capabilities, gaining political support and collaborating with local industries.
- **Digitalization is crucial to resolve supply chain and manufacturing issues:** Additive manufacturing, generative design, AI, automation and robotization can help solve design, supply chain and manufacturing challenges, improving both operational efficiency and product quality.
- **Suppliers need support:** Financial assistance is vital for supplier stability and performance, especially during geopolitical turmoil. Equally important is technology transfer, which helps suppliers upgrade production facilities and improve operations.
- **Cybersecurity threats are growing:** The defense industry remains a prime target for cyberattacks. Robust security protocols and employee training are essential to mitigate these risks effectively.

"In one dimension we need to keep pace and stay at the forefront of technology advancement. On the other hand, there are adversaries that have lesser capabilities that also are aggressors. And we need to make sure that we are able to have the capability and capacity to address those threats as well."

Kathy J. Warden, CEO, Northrop Grumman

"Young people with a mobile phone connected to the satellite, driving a drone, can destroy machines that are worth millions and millions. So, clearly, defense now is no longer bullets, but it's bullets and bytes."

Roberto Cingolani, CEO, Leonardo

With countries looking to improve defense capabilities, the window of opportunity for developing business in these regions is open now. Defense suppliers must adopt a multipronged approach to create competitive differentiation and meet evolving customer expectations:

1. **Think globally, engage selectively:** Identify country-specific needs to build lasting partnerships and meet demand for localized production and technology transfer. Learn from past and ongoing conflicts to anticipate future trends. Integrate international customer requirements early in design to ensure exportability and competitive pricing.
2. **Embrace disruptive technologies:** Invest in AI and unmanned systems to meet customer needs. Use innovative solutions to address supply chain and manufacturing issues, and to outperform competition on cost efficiency. Use technology to diversify products and engage with niche and emerging markets, enhancing your company's resiliency.
3. **Overcome regional barriers:** Understand barriers specific to each target market and design localization strategies to overcome them. Train personnel on regulatory and compliance changes. Develop localized pricing and marketing strategies through local partnerships.

New engines of growth

Growing geopolitical instability has prompted most key countries in APAC, Europe and MENA to increase their defense procurement spending, and they are expected to ramp it up further (see Figure 1). This rise in defense expenditure has put major defense suppliers on an accelerated growth curve, which is evident from their burgeoning order books.

Lockheed Martin, for example, reported record global defense backlog levels for 2023, as did General Dynamics and BAE Systems, reaching $161B, $73B and $87B, respectively.[3] This surge is fueled by a wave of defense procurement contracts, including a $5B air defense system for Poland, South Korea's commitment for up to 25 additional F-35 combat aircraft and Saudi Arabia's $3.2B air defense deal.[4]

This upswing in orders, however, comes with its own set of challenges. International defense sales have always been tricky, with hurdles like deciphering foreign markets, navigating political considerations and complying with restrictive regulations. While these obstacles persist, new challenges are weighing on defense companies even more. For example, one pressing issue is the need to quickly deliver products and replenish inventories, a demand not seen in decades. This urgency is compounded by rising competition from new defense manufacturers in countries such as Turkey, South Korea and Brazil. On top of that, supply chains are in disarray, with raw material shortages adding another layer of complexity. Together, these factors could limit companies' abilities to capitalize on rising demand.

Figure 1: Representative defense acquisition forecast in key markets, 2024–2028[2]

	Total defense acquisition 2024 - 2028	5-year CAGR
APAC		
Japan	$239B	10.0%
India	$123B	6.8%
South Korea	$74B	2.7%
Europe		
United Kingdom	$139B	7.0%
Poland	$51B	11.2%
Germany	$52B	4.4%
MENA		
Saudi Arabia	$101B	3.5%
Qatar	$25B	7.8%
UAE	$24B	4.5%

"I think there will be growth that wasn't forecasted because of all the new orders that are likely to come in as we replenish and backfill supplies, but also address the growing demand that we'll see."

Senior executive, major US defense company

As the nature of defense planning evolves, spending is increasingly focused on specific capabilities, systems and platforms. Air and missile defense, in particular, is a priority area across all three regions. A significant focus is countering threats demanding the integration and coordination of multiple systems and technology-driven capabilities.

Defense equipment manufacturers must keep pace with the demand for innovative defense capabilities and the accompanying hardware. Customer needs dictate a constant stream of new technology to address a rapidly evolving threat environment. An example of this is integrating manned and unmanned platforms. Firms that can adapt and deliver these types of solutions at speed will be best positioned for growth.

Executives across all three regions see AI as a game-changing technology—one that will enable them to meet customer requirements for advanced defense systems. Use cases are broad, ranging from AI-enabled combat perception to drone automation and control.[5]

Asia Pacific

With defense spending moderately on the rise in APAC (3.4% CAGR in 2014–2023)[6], the region is unlikely to see dramatic increases akin to those in Europe. But this doesn't dampen demand—more than half of surveyed executives anticipate higher spending over the next 12 months and 65% expect further increases over the next three years. These projected increases are attributable to regional security dynamics. Japan, for example, will spend a record $57 billion in the financial year ending March 2025 to bolster its defenses.[7] Similarly, Australia plans to steadily increase its defense spending, aiming for a historic 2.4% of its GDP by 2033.[8]

Beyond current defense needs, executives see AI/data analytics and hypersonics as the key disruptive technologies for APAC (see Figure 2). This focus stems from the need to effectively monitor activity over vast areas and respond to advancements in developing hypersonic missile programs.[9]

On the manufacturing side, there are notable differences within APAC in terms of local production capabilities. Certain countries produce defense products independently or with minimal foreign support while others rely on "off-the-shelf" purchases and partnerships with foreign companies, sometimes to maintain alliance interoperability.

Figure 2: APAC defense priorities: Current needs and disruptive tech (as cited by executives)

Current defense needs	Disruptive defense tech
1. Air superiority	1. Artificial intelligence
2. Intelligence, Surveillance and Reconnaissance	2. Big data analytics
3. Long-range strike	3. Hypersonics
4. Air and missile defense	

"The Japanese are essentially doubling their defense budget over the next five years … Singapore and New Zealand are also increasing their spending. Taiwan is trying to expand their services as well. There's a lot of growth in that part of the world."

Managing director, major US defense company

Europe

After a period of constrained defense budgets, Europe is now experiencing a surge in defense spending with record year-over-year (YoY) growth of 13.4% in 2022 and 14.7% in 2023.[10] While this rapid growth may not persist, our survey suggests continued increases, albeit probably at a slower pace. Seventy-three percent of executives expect spending to rise in the next 12 months and 85% foresee growth over the next three years. Several European countries have begun large-scale defense modernization programs. For example, Romania and Czechia plan to procure F-35 combat aircraft while Poland aims to completely modernize its helicopter fleet.[11]

Moving past existing defense requirements, executives view AI and AI-enhanced capabilities—such as first-person view (FPV) drones and autonomous unmanned vehicles and systems—as the key disruptive technologies for Europe (see Figure 3).

Europe's new defense industrial strategy, coupled with rapidly growing demand, is already yielding results for European companies. For example, Sweden's Saab reported 23% YoY sales growth in 2023 while Polish defense electronics and unmanned systems manufacturer WB Electronics saw a staggering 258% YoY increase in revenue during the same period.[12]

Figure 3: European defense priorities: Current needs and disruptive tech (as cited by executives)

Current defense needs	Disruptive defense tech
1. Air and missile defense	1. Artificial intelligence
2. Spectrum dominance	2. First-person view drones
3. Cyber defense	3. Autonomous unmanned vehicles and systems
4. Intelligence, Surveillance and Reconnaisance	

"This year, for the first time since the alliance's creation, NATO's European allies will spend 2% of their collective GDP on defense."

Jens Stoltenberg, Secretary General of NATO

Middle East and North Africa

Despite persistent security threats and intra-regional rivalries, defense spending in MENA remained flat over the last decade, with some countries like Morocco even seeing declines.[13] But new regional tensions are estimated to trigger a 9% rise in Middle East defense expenditure in 2023.[14] This expectation is echoed by the executives we surveyed—70% of them anticipate higher defense spend over the next 12 months and the next three years.

Looking beyond current defense needs, executives identified directed energy systems, AI and autonomous unmanned vehicles and systems as pivotal technologies (see Figure 4). This aligns with the region's need for cost-effective air defense solutions to counter threats.[15]

Apart from the United Arab Emirates and Saudi Arabia, which are looking to build domestic manufacturing capabilities, most MENA countries remain reliant on off-the-shelf foreign imports.[16]

Figure 4: MENA defense priorities: Current needs and disruptive tech (as cited by executives)

Current defense needs	Disruptive defense tech
1. Air and missile defense	1. Directed energy systems
2. Cyber defense	2. Artificial intelligence
3. Air superiority	3. Autonomous unmanned vehicles and systems
4. Spectrum dominance	

"The Middle East governments are wanting more autonomy. I don't know if they're sick and tired of this word, but they want more local content in their defense."

Regional director, US defense company

Navigating regional challenges

As defense companies ramp up and redirect investments to meet new demand, they must also deal with regional challenges such as the influx of new competitors, evolving customer expectations and a complex regulatory landscape.

New competition and calls for localization: Executives highlight competition from new market entrants as a major barrier to growth across all three regions. This challenge is especially pronounced in APAC, where countries are prioritizing the growth of indigenous defense industries. For example, India has an initiative supporting the production of defense systems for both local and export markets.[17] South Korea (one of the fastest-growing defense material exporters globally), Turkey and India are home to numerous emerging defense companies that are manufacturing advanced products, such as UAVs, light combat aircraft and even cruise missiles, at competitive prices.[18]

There are also calls for more localized production, driven by a desire for industrial autonomy, economic benefits and supply chain resilience. For example, Airbus is establishing a local production plant for parts and a final assembly line for C295 transport aircraft recently procured by India.[19] Similar demands exist in other countries, such as Finland, where Patria has become a local industrial partner to produce F-35 components and engine assemblies.[20] This push for localization brings its own set of challenges, such as finding and developing a local workforce with the necessary skills and expertise and managing an already complex global supply chain.

Political hurdles and production pressures: Political considerations between a company's home country and the countries where potential customers are located are not uncommon. Additionally, companies often face barriers from domestic laws and policies that restrict sales to certain international markets. Recent efforts to address these barriers include the US reducing licensing requirements for Australia and the UK within the context of the AUKUS partnership.[21]

"A significant challenge is that we are seeing increased competition from foreign countries that 10 years ago we wouldn't give a second thought to. Countries now have more options and if they can purchase something with 90 percent of the capability but at a reduced price it can be a difficult landscape for US primes."

Strategy executive, US defense industry

"There is increased demand for localization in the Middle East, but they still do not have the populace with the skillsets to fill some of those jobs. A large US company may need to do something non-defense related in those countries which poses a significant risk for the company."

Senior executive, US defense industry

How companies are responding

New competition: Our research reveals that leading suppliers of defense products are looking to tackle new competition with a trifecta of cost efficiency, diversification and expansion into adjacent markets.

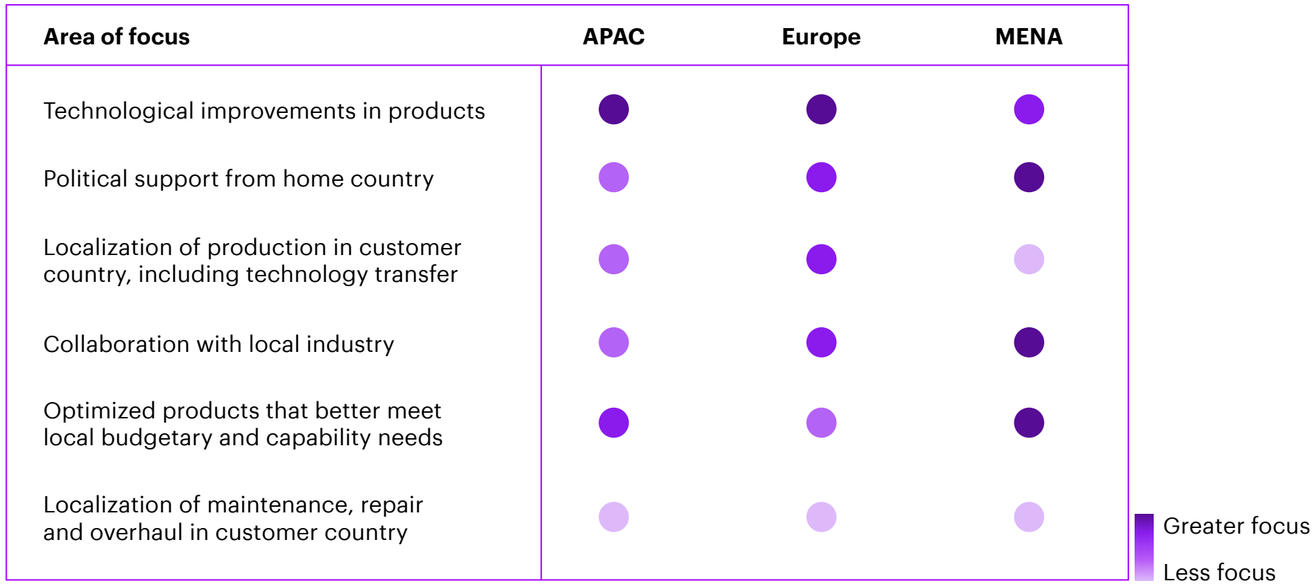
- **Improving costs:** BAE Systems plans to use AI to increase manufacturing efficiency, reducing overall costs and enhancing competitiveness.[22]
- **Diversifying products and services:** Thales has acquired Cobham Aerospace to improve its position in the communication and connectivity market, expanding its product offerings and market reach.[23]
- **Expanding into new markets:** Anduril Industries' acquisition of Adranos strengthens its manufacturing capabilities in solid rocket motors, opening new avenues for growth in the hypersonic missile market.[24]

Technological enhancements and regional focus: Depending on the region, executives are shifting focus toward making technological improvements, gaining political support, collaborating with local industries and developing optimized products that better align with local budgetary and capability constraints—or a combination of these strategies (see Figure 5).

Defense companies are also investing in digital technologies such as web platforms and computational data analytics to streamline compliance and product tracking. This aligns with the broader digitalization trend in the aerospace and defense industry.

Executives are keeping pace with regulatory changes through continuous training and by establishing compliance monitoring systems.

Figure 5: Anticipated shift in defense companies' focus to meet customer expectations



Overcoming supply chain complexities

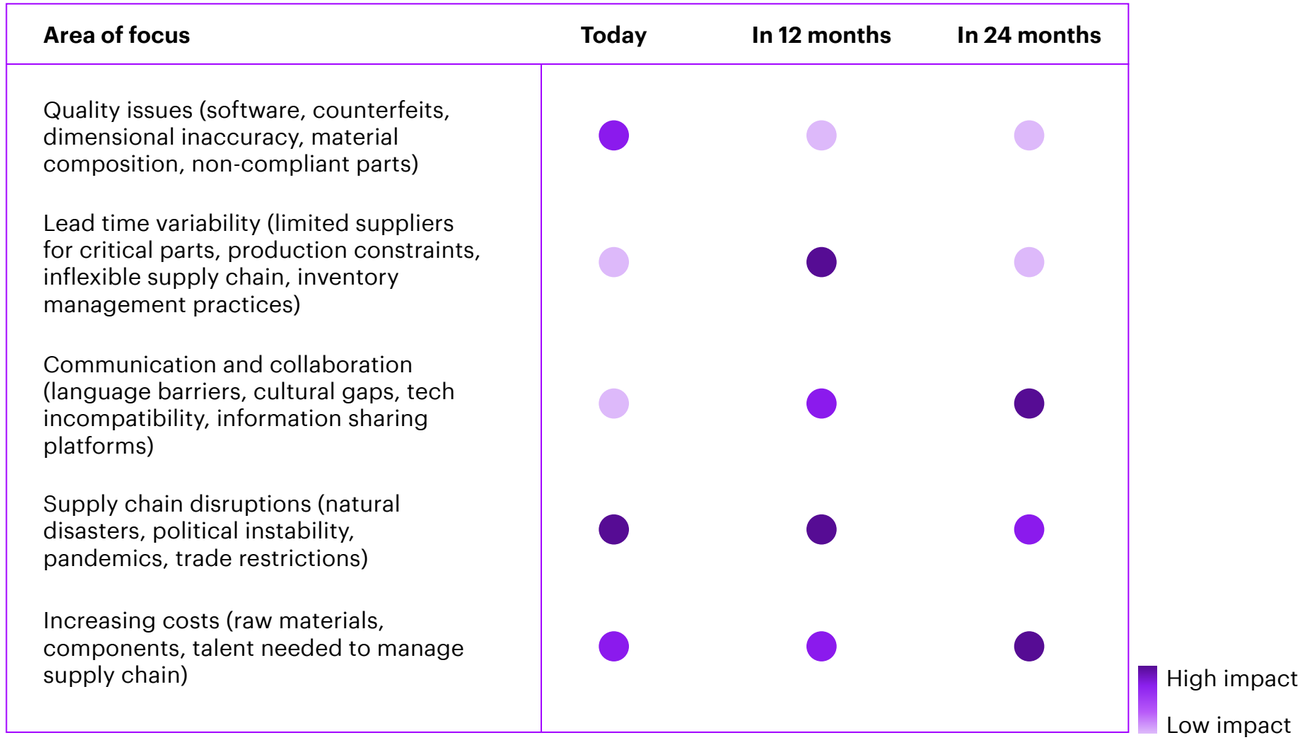
* This image was created with help of AI.

Executives today consider disruptions from natural disasters, political instability, pandemics and trade restrictions as the most significant threats to supply chains. The restricted availability of essential raw materials such as gallium and rare earth elements due to trade restrictions is particularly concerning.[25] Even when local sources are identified, environmental concerns loom large.[26] These issues are expected to persist over the next 12 months. Looking further ahead (24 months), executives identified rising costs on the raw material, component and talent fronts, along with communication and collaboration challenges, as key supply chain risks (see Figure 6).

"I would say the largest risk right now would just be the overall supply chain. We're still seeing logistics delays. We're still seeing material shortages. That's not just specific to my division but across the board."

Senior supply chain executive, major defense company

Figure 6: Supply chain challenges for defense companies



Go digital to fortify supply chains

The critical role of technology in overcoming supply challenges is not lost on executives. Digital tools, AI, automation, optimization of manufacturing processes and material substitution are all central to companies' strategic responses. Honeywell, for example, is transforming its supply chain by deploying AI in procurement, planning and logistics, among other areas.[27]

"Europe needs more disruptive technology to make up for underinvestment in the preceding years. Cooperation between the US and Europe could help mitigate some of the supply chain issues. The cost-prohibitive nature of shipping has placed a greater emphasis on warehousing. More innovating manufacturing processes like 3D printing are proving beneficial as well."

Executive, US defense industry

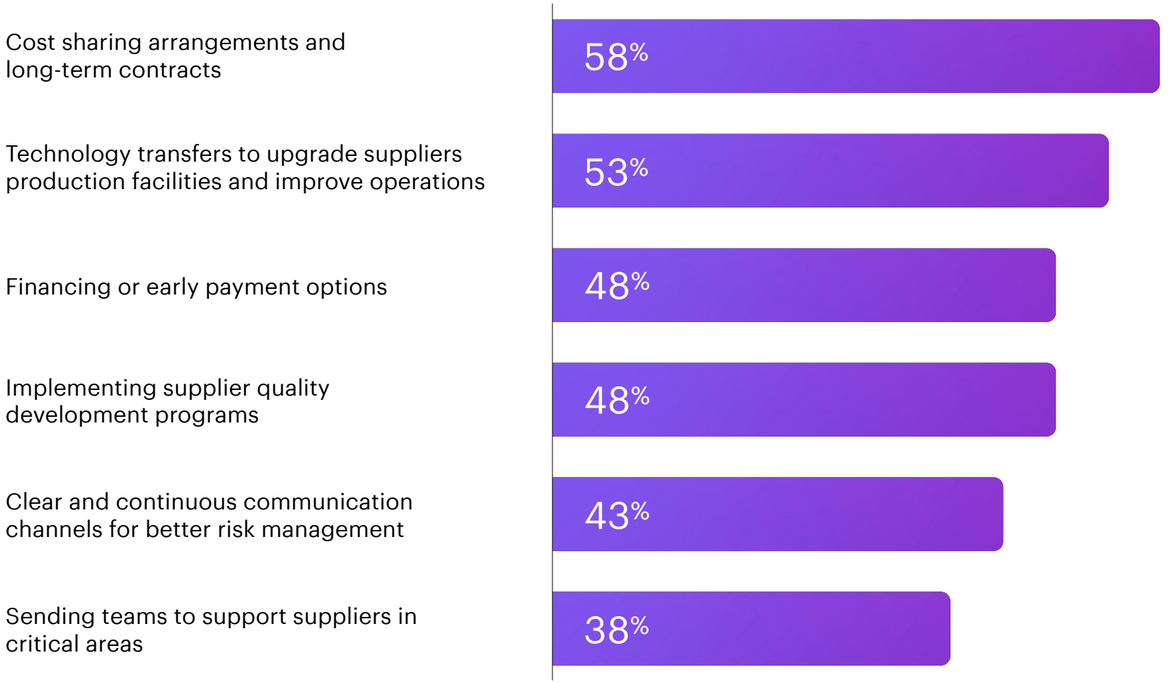
Support suppliers with financing and technology transfer

Our survey backs the view that the health of a supply chain depends on the financial well-being of suppliers. Executives highlighted several ways to support suppliers, including cost-sharing arrangements, long-term contracts for better pricing stability, financing and early payment options (see Figure 7). For example, Rolls-Royce has struck a seven-year deal with Indian manufacturer Azad Engineering to secure the supply of crucial engine parts.[28]

In addition to financial support, defense companies are engaging in technology transfer to help suppliers upgrade their production facilities and improve operations.

This approach not only addresses supply chain challenges, but it also enhances overall supply chain efficiency and cybersecurity. Leonardo's Digital Supply Chain project, for example, helps more than 50 suppliers accelerate their digital transformation, creating a more innovative, efficient and digitally secure ecosystem benefiting all stakeholders.[29]

Figure 7: Top focus areas for defense companies in supporting suppliers



> "When you think of power suppliers passing on inflationary concerns, most of these contracts are written in a way that you're trying to balance it on both sides so we're trying to reach a mutually agreed upon risk sharing."
>
> Supply chain executive, major US defense company

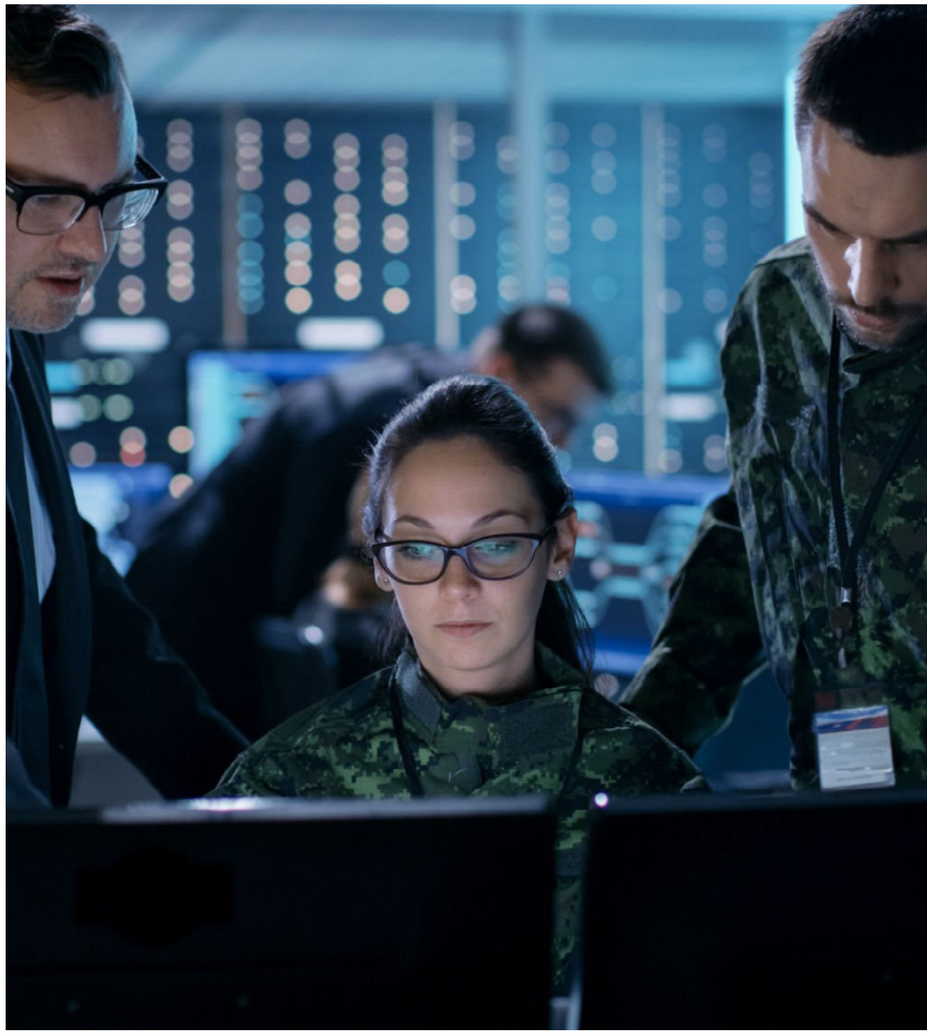
Devise local solutions to local problems

Defense companies are implementing tailored initiatives that address the specific supply chain challenges faced in each region. Market intelligence is crucial in this process, as it allows them to develop pricing and marketing strategies that resonate with local needs and preferences. Take EDGE, for example, which formed strategic partnerships with two Bulgarian firms—TBS and Samel-90—to identify and pursue European opportunities, leveraging valuable local expertise.[30]

> "A challenge we face is how to increase capacity without greatly increasing cost. One way is to find international partners capable of producing systems and licensing out our technology so they can make it. In that scenario we get revenue from licensing, without having to invest in a new factory."
>
> Strategy executive, US defense company

Specific regional initiatives:

- **APAC:** Building long-term partnerships through technological collaboration is seen as the most successful approach to solving supply chain issues. Examples include deep technological collaborations between Western companies and their Japanese, Australian or South Korean partners, such as Lockheed Martin's agreement with Korea Aerospace Industries for TF-50 jets.[31]
- **Europe:** Adapting products to meet specific customer needs and working with regional suppliers is critical. For example, Raytheon's agreement with Poland's PGZ group enhances supply chain diversification.[32]
- **MENA:** Optimizing distribution networks for efficient delivery to foreign customers and utilizing local manufacturing to reduce production costs have proven successful.

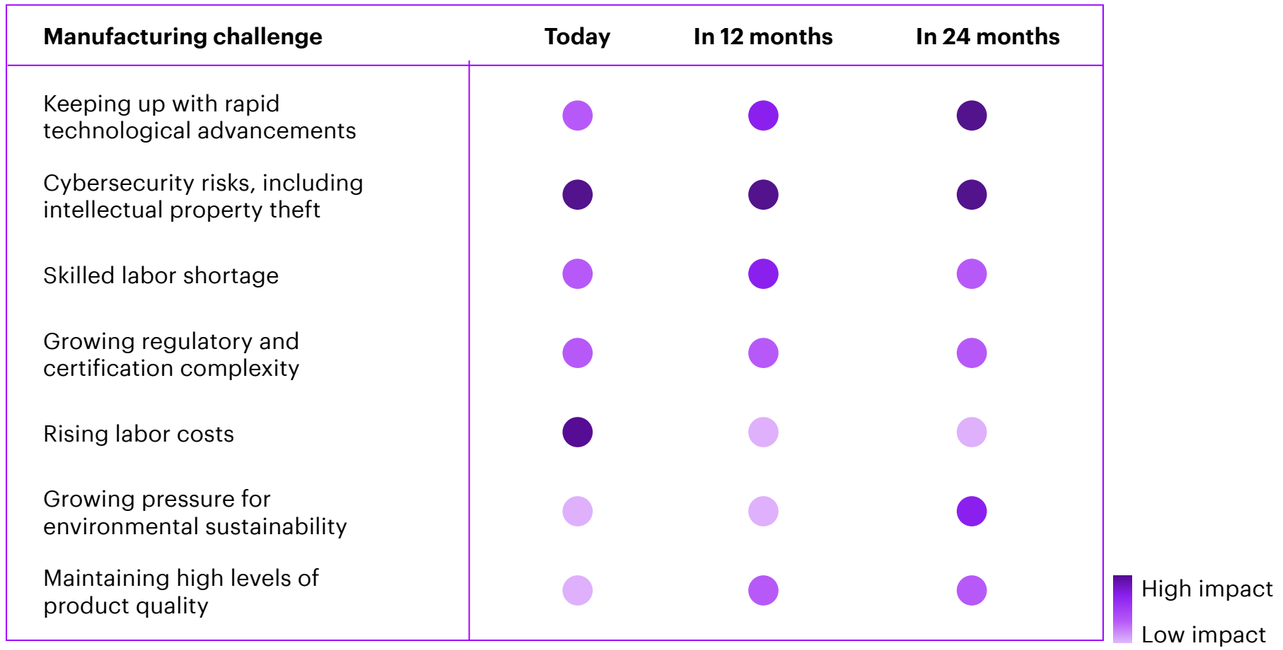


Embracing tech to pre-empt manufacturing disruptions

Executives say cybersecurity threats and rising labor costs are currently the most significant challenges facing defense manufacturers. Over the next one to two years, concerns about cybersecurity are likely to persist, and the pressure to keep up with rapid technological advancements is expected to become a major factor affecting the manufacturing process (see Figure 8).

Additionally, the growing demand for environmental sustainability is becoming an important consideration. This trend is already gaining momentum, exemplified by Fincantieri securing financing from the Italian government contingent on achieving environmental KPIs.[33]

Figure 8: Key manufacturing challenges facing defense companies



"One of the biggest scares we were always planning for is if we had some kind of a hacking event, where people take over systems. That would really hurt the manufacturing process, and then you just start falling behind really quickly."

Director of quality, major European defense company

Defense companies are deploying innovative technologies to tackle manufacturing challenges. Investments in AI-enabled solutions, automation and robotization are increasing and are the primary strategies for streamlining manufacturing processes (see Figure 9). While impactful, our data highlights that the majority of defense companies have yet to fully embark on these programs.

Executives also emphasize the importance of addressing cybersecurity threats through implementing multi-layered security measures and educating employees on best practices. Northrop Grumman, for example, has partnered with leading universities to advance the understanding of cybersecurity threats and inform course curricula to train the next generation of defense cybersecurity experts.[34]

Figure 9: Top focus areas for defense companies in addressing manufacturing issues

Seizing the opportunity

The future of the defense industry belongs to the swift and the adaptable. Rising defense spending promises ongoing demand for defense companies but adopting a wait-and-see approach or merely reacting to the market will not suffice.

Defense companies must tailor their approach to markets in line with regional procurement trends, break expansion barriers and infuse disruptive technologies like AI and autonomous systems into their operations. Continuous reinvention to address supply chain and manufacturing vulnerabilities will be key to seizing not just the opportunities of today but also securing competitive advantage for tomorrow. Companies that fare well on these fronts will not just survive—they will chart the course for the industry's future.

About the International Defense Insight Report

The Accenture International Defense Insight Report combines analysis of primary and secondary research on both demand and supply sides of international defense market with the focus on three regions of growth: Asia Pacific, Europe, as well as Middle East and North Africa. Primary research covers interviews with experts, including current and former military and defense industry officials, while a survey was conducted with executives at major defense industry companies from North America, Europe, and Growth Markets. The research provides a unique perspective on existing and future trends and drivers in international defense market, covering a wide range of areas, from capability and technology needs to entry barriers and supply chain and manufacturing headwinds.

We conducted interviews and the executive survey in 2Q 2024; views are subject to considerable change as geopolitical conditions can rapidly evolve.

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