

ON THE OFFENSIVE

Lockheed Martin's board has not shied away from grappling with risks so that the company is more than just a defense contractor.

By Paul Gillin

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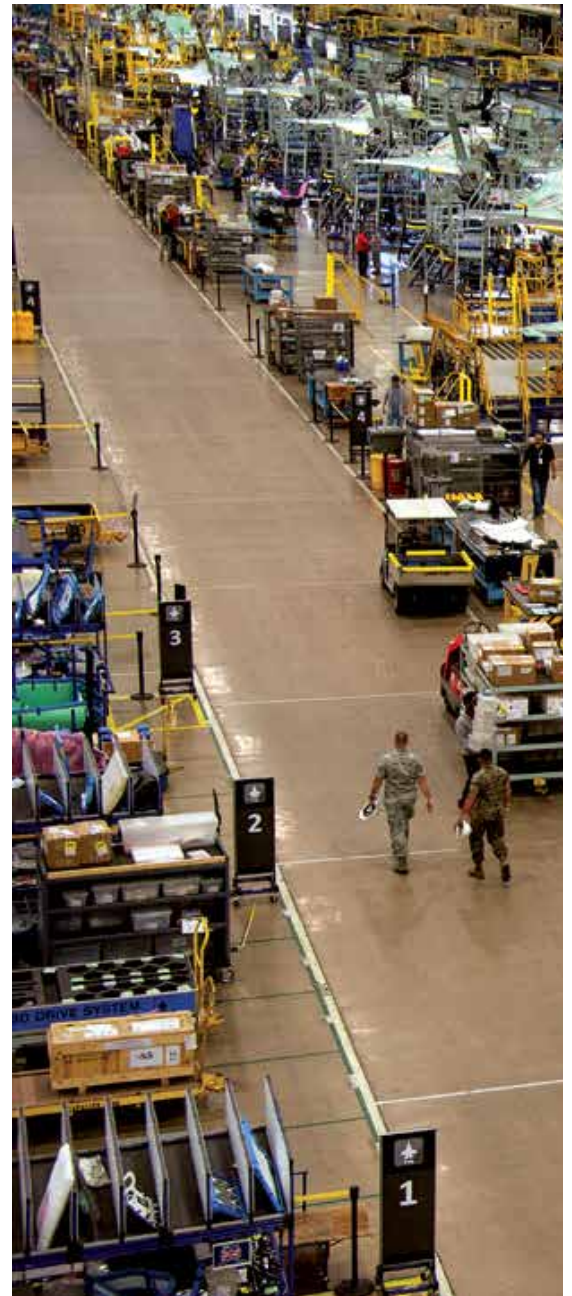
—Dr. Leo S. Mackay Jr., senior vice president of internal audit, ethics and sustainability, Lockheed Martin

In the defense industry, it is known as the Last Supper. In 1993, then-U.S. Secretary of Defense Les Aspin and his deputy, William J. Perry, hosted a dinner at the Pentagon that was attended by the top brass from a dozen of the nation's largest defense contractors. After the meal, Secretary Aspin dropped a bombshell: The peace dividend resulting from the end of the Cold War would bring about massive cuts in U.S. defense spending.

The news kicked off a frenzy of closures and consolidations that, in four short years, would reduce the number of major U.S. defense contractors from 15 to four. One such merger resulted in the creation of Lockheed Martin, the world's largest defense contractor.

The board of this newly formed company quickly realized that an overreliance on a single customer put the entire company at risk. The U.S. government at one point had constituted more than 90 percent of the company's business. So, over the past two decades, Lockheed Martin has diversified its business with a long-term focus, moving into areas such as health care, renewable energy, intelligent energy distribution and compact nuclear fusion. It also expanded globally. Now, government contracts account for 69 percent of the company's \$51 billion in annual sales, and international sales make up most of the rest.

Despite this aggressive shift, Lockheed Martin's strategy continues to evolve. Although the defense industry never will be disrupted out of existence—governments will always need militaries—it is not immune to volatility. New



technologies and inconsistent defense spending levels are two variables in play. To begin securing its next 100 years (Lockheed Martin has historical roots dating back to 1912), Lockheed Martin's board charged Dr. Leo S. Mackay Jr. with developing a management plan that would establish a strategic approach to achieving performance targets for the long-term.

The ultimate goal? Sustainability.

The concept usually is associated with the environment, but it has a different meaning at Lockheed Martin. “We define it more around materiality and business resilience,” says Dr. Mackay, senior vice president of internal audit, ethics and sustainability. He reports directly to the committee of the board of directors charged with governance as part of his duties.



Lockheed Martin's Fort Worth, Texas, USA production facility brings together more than 300,000 parts from aerospace leaders across the industry to assemble the F-35 jet.

PHOTO COURTESY OF LOCKHEED MARTIN

“Everything in the sustainability program revolves around the resilience of the business.”

FIVE DIMENSIONS

Driving strategic change at a 100,000-person company starts with choosing the right leadership. A former U.S. Navy fighter pilot with a degree from the U.S. Naval Academy and a doctorate in public policy from Harvard University, Dr. Mackay had both strong military and academic credentials. He also had experience driving change within large organizations. As the U.S. deputy secretary of Veterans Affairs in President George W. Bush's administration, Dr. Mackay oversaw a sweeping reorganization of the department that cut pending claims by 30 percent while eliminating \$300 million in

costs from the western world's largest integrated health care network.

Those years of experience in government taught Dr. Mackay that successful change requires clear goals—touchy-feely ideals and pie-in-the-sky ambitions would not cut it with Lockheed Martin's workforce, over half of whom are highly trained scientists and engineers. “This is a pretty business-focused place,” he says. “We knew we had to define sustainability in a way that was sensible to our leaders and employees, and that related to the material concerns of the business.”

To create the right plan, Dr. Mackay and the Sustainability Management Council went on an eight-month journey to define the constructs of what sustainability would ultimately



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mean to Lockheed Martin. Step one included a rigorous internal assessment of environmental, social and governance data, led by Dr. Mackay and Lockheed Martin’s executive leadership. From that review, Dr. Mackay and the board committee identified more than 30 potential priorities—including supplier diversity, product eco-innovation and science, technology, engineering and mathematics education—where the company could seek to accelerate progress by setting related targets in the pursuit of organizational sustainability.

To narrow those priorities, Dr. Mackay’s team solicited input from people inside and outside the organization through interviews and surveys. “You have to capture mindshare,” he says. “You do that by inviting people into the change process at a formative stage where they can be co-owners and not have change happen to them.”

Ultimately, Dr. Mackay and the council settled on 16 tier-one sustainability performance factors, each ladder up to what Lockheed Martin has defined as its five dimensions of sustainability:

1. Business integrity: Conducting business according to high ethical standards attracts better-quality customers and employees while reducing pressure from government regulators. “Lockheed Martin’s business success depends on our commitment to integrity,” Dr. Mackay says. “We do more than just comply with laws and regulations. We aim to do what is

right every day.” Corresponding sustainability priorities include anti-bribery and corruption controls, ethical governance and leadership, supplier conduct and responsible sales.

- 2. Employee well-being:** Fostering an innovative and inclusive workforce contributes to Lockheed Martin’s high-performance and enhances the organizations’ competitive advantage. Corresponding sustainability priorities include: workplace safety and wellness, talent recruitment, talent development, and diversity and inclusion.
- 3. Product impact:** By building an innovative portfolio products and solutions for national defense, cybersecurity, logistics and energy and recognizing the nexus between customer needs and sustainability, Lockheed Martin can design solutions that deliver greater value to the customer and society. Corresponding sustainability priorities include: product safety, total cost of ownership, global infrastructure needs and counterfeit parts prevention.
- 4. Information security:** In a time of near-constant security challenges, Lockheed Martin’s ability to protect intellectual property and sensitive employee personal information is integral to mission success and trust. Corresponding sustainability priorities include customer information systems and network security, employee privacy and data protection.
- 5. Resource efficiency:** Renewable energy is good for the environment and the bottom line, Dr. Mackay says. Lockheed Martin sees

Lockheed Martin is the prime contractor building NASA’s Orion Multi-Purpose Crew Vehicle.





its biggest opportunities for optimizing resources around energy efficiency and greenhouse gas emissions. The company's board of directors and executive leadership team review the environmental performance of the organization at least twice annually. Corresponding sustainability priorities include energy and carbon management.

Taken together, these dimensions define a culture that does business ethically, develops the skills of its people and focuses its research and resources in areas that make the world better. The bottom line, says Dr. Mackay, is clear: Sustainability makes the business better. "Leaders want to manage for both the short- and long-term, and resilience is good for the long-term."

VALIDATE AND DOCUMENT

Establishing these priorities is not a one-and-done process. Dr. Mackay and the board committee seek constant endorsement of their efforts. For example, select members of an advisory committee of scientists and engineers from outside the company were invited to sit in on executive team meetings and provide input on progress.

Dr. Mackay emphasizes that involving outsiders is essential to validating Lockheed Martin's sustainability strategy. Third-party validation also is critical to winning over shareholders as environmental, social and governance (ESG) investors. They are a growing and vocal group that uses annual meetings to hold companies' feet to the fire, he says.

Validating the company's approach is one thing, and measuring change is another. Lockheed's progress in the five dimensions is documented in an exhaustive annual report detailing the company's performance relative to each of the 16 tier-one factors.

"We report not just the good but also where we need to redouble our efforts," Dr. Mackay says. The report has been a critical asset in connecting with and informing stakeholders. For example, one ESG investor who regularly criticized the company's communication efforts and pressured it for years to provide more information became very complimentary after

seeing the first report. "The answers to all their questions are in there," he says.

RISK AND REWARD

Dr. Mackay's newest assignment from the board is to spearhead Lockheed Martin's enterprise risk management initiative. It is an effort to develop a disciplined approach to mitigating risks and identifying the most promising areas of business opportunity. The seven-year campaign to integrate sustainable practices throughout the organization makes risk assessment a natural next step, he says.

"There's a lot of overlap between the two," Dr. Mackay says. "Many of the risks the corporation faces are best addressed through sustainability. Business resilience should be juxtaposed with enterprise risk." Risk management is a natural outgrowth of business sustainability—they both keep the business viable for the long term.

Integrating the two initiatives under Dr. Mackay's leadership also has practical benefits. For example, reports on sustainability initiatives for compliance purposes often go hand in hand with the kind of transparency that prospective business partners require prior to entering into long-term contracts.

"It's part of shaping our future operating environment, our corporate perception and, in a concrete fashion, building resilience and efficiency into the business," Dr. Mackay told *Forbes*. "Those things are operationalized as risk mitigation, modulation of risk and exploitation of opportunity."

The turbulence of the 1990s is now a distant memory at Lockheed Martin. The company has diversified itself for the 21st century and built a culture that hews to a clear set of operating principles, letting the organization look well beyond the horizon.

From where he sits, Dr. Mackay likes what he sees.

"With all apologies to our other colleagues in the aerospace and defense industry, I think we have been the most successful in moving with alacrity to position ourselves to prosper in the world to come." **IQ**