

# THE CHALLENGE OF RESHORING THE DEFENSE DEPARTMENT SUPPLY CHAIN

The Defense Department is increasingly turning its attention to safeguarding critical nodes in its supplier base. In addition to mitigating the economic disruptions caused by COVID-19, the Department aims to limit opportunities for rival nations to compromise the development and provision of essential supplies. Ellen Lord, head of acquisition for the Defense Department, announced in early July that the Department aims to “reshore” vulnerable elements of the supplier base such as single-source, offshore providers of critical items. She specifically noted the vulnerabilities associated with microelectronics, pharmaceuticals, and rare earth elements.

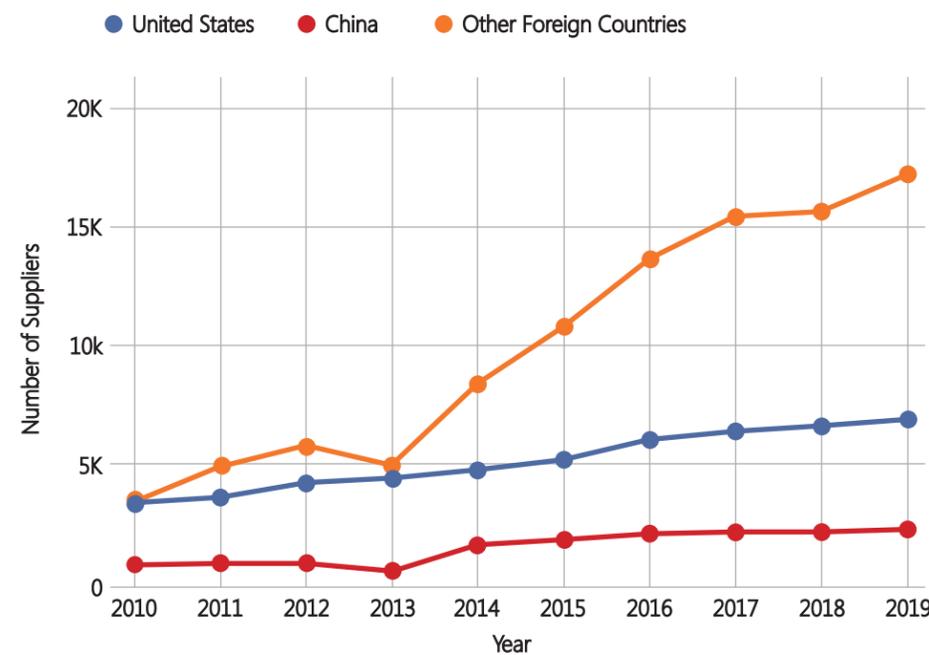
As a starting point to identify targets for reshoring, it is necessary to understand the Defense Department’s overall reliance on foreign companies. A selective assessment of a portion of the Department’s supplier base underscores the magnitude of the challenge. The vast majority of the Department’s Tier 1 vendors examined (84%) are American companies. However, foreign companies make up an average of 70% of suppliers across Tiers 2–5. Reshoring many of these goods and services to U.S.-based companies would be a significant challenge given that U.S. companies

make up the majority of the Department’s subprime suppliers within only a handful of the critical industries analyzed.

The Department is primarily concerned with the People’s Republic of China’s ability to influence its supplier base. From 2010–2019, the number of Chinese suppliers in the Department’s supplier base in the sample Govini assessed increased by a total of 420%, to 655, across numerous critical industries. In comparison, U.S. companies grew 97%, to 2,219. Moreover, Chinese suppliers’ share of these critical industries grew to 9% in 2019, up from 6% in 2010. The prevalence of China-based companies across the Department’s supplier base will make it difficult to identify with certainty all of the cases where they are a single-source provider of a key technology or material.

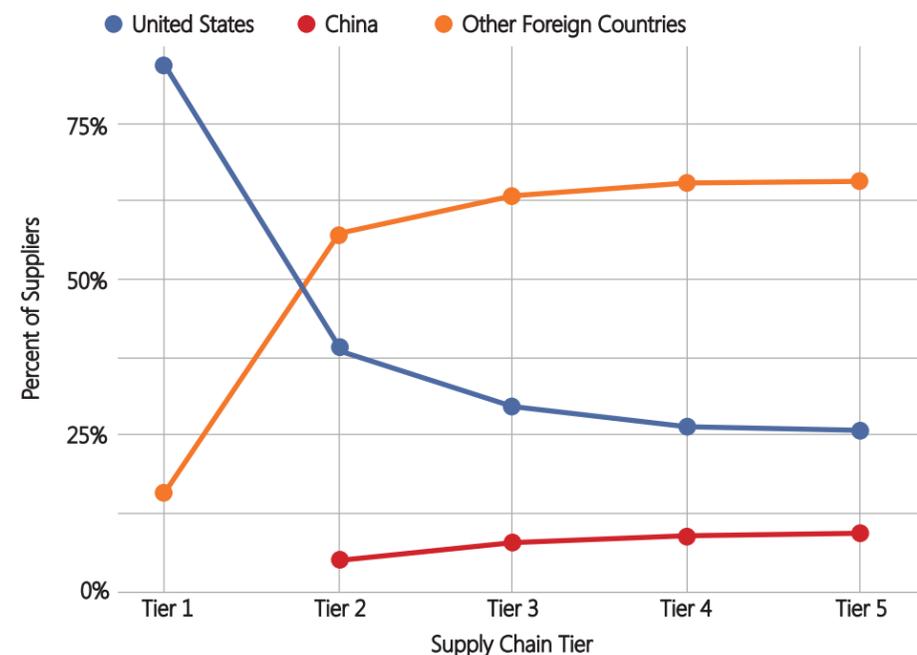
Govini performed this assessment by examining the supply chains of over 1,000 Tier 1 Defense Department vendors across nearly 100 industries. This sample focuses on large, public corporations headquartered in the United States and provides an estimate of the general distribution of U.S. and foreign suppliers within the Department’s supplier base. The assessment considers supplier relationships, not the volume of supplies transferring between companies.

### ACTIVE SUPPLIERS BY YEAR



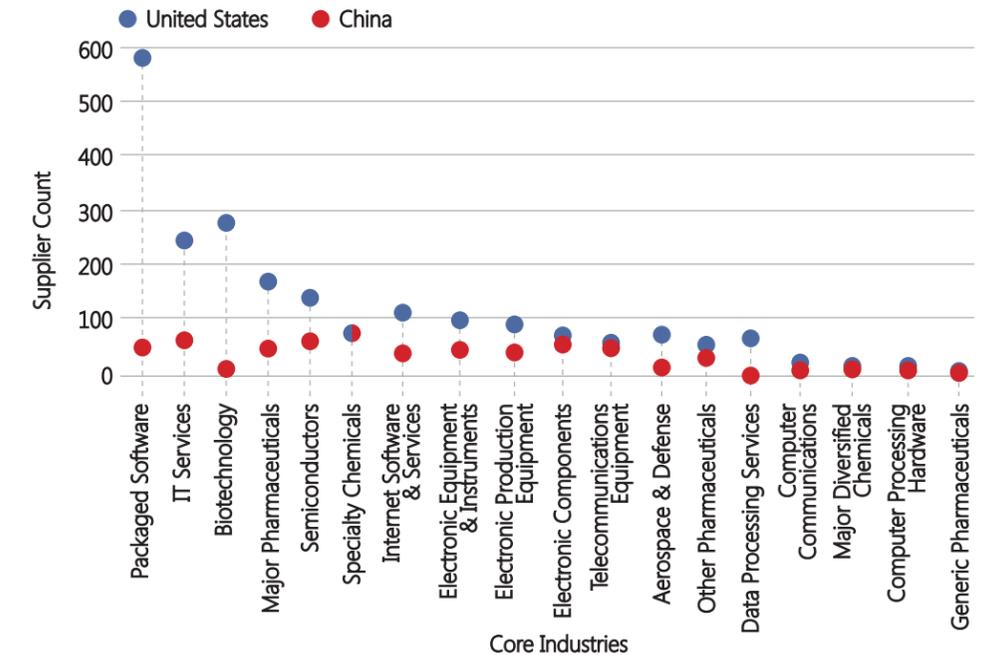
- The steep rise in foreign suppliers starting in 2014 is driven by Japan- and South Korea-based companies, whose presence grew 336% (to 2,588 companies) and 1,057% (to 1,735), respectively, between 2013 and 2019; the number of Chinese suppliers grew to 2,235 in 2019, a 356% increase since 2013
- Of the top ten foreign suppliers in 2019, Canada, Germany, and France saw the least growth between 2013 and 2019 (124%, 115%, and 161%, respectively)
- Between 2010 and 2019, other foreign country suppliers’ share of the Department’s supplier base grew the most in Packaged Software (to 8% from 3%), IT Services (to 7% from 3%), and Electronic Components (to 5% from 2%)

### COUNTRY-BASED SUPPLIERS BY TIER (2019)



- U.S.-based companies make up less than half of the supplier base starting at Tier 2 and stabilize at approximately 25% by Tiers 4 and 5; U.S. companies have the greatest share in the Data Processing Services (58%), Biotechnology (52%), and Packaged Software (48%) industries
- No Chinese suppliers were found to have direct commercial relationships with the Defense Department; their presence emerges in Tier 2 at 5% and gradually increases at each tier in the supplier base, reaching 9% by Tier 5
- Across all five tiers, foreign-based companies (including those in China) make up 75% or more of total suppliers in 7 of the 18 critical industries analyzed, and have the greatest share in Major Diversified Chemicals (85%), Electronic Components (84%), and Specialty Chemicals (83%)

### U.S. & CHINESE SUPPLIERS IN CORE INDUSTRIES (2019)



- Reshoring may be most challenging for industries in which China-based companies have a substantial share; they rival U.S.-based companies’ share in Specialty Chemicals, Major Diversified Chemicals, Telecommunications Equipment, and Electronic Components
- China-based companies have the greatest share of the supplier base in Telecommunications Equipment (20%) and Specialty Chemicals (17%), and have over 10% of the supplier base in nine other critical industries
- In the Semiconductors industry, the number of China-based companies has grown 364% between 2010 and 2019, to 65 companies, increasing China’s share to 13% from 7%; the share of U.S. companies (144 in 2019) dropped to 28% from 56% due to a surge of other foreign suppliers