Capital Flows, Market Structure and the Durability of the Opportunity

April 2026

Key Takeaways

- Capital is moving beyond traditional defence contractors into a broader ecosystem of technology, industrial and supply chain companies, expanding the range of investment opportunities.
- A significant portion of defence spending remains unallocated, creating a multi-year pipeline of demand that is expected to be deployed across a wider range of participants.
- The combination of sustained government spending, evolving procurement frameworks and increasing private capital participation is driving a more durable and investable defence innovation cycle.

I. Introduction

Public market exposure to defence has historically been concentrated among a small number of large contractors, limiting how investors participate in the sector. While these companies remain central to defence capability delivery, they capture only a portion of the activity taking place across the broader ecosystem.

As defence spending expands and the sources of innovation shift, capital is being deployed across a wider range of companies, including technology firms, industrial suppliers and emerging businesses operating outside of traditional defence supply chains.

Understanding how that capital is flowing, and what makes the current cycle durable, is increasingly important for investors.

II. Capital Is Moving Earlier and Broadening Across the Ecosystem

One of the most significant changes in the defence landscape is the stage at which capital is being deployed.

Historically, investment in defence was concentrated at later stages of development, once technologies had been integrated into formal procurement programs and supported by long-term government contracts. Today, capital is increasingly being deployed earlier in the development cycle, often before companies are incorporated into traditional defence supply chains.

This shift is reflected in the growing role of private capital in defence-relevant sectors. Investment into dual-use and defence-related technologies has accelerated, with venture capital increasingly directed toward areas such as artificial intelligence, autonomy, aerospace and cyber security.[1]

In Canada, this dynamic is supported by a technology ecosystem that includes more than 17,000 scale-ups operating in sectors with defence-relevant applications.[2] Federal initiatives have also allocated approximately C$650 million toward the commercialization of dual-use technologies, reinforcing the role of private capital in bridging commercial innovation and defence capability development.[1]

This earlier-stage capital is particularly important because the path from initial defence-related research funding to scaled procurement remains difficult. In the United States, many startups first access the defence market through the Small Business Innovation Research (SBIR) program, which provides early non-dilutive funding for research and prototype development. But very few companies progress from those initial awards to larger commercialization contracts or formal procurement programs with recurring government funding. Over the last decade, only 16 percent of Department of Defense SBIR-funded companies reached Phase III, the stage associated with commercialization, and fewer than 1 percent of Phase I awardees ultimately achieved Program of Record status, meaning their product was adopted into an officially funded long term procurement pathway.[3]

As a result, capital is no longer confined to companies already embedded within procurement programs but is increasingly directed toward earlier-stage firms shaping the future defence innovation pipeline. In parallel, large defence contractors are increasingly partnering with or acquiring earlier-stage companies to access innovation more quickly, further reinforcing the role of private capital at earlier stages of the development cycle.

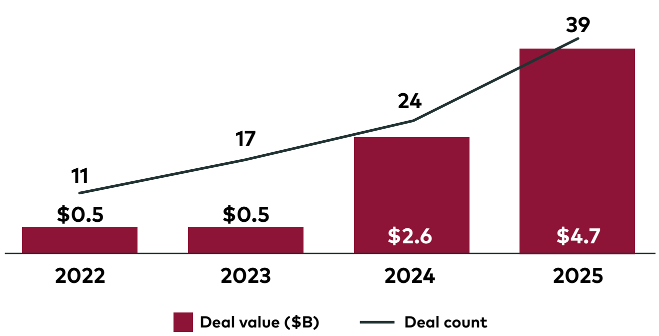
III. Spending Is Shifting Toward Production and the Industrial Base

The composition of defence spending is becoming as important as the scale of spending itself. As modernization programs move from planning to implementation, a larger share of capital is being directed toward equipment, production capacity and industrial readiness. Canada's defence spending trajectory indicates that the share of expenditures allocated to equipment procurement is expected to increase materially as modernization programs move from planning to implementation. In some cases, estimates suggest procurement could increase from approximately 19 percent to as much as 35 percent of total defence spending over time.[4]

More broadly, similar trends are visible across North Atlantic Treaty Organization (NATO) economies, where governments are placing greater emphasis on production, manufacturing capacity and supply chain resilience. This shift is evident in efforts to expand munitions production capacity and rebuild domestic manufacturing capabilities across North America and Europe in response to supply constraints exposed by recent conflicts.[5]

The market is also placing greater emphasis on industrial execution. Manufacturing-focused defence investment in the United States rose from roughly US$0.5 billion annually in 2022 and 2023 to US$2.6 billion in 2024 and US$4.7 billion across 39 deals in 2025, underscoring that production capacity has become a central investment theme rather than a later-stage consideration.[6]

Defense tech manufacturing VC deal activity in scaleups



Source: Pitchbook • Geography: US • As of January 5, 2026

These developments extend the impact of defence spending beyond prime contractors to a broader set of companies involved in manufacturing, components, logistics and supply chain infrastructure. Production investment is structurally harder to unwind than research and development: once governments commit to manufacturing capacity and industrial infrastructure, the demand it generates spans multiple budget cycles.

IV. A Large Share of Defence Spending Remains Unallocated

A defining feature of the current defence investment cycle is the extent to which planned spending has yet to be deployed.

In Canada, a substantial portion of new platform spending remains uncontracted, with estimates indicating that as much as 85 percent of planned spending has not yet been allocated.[4]

This reflects the lag between policy commitments and procurement execution, as governments move from planning to implementation across large-scale modernization programs. Major procurement initiatives in areas such as air defence, naval systems and advanced communications infrastructure remain in early stages, with contract awards expected to be phased over time.[4]

This unallocated spending represents funded but not yet priced demand. Programs are defined and budgets are committed, but contract awards are expected to be phased over multiple years. For investors, this provides unusual forward visibility into both the shape and scale of capital deployment.

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V. Procurement Reform is Expanding Access Across the Ecosystem

Changes in procurement frameworks are reinforcing these capital dynamics by enabling greater participation from non-traditional vendors.

Historically, defence acquisition processes were structured around long development cycles and large contracts awarded to a limited number of established suppliers. As commercial technologies have become more central to national security, governments have begun adapting procurement models to better integrate smaller companies and emerging technologies.

In Canada, the establishment of the Defence Investment Agency is intended to accelerate high-priority procurements and centralize acquisition efforts.[7] In the United States, acquisition reforms have focused on reducing procurement timelines and expanding access for non-traditional vendors, particularly in areas such as software, autonomy and advanced systems.[8]

The result is a procurement environment that allows capital to reach a wider range of companies than was possible under traditional acquisition frameworks.

VI. Why the Current Defence Investment Cycle is Durable and Investable

Taken together, these developments point to a defence investment cycle supported by multiple reinforcing dynamics.

Government spending commitments are increasingly embedded in multi-year policy frameworks rather than appropriations alone. In Canada, defence expenditures are expected to become one of the largest components of federal spending over the next decade, representing a structural reallocation rather than a temporary increase.[9]

At the same time, a significant portion of approved capital has not yet been deployed. The gap between committed and contracted spending creates a sustained forward pipeline, with major program awards expected to be phased across several years.

For investors, this provides greater visibility into the likely direction and timing of deployment.

The composition of that spending is also shifting. As governments place greater emphasis on procurement, production capacity and industrial readiness, the opportunity set is broadening beyond traditional contractors to include a wider range of manufacturing, supply chain and technology participants. Because these investments are tied to industrial buildout rather than short-term research spending, they are also structurally harder to unwind once committed.

Capital is also entering the sector earlier. Investment is moving upstream of formal procurement toward companies developing emerging capabilities and building industrial capacity. That extends both the timeline of investment activity and the range of participants able to benefit from it.

For investors, the implication is clear. Capital is no longer concentrated among a small number of contractors, but is transmitted across a wider ecosystem of technology, industrial and supply chain participants. This expansion of the investable universe is a defining feature of the current investment cycle and underpins the durability of the opportunity.

VII. Conclusion

The evidence across government budgets, private investment flows and procurement frameworks points to the same conclusion: capital is flowing into defence at scale, and the structural conditions supporting this cycle are unlikely to reverse in the near term.

Capital is no longer channelled through a small number of established contractors. It is moving through a broader and more fragmented set of companies, spanning stages of development, industrial subsectors and forms of capital. That breadth is what makes the opportunity durable. It is also what makes exposure to it less straightforward.

Endnotes

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