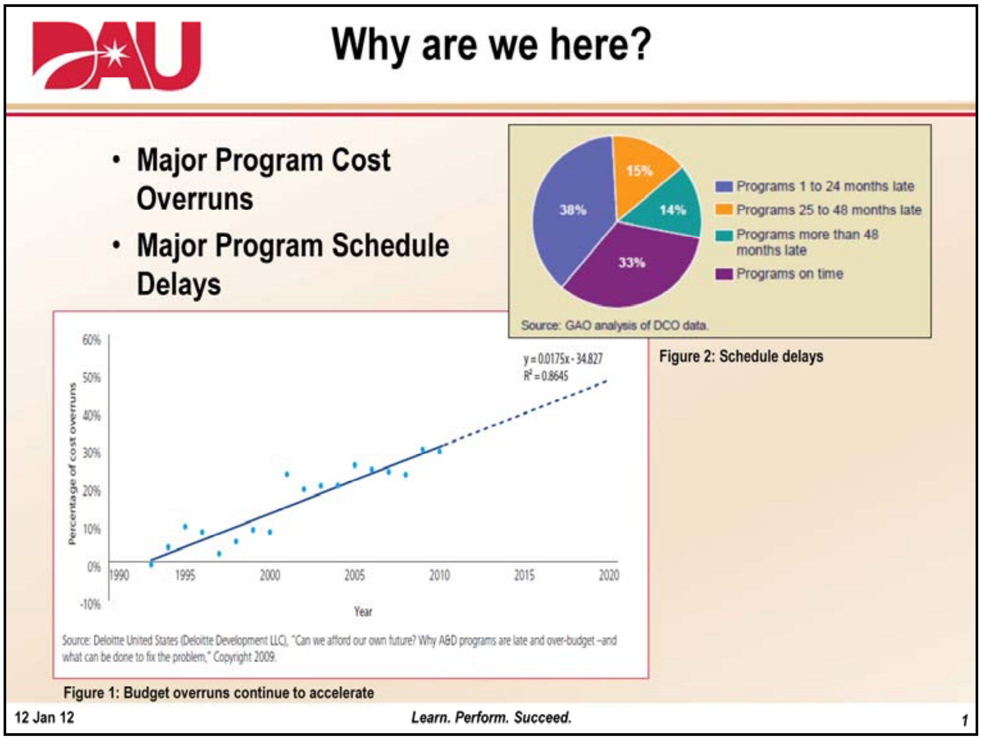
Defense Acquisition University

USD (AT&L) Better Buying Power Initiative:

Incentivize Productivity & Innovation in Industry
Reward Contractors for Successful Supply Chain and Indirect Expense Management

Better Buying Power Gateway: https://dap.dau.mil/leadership/Pages/bbp.aspx
Better Buying Power Community of Practice: https://acc.dau.mil/CommunityBrowser.aspx?id=432727

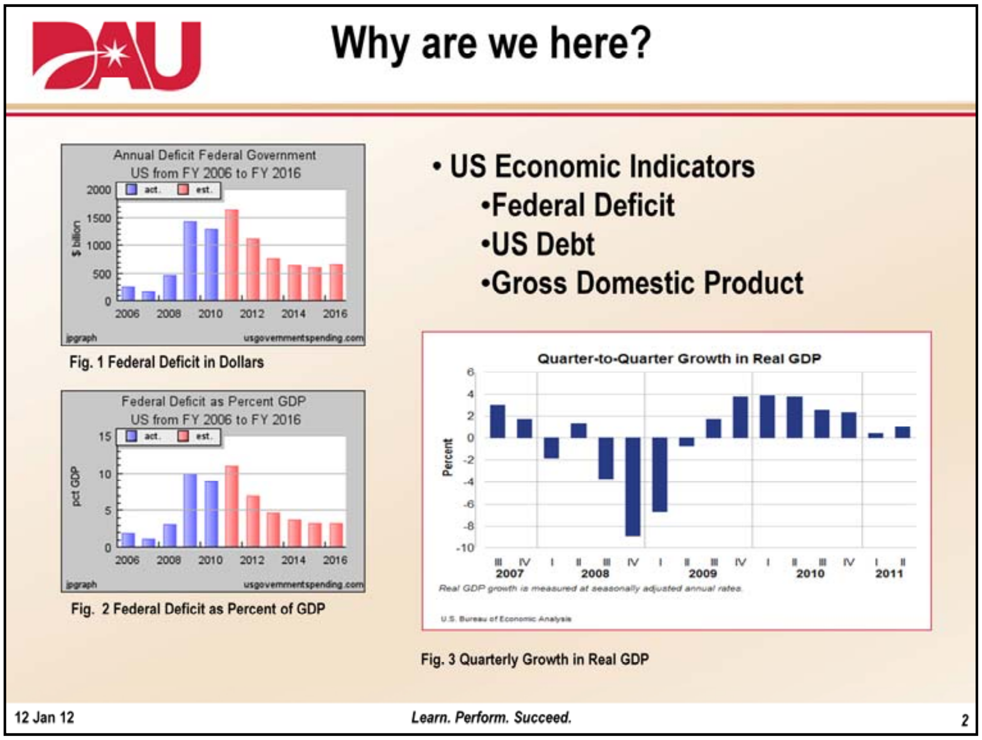
MA Brief 8-25-2011



-Over the course of the last 15-20 years major DoD programs have a consistent track record of cost and schedule delays. This has made the prospect of successfully developing and producing new DoD systems very daunting, as we contemplate moving into reduced budgets in the coming years.

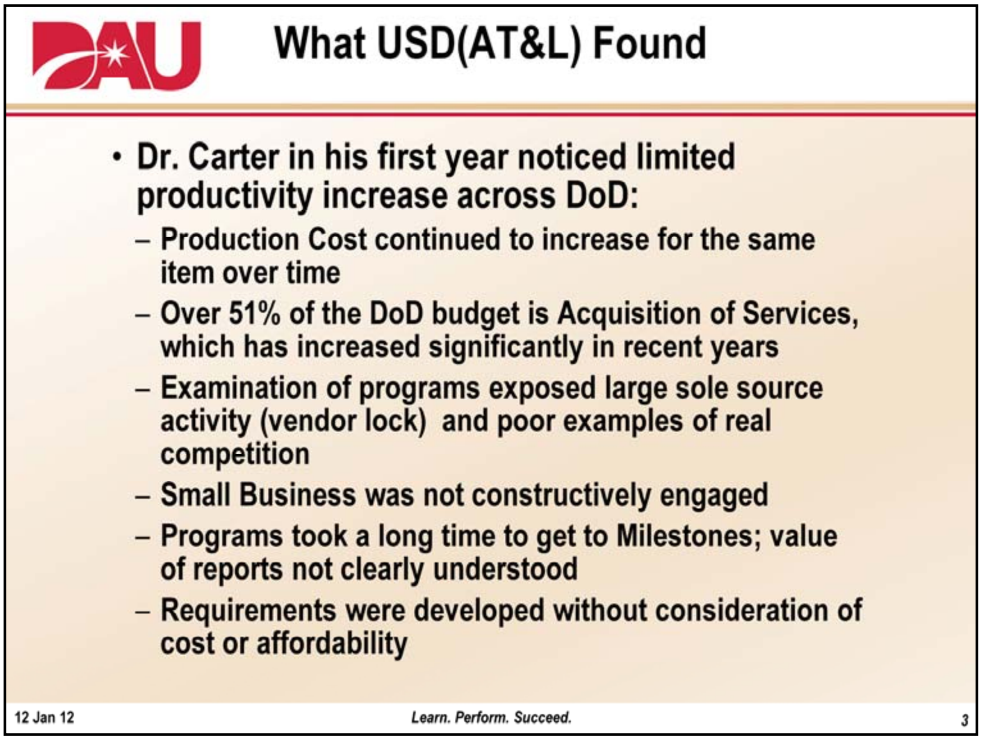
- In order to change the current trend a major change in business practices is required.

- The Better Buy Power effort provides a set of proven business practices that are intended to improve DoD's system and services acquisitions.



Real gross domestic product -- the output of goods and services produced by labor and property located in the United States.

These economic factors and other are creating pressure on the DoD budget, by reducing the amount of funds available for DoD to acquire products and services.



All of these key factors need to be talked about separately., and map them to the different parts of the BP, see page 6.

•Production Cost continued to increase for the same item over time *(Target Affordability and Control Cost Growth)*

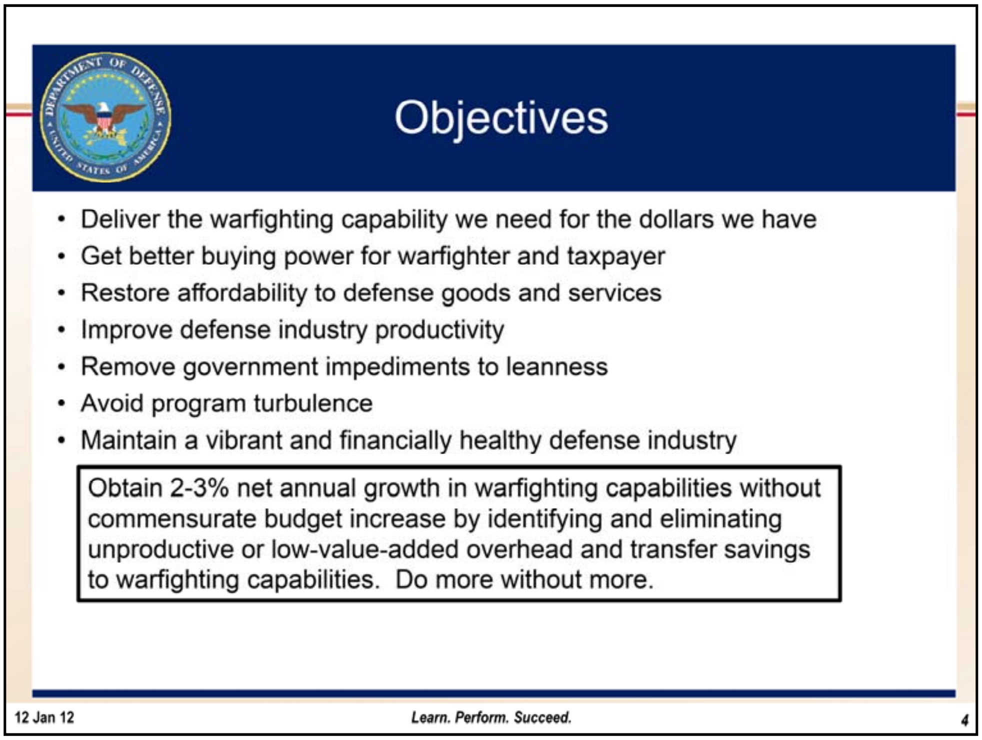
•Over 51% of the DoD budget is Acquisition of Services (*Improve Tradecraft in Acquisition of Services)*

•Examination of programs exposed large sole source activity (vendor lock) and poor examples of real competition *(Promote Real Competition)*

•Small Business was not constructively engaged *(Promote Real Competition)*

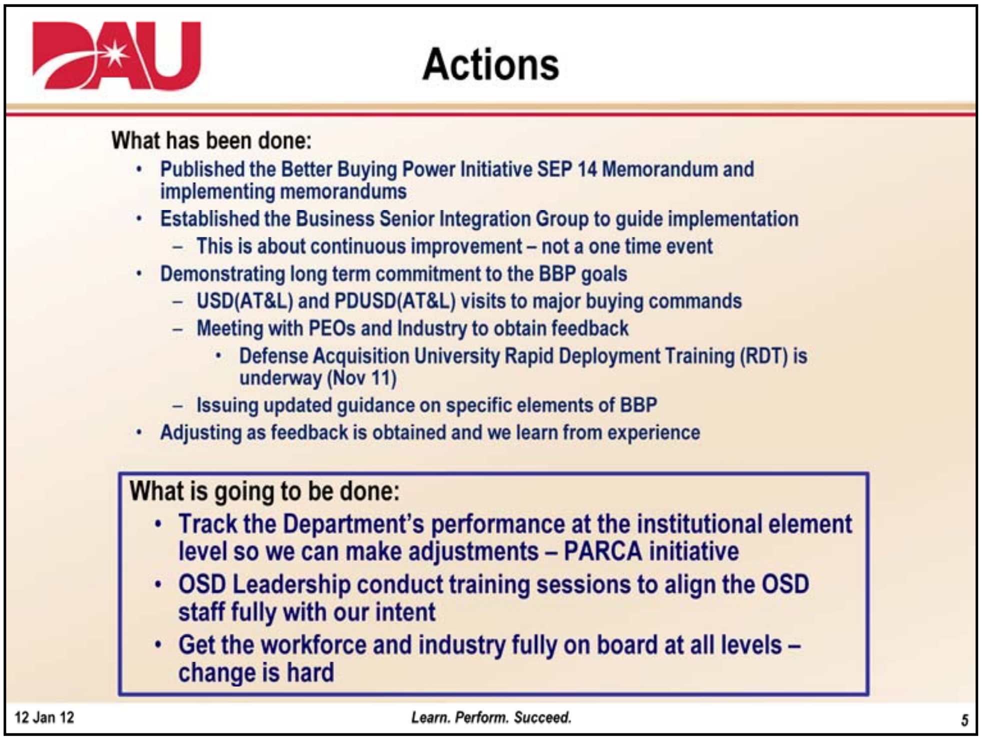
•Programs took a long time to get to Milestones; value of reports not clearly understood *(Reduce Non-Productive Processes and Bureaucracy)*

•Requirements were developed without consideration of cost or affordability *(Reduce Non-Productive Processes and Bureaucracy)*



These best practices will make the DoD better customers and better businessmen / women in developing our capabilities and incentivizing our suppliers

The BBPi is all about "returning to our roots", revisiting proven practices that have real ability to reduce the costs of our products and services, thus allowing us, as government acquisition professionals, to deliver capability to the user / warfighter more efficiently.



Each program and each acquisition professional is enabled to implement these business practices in their programs.

Guidance Roadmap

Target Affordability and Control Cost Growth

- Mandate affordability as a requirement
- Implement "should cost" based management
- * ARA memo 12 Dec 2011 – Should-Cost Templates
- * AT&L memo 24 Aug 2011 – Should-Cost and Affordability
  - * AT&L memo 22 Apr 2011 – Will Cost/Should Cost
  - * USA SAAL_ZR memo 10 June – Army Implementation of USD (AT&L Affordability Initiatives
  - * USAF memo 15 June 2011 – Implementation of Will-Cost and Should Cost Management
  - * SECNAV ASN-RDA memo 19 July2011 – Implementation of Should Cost Management
- Eliminate redundancy within warfighter portfolios
- Achieve Stable and economical production rates
- Manage program timelines

Incentivize Productivity & Innovation in Industry

- Reward contractors for successful supply chain and indirect expense management
- Increase Use of FPIF contract type
- Capitalize on progress payment structures
  - * DPAP memo 27 April 2011 – Cash Flow Models
- Institute a superior supplier incentive program
- Reinvigorate industry's independent research and development

Reduce Non-Productive Processes and Bureaucracy

- * PDUSD AT&L memo 14 Sept 2011 – Document Streamlining-Life-cycle Sustainment Plan
- * PDUSD AT&L memo 18 July 2011 – Document Streamlining-Program Protection Plan
- * PDUSD AT&L memo 23 June 2011 – Improving Milestone Process Effectiveness
- * PDUSD AT&L memo 20 April 2011 – Document Streamlining-Program Strategies and SEP
- Reduce frequency of OSD level reviews
  - * AT&L memo 11 May 2011 – Improving Technology Readiness Assessment Effectiveness
- Work with Congress to eliminate low value added statutory requirements
- Reduce the volume and cost of Congressional Reports
- Reduce non-value added requirements imposed on industry
- Align DCMA and DCAA processes to ensure work is complementary
  - * DPAP memo 4 Jan 2010 – Align DCMA and DCAA
- Increase use of Forward Pricing Rate Recommendations (FPRRs) to reduce administrative costs
  - * DPAP memo 4 Jan 2010 – Align DCMA and DCAA

Promote Real Competition

- Emphasize competitive strategy at each program milestone
- Remove obstacles to competition
  - Allow reasonable time to bid
  - *DPAP memo 27 April 2011/24 Nov 2010 –Improving Competition
  - Require non-certified cost and pricing data on single offers
  - Enforce open system architectures and set rules for acquisition of technical data rights
- Increase small business role and opportunities (OSD OSA Contract Guidebook for PMs)
  - *DPAP memo 14 Jul y 2011 Use Government –wide Acquisition Contracts Set Aside Exclusively for Small Business
  - *DPAP memo 27 June 2011 Increase Dynamic Business Roles in the Defense Marketplace

Improve Tradecraft in Acquisition of Services

- Assign senior managers for acquisition of services
  - *Senior Manager's appointed similar to AF PEO (Army Nov 2010/Navy Jun 2011)
- Adopt uniform services market segmentation (taxonomy)
  - * DPAP memo 23 Nov 2010 – Taxonomy for Acquisition of Services
- Address causes of poor tradecraft
  - Define requirements and prevent creep
  - Conduct market research
- Increase small business participation
  - * DPAP memo 14 Jul y 2011 Use Government –wide Acquisition Contracts Set Aside Exclusively for Small Business

Related Memos/DTMs:

* AT&L memo 6 Dec 2011– Value Engineering (VE) and Obtaining greater Efficiency & Productivity in Defense Spending
* PDUSD AT&L memo 19 July 2011– Roles & Responsibilities of the OSD OIPT Leaders, Teams and Team members
* AT&L memo 23 June2011– DTM 11-009 – Acquisition Policy for Defense Business Systems
* AT&L memo 21 March 2011– DTM 11-003 – Reliability Analysis, Planning, Tracking and Reporting
* PDUSD AT&L memo 24 Feb 2011– Expected Business Practice: Post Critical Design Review Reports and Assessments
* OMB memo 2 Feb 2011 – "Myth Busting"; Addressing Misconceptions to Improve Communications with Industry during the Acquisition Process

Reward contractors for successful supply chain and indirect expense management

Yet managers who run into a problem in program execution generally cannot easily compromise requirements and face an uphill battle to obtain more than their budgeted level of funding. The frequent result is a stretch in the schedule.

An example of the importance of addressing schedule directly as an independent variable is the Army's GCV. An initial acquisition plan had this program taking approximately 10 years to complete a first production vehicle, typical of the normal leisurely pace of programs. (In contrast, the MRAP-ATV began in 2009 and delivered more than 5,700 vehicles to Afghanistan by August 2010.) Given the large investment in ground vehicle technology made in the cancelled Future Combat Systems (FCS) program, there was no need to take this much time, especially if the basic requirements were limited to those essential to an infantry fighting vehicle

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MEMORANDUM FOR ACQUISITION PROFESSIONALS

SUBJECT: Better Buying Power: Guidance for Obtaining Greater Effic
Defense Spending

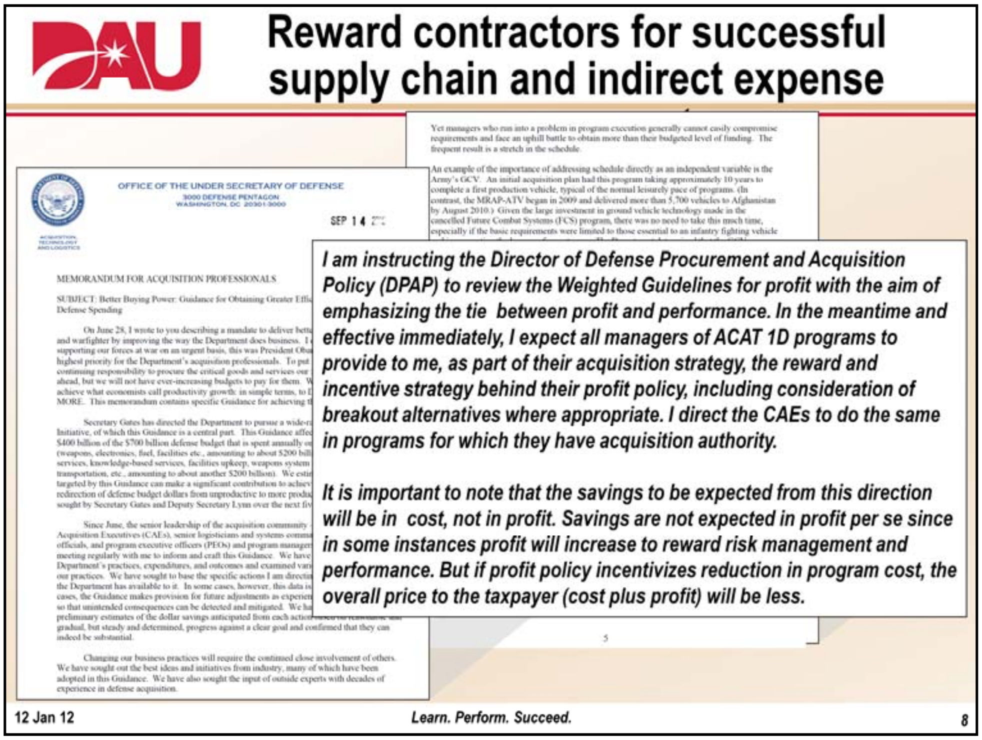
On June 28, I wrote to you describing a mandate to deliver bett
and warfighter by improving the way the Department does business. I
supporting our forces at war on an urgent basis, this was President Oba
highest priority for the Department's acquisition professionals. To put
continuing responsibility to procure the critical goods and services our
ahead, but we will not have ever-increasing budgets to pay for them. W
achieve what economists call productivity growth: in simple terms, to D
MORE. This memorandum contains specific Guidance for achieving t

Secretary Gates has directed the Department to pursue a wide-r
Initiative, of which this Guidance is a central part. This Guidance affec
$400 billion of the $700 billion defense budget that is spent annually o
(weapons, electronics, fuel, facilities etc., amounting to about $200 bill
services, knowledge-based services, facilities upkeep, weapons system
transportation, etc., amounting to about another $200 billion). We esti
targeted by this Guidance can make a significant contribution to achiev
redirection of defense budget dollars from unproductive to more produ
sought by Secretary Gates and Deputy Secretary Lynn over the next fiv

Since June, the senior leadership of the acquisition community
Acquisition Executives (CAEs), senior logisticians and systems comma
officials, and program executive officers (PEOs) and program manager
meeting regularly with me to inform and craft this Guidance. We have
Department's practices, expenditures, and outcomes and examined vari
our practices. We have sought to base the specific actions I am directi
the Department has available to it. In some cases, however, this data is
cases, the Guidance makes provision for future adjustments as experien
so that unintended consequences can be detected and mitigated. We ha
preliminary estimates of the dollar savings anticipated from each action
gradual, but steady and determined, progress against a clear goal and c
indeed be substantial.

Changing our business practices will require the continued clos
We have sought out the best ideas and initiatives from industry, many of which have been adopted in this Guidance. We have also sought the input of outside experts with decades of experience in defense acquisition.

<u>Reward contractors for successful supply chain and indirect expense management</u>.
The Department pays profit/fee to prime contractors on work they conduct themselves, work subcontracted by the prime contractor to subcontractors, and allowable overhead and administrative costs. All three are appropriate, but in each instance the level of profit should be calculated to reward performance. Profit on subcontracted work is meant to compensate the prime for taking on the burden of managing subcontractor risk and delivering subcontractor value. Otherwise, the government would have to manage the subcontractor itself (an alternative called "breakout"). It follows that higher profit should be awarded to management of higher-risk subcontracts, and higher profit should be given when the prime succeeds in driving down subcontractor costs every year. Likewise, profit on overhead should incentivize control of overhead cost. There is evidence, however, that blanket profit levels are set and, what is more, are not revisited periodically in light of actual performance. This should be done as a matter of course. Additionally, incentives have not kept pace with fundamental changes in the defense industrial environment, among them the growth of services contracts and a shift in the role of prime contractors from manufacturers to integrators of components manufactured by subcontractors.

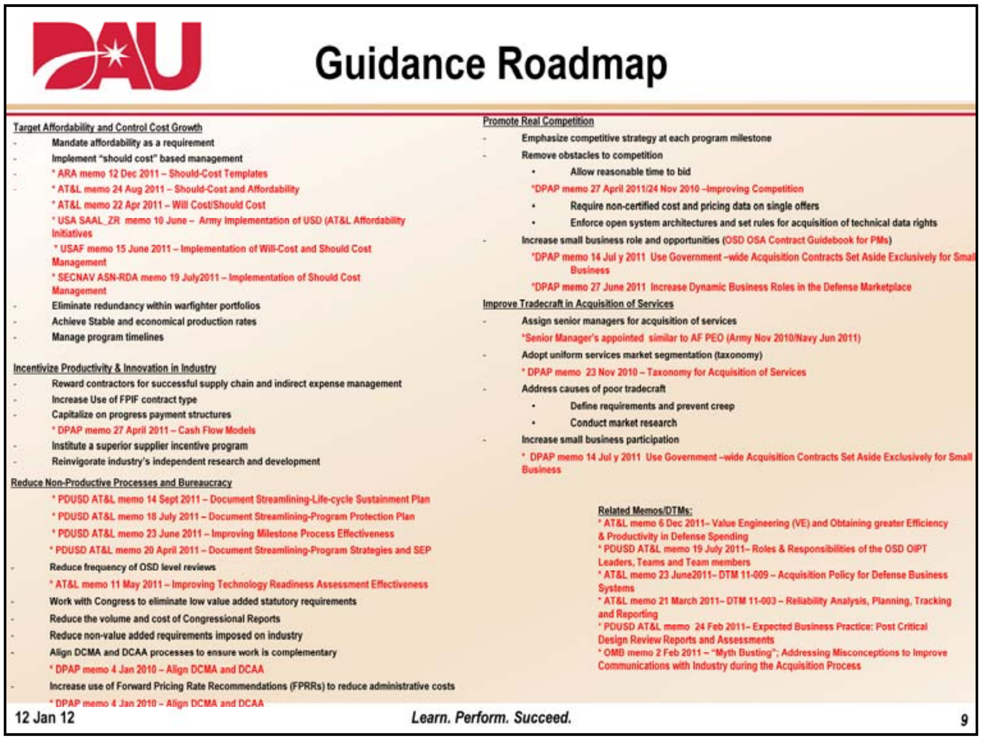


Important note is that the focus is on lowering cost, not on lowering profit. It is OK to pay more in profit in parallel with reducing overall cost!

- Cost reductions are not mandated in profit per se since in most instances profit should be used to incentivize /reward risk management and performance that reduces overall cost
- If profit policy is effectively used to incentivize reduction in program cost, the overall price to the taxpayer (cost plus profit) should be less
- Example: Using a 90/10 share ration, the numbers would work like this:
  - Using a share ratio, in this case the contractor could increase profit by 10% of any cost reductions:
  - (before cost reduction): 90 (C) + 10 (P) = 100 (TPC)
  - (after cost reduction): 80 (C) + 11 (P) = 91 (TPC)
    - Profit increases even with a total cost reduction

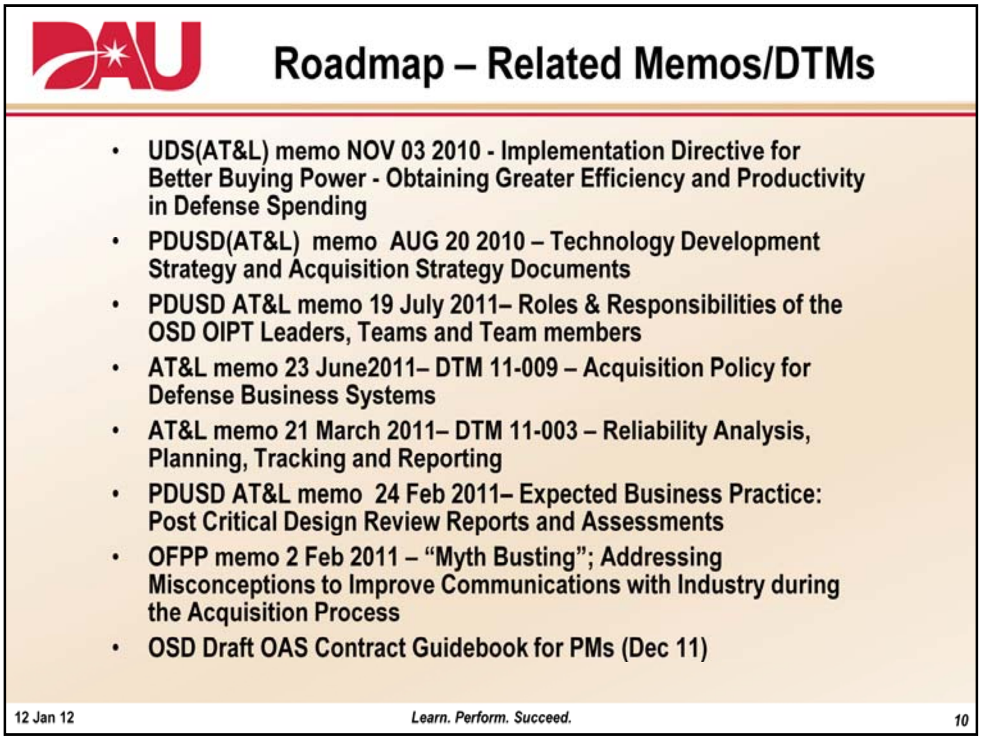
(C) – cost; (P) – profit; (TPC) – total program cost

- Need to identify ways to remove costs from programs – challenge the status quo
- Focus your use of incentives in schedule, technical and cost areas, tailored to your specific program, to achieve cost reduction
  - Review the full spectrum of available techniques - don't stick to what's been routinely done in the past



This is the same road map as the last chart with the specific guidance memos included for the different parts of the BBPi.

The instructor should review the different memos and policy guidance before the class. In addition each area has a specific DAU faculty who are responsible for coordinating training. A list of the key faculty is at the end of this briefing.



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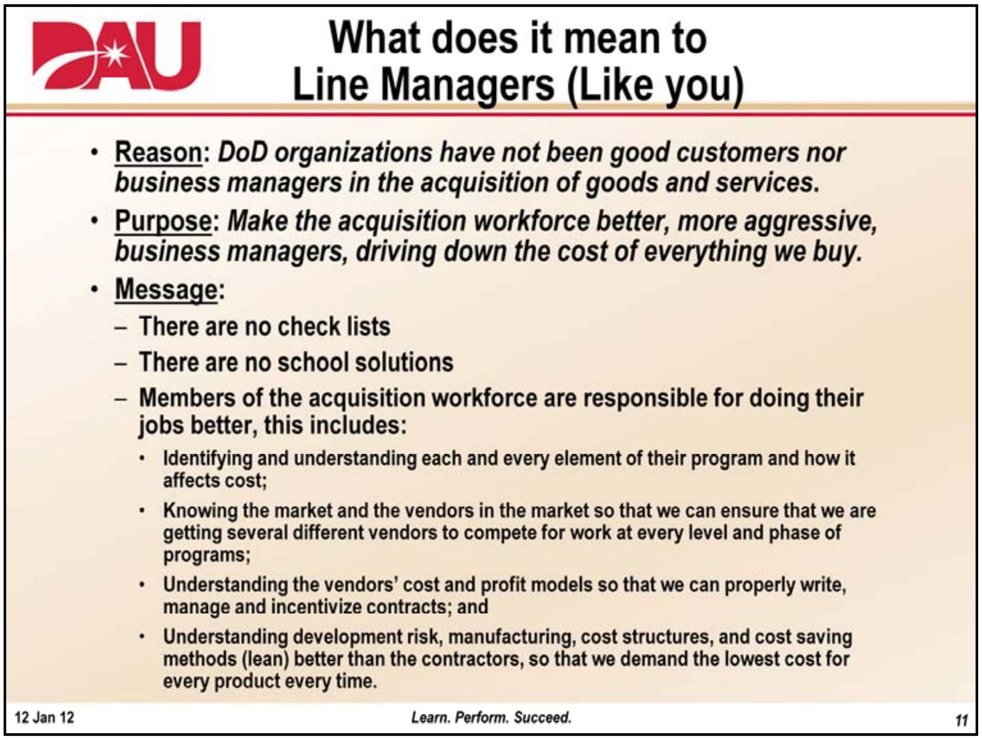
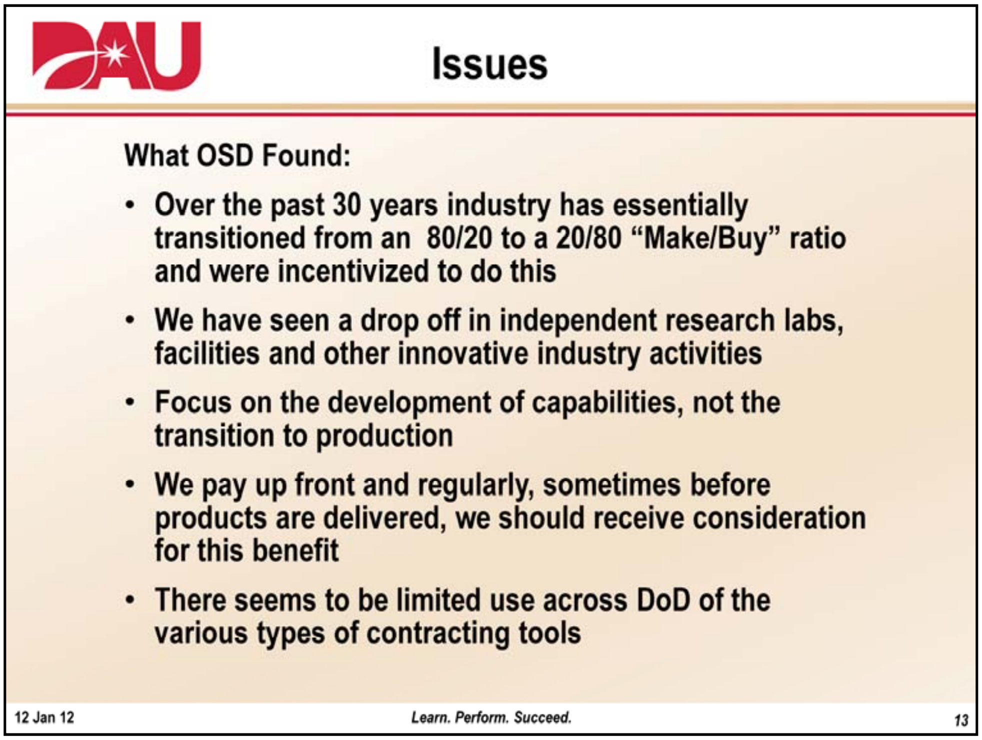


When you teach this, there are a number of issues meriting mention and discussion.

First this is not another management trend. This is an effort by the senior leadership to ensure that the acquisition workforce does their jobs better, by returning to proven practices that have controlled costs in the past.

So there are no school solutions. There are no check lists.   We as representatives of the US government need to use critical thinking to make better decisions when buying the systems and services we need, at the lowest practical cost to the government.

This chart is an agenda for the rest of the briefing..


DAU
Issues
What OSD Found:
• Over the past 30 years industry has essentially transitioned from an 80/20 to a 20/80 "Make/Buy" ratio and were incentivized to do this
• We have seen a drop off in independent research labs, facilities and other innovative industry activities
• Focus on the development of capabilities, not the transition to production
• We pay up front and regularly, sometimes before products are delivered, we should receive consideration for this benefit
• There seems to be limited use across DoD of the various types of contracting tools
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Issues

What OSD Found:

- Program costs have increased for the same products over subsequent production lots
- Appears to tie to incentive structures employed, which have not kept pace with fundamental changes in the defense industrial environment

The Results:

JUN 28 2010 USD(AT&L) memo

"This initiative should contribute to the continuing vitality and financial viability of the defense industry in the era ahead by aligning the direction and incentives of the Department and industry. It is intended to enhance and incentivize efficiency and total factor productivity. Most of the rest of the economy exhibits productivity growth, meaning that every year the buyer gets more for the same amount of money. So it should be in the defense economy."

-

One of the most important aspects of this part of the BBPi is the requirement to develop and document incentives for the contractors to reduce their overhead and supply chain costs.

These incentive plans will be documented in the program Acquisition Strategy. Consult the published template for the AS/TDS, along with the other required document templates emerging from BBP (all are available on the BBP Gateway, reachable from the Defense Acquisition Portal)

https://dap.dau.mil/

Supply chain management includes a wide range of different activities including the selection and management of subcontractors on major systems development.

In many cases the sub-contractors on a major program can have over 50% of the overall work and cost on a project. However the Government has no direct legal relationship with the sub-contractions and therefore limited ability to manage their work and their costs.

Subcontract Management

- DoD pays profit/fee to prime contractors on work subcontracted by the prime contractor to subcontractors.
- The level of profit should be calculated to reward performance. Profit on subcontracted work is meant to compensate the prime for taking on the burden of managing subcontractor risk and delivering subcontractor value.
- The alternative is for the Government to manage the subcontractor itself – Component Breakout.
- Higher profit should be awarded to management of higher-risk subcontracts, and higher profit should be given when the prime succeeds in driving down subcontractor costs every year.

Because of the importance of the supply chain, including sub –contractors, maintaining competition is critical. There are a number of different ways to insure competition in the way the prime manages their supply chain

First is to incentivize the prime to actively compete as much sub contractor work as possible, using cost sharing.

Second, provide provisions in the contracts to remove parts of the work from the prime (break out) when necessary so that the government can compete the work independent of the prime.

Breaking out work (parts of contracts) from the prime contractors is not a common practice in many parts of the DoD.

The ability to breakout work should be written into the contract from the start. After a contract is in progress the decision to breakout work from the prime needs to follow a well defined process.

After work is broken out from the prime the government can recompete the work and/or manage the work themselves.

What Happens When Competition is Appropriately Addressed

- Family of Medium Tactical Vehicles Competition: The Army awarded a competitive 5 year multiple year requirements contract to Oshkosh that resulted in an average cost savings of 28% over the previous sole source contract. The end result is a cost savings of an estimated $578 million over the contract period of performance.
- The JTRS Enterprise Business Model (EBM) is predicated upon fostering and leveraging competition in production. For the Multifunctional Distribution Information System – Low Volume Terminal (MIDS-LVT) radio program initial radios started at $426K per unit. Since then, through competition between the two approved vendor production sources, the radios have decreased steadily to a cost of only $181K per unit, a savings of nearly 60% on each radio. With over 2600 MIDS units purchased, the total savings is approximately $500 million.

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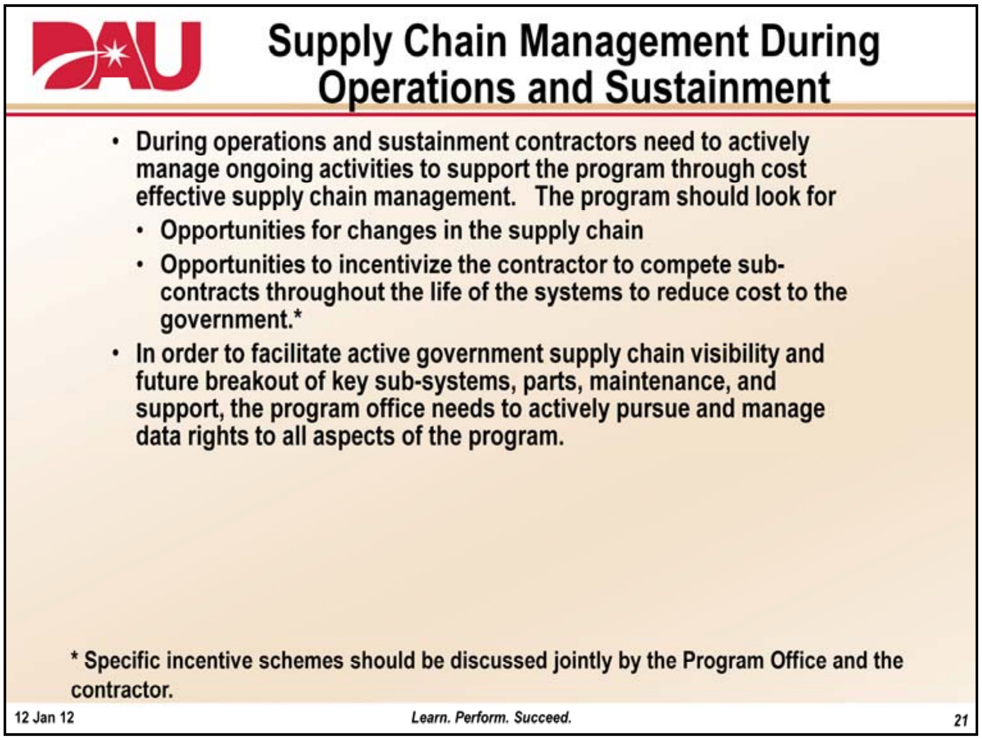
These are two specific example s of using competition to reduce the overall cost to the government of production contracts.

Managing all aspects of the supply chain is critically important to the success of any program.

Sometime it is difficult to get all the data that you need from prime contractors to get visibility into how the prime is managing the supply chain. DCMA is responsible for overseeing contract administration for awarded contracts - under the DFAR you can request and get information that you need to manage, or oversee management of, the supply chain if these requirements and deliverables are written into the contract.



After the system is fielded active management of the supply chain is still required. The majority of the overall system costs reside in the operation and sustainment of a system.

All parts of the sustainment effort including services should be recompeted as often as practical in order to reduce the overall cost to the government.

What Happens When Supply Chain and Indirect Expenses are Addressed

- Value of considering a breakout option is illustrated by results of a review of DDG-51 Destroyer costs
  - Review noted that the new cost for Restart Main Reduction Gears (MRG), previously subcontracted by two construction shipyards as Class Standard Equipment, was now more than three times the previous cost
  - Incumbent manufacturer exited the MRG market and sold its intellectual property to another firm
  - Prime passed on subcontractor's new bill to government without aggressive cost management
- PEO broke out the MRG from prime contract and conducted a full and open competition, which resulted in savings of over $400 million to the government for a lot buy of nine ship sets

Enforce Open Systems Architectures and Set Rules for Acquisition of Technical Data Rights

- **Enforce Open Systems Architectures**
  - Defense Acquisition Guidebook (DAG) requires an Open Systems Strategy Summary.
  - Not all programs are using open systems architecture, which adversely effects acquisition and sustainment costs and program affordability.
  - See Naval Open Architecture Contract Guidebook for Program Managers Version 2.0., and the DoD Draft OSA Contract Guidebook for PMs
- **Technical Data Rights**
  - A plan for acquisition of Data Rights is required in order to maximize the Government's ability to manage breakouts and competition.
  - Data Rights are expensive and complex.
  - Detailed analysis of Data Rights needs to be done before contract is finalized.
  - This analysis needs to include engineering and technical teams, as well as lawyers, contracting and cost estimating teams.

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Open System Architecture and Technical Data Rights are absolutely critical to the ability of the government to get the data we need to manage programs and recompete them to get the best value and lowest cost for the government.

Open architectures and data rights approaches should developed at the beginning of contract and can be used as a selection criteria.

These are complex technical, legal and contracting issue that require the program manager to use his whole team to insure that they are correctly formulated from the beginning of the program.

Indirect Expense Management

Indirect Expense Management

- DoD pays profit/fee to prime contractors on work they conduct themselves, work subcontracted by the prime contractor to subcontractors, and allowable overhead and administrative costs.
- All three are appropriate, but in each instance the level of profit should be calculated to reward performance.
- Profit on overhead should incentivize the prime contractor to control overhead cost as well as direct cost.
- Control Direct Costs when incentivizing Indirect Costs reductions
  - If not controlled, we will incentivize the contractor to shift costs from one cost category to another cost category without realizing any overall cost reductions

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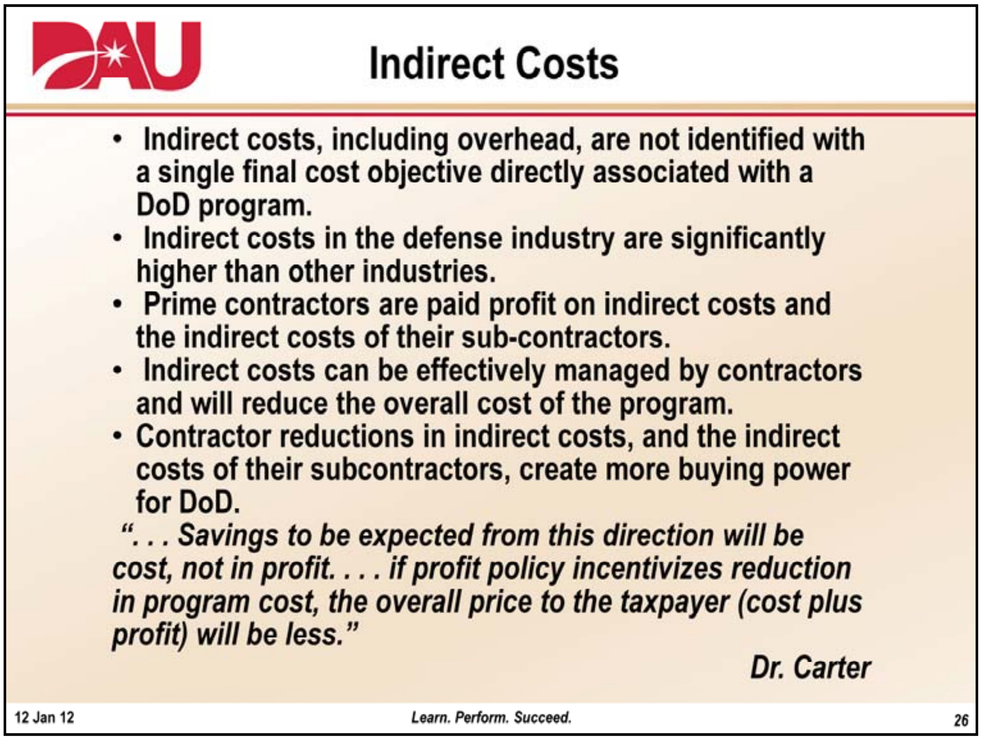
Because of the importance of the supply chain, including sub –contractors, maintaining competition is critical. There are a number of different ways to insure competition in the way the prime manages their supply chain

First, incentivize the prime to actively compete as much sub contractor work as possible using cost sharing.

Second, provide provisions in the contracts to remove parts of the work from the prime (break out) when necessary so that the government can compete the work independent of the prime.

Insure you also control Direct Costs when incentivizing a reduction in indirect Costs. If not controlled, we will incentivize “accounting changes” that actually will not reduce overall costs, but only shift costs from one cost category to another cost category.



Many government contractors measure success in terms of both revenue (the $ value of business) and profit.

The goal of better managing and reducing indirect cost is to reduce the total costs of programs and services to the government. Cost is the target here…not profit. If proper incentives are established , it is entirely possible that a reduction in overall cost may also result in an increase in contractor profit.

Reward Contractors for Successful Supply Chain and Indirect Expense Management

Actions ongoing or planned OSD/CAE:

- Incentivize prime to aggressively manage high-risk subcontracts.
- Incentivize prime/subcontractors to identify alternate supply chain paths, commencing during sustainment support strategy discussions.
- Profit / Fee incentives should focus on reducing areas of major cost ("heavy hitters"), in order to reduce overall cost
- Evaluate Supply Chain performance success during contract review.
- Require consideration of "Breakouts" when Government has option of managing subcontractor rather than relying on Prime to effect same.

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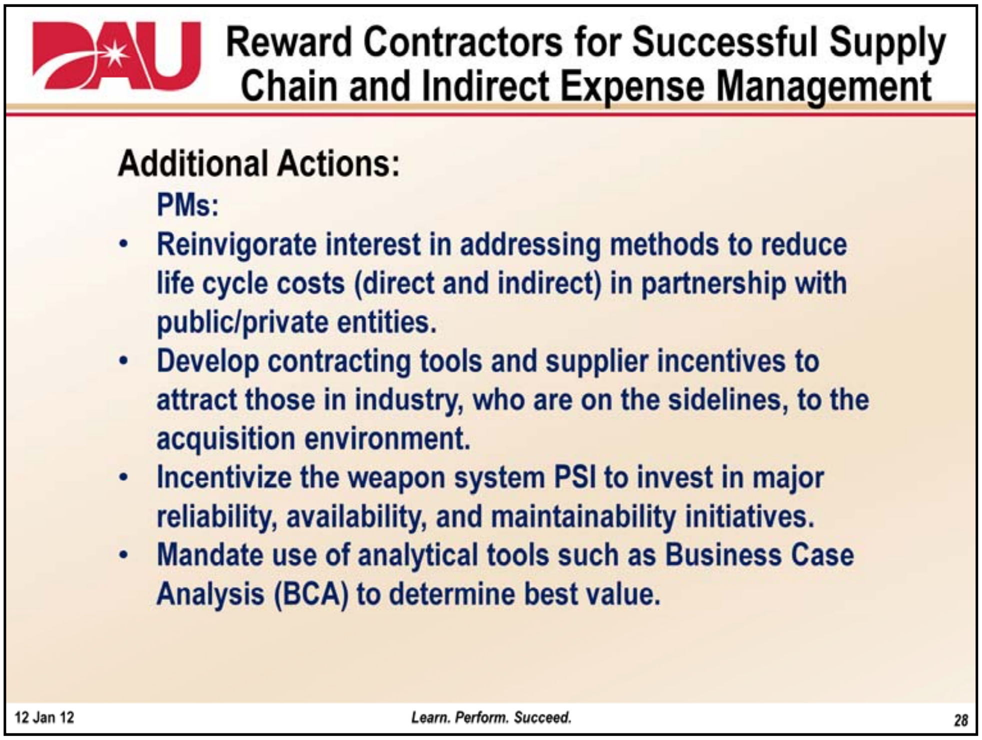
Our First Area is Reward contractors for successful supply chain and indirect expense management

• Incentivize prime to aggressively manage high-risk subcontract, and higher profit will be given when prime succeeds in driving down subcontractor costs every year
• Profit levels should be reexamined each time a procurement is planned (including follow on procurements).
• Overhead: Included in this category are indirect labor costs (such as management, quality control, material handling), facility rent and utilities, depreciation, training not directly billable to a specific contract, travel for non-contract activities, morale and welfare. These costs are reflected in the overhead rate.
• Take the time to investigate and understand what cost elements are contained in overhead, and are they reasonable? If not., challenge their continuation in the contract
• Smaller overhead does not always equate to higher efficiency. Evaluate each situation on its specific merits/demerits
  •You should be able to calculate an accurate overhead rate for any of your contracts…if you cannot, you need to learn how to do so

• Although certain expenses may be chargeable to overhead, most companies constantly work to minimize these costs to keep their rates competitive in the marketplace

• Additionally, the components of overhead and the way costs are collected and grouped can vary by company. For example, in one company, contracting officers and supply chain personnel may be handled as indirect labor (overhead), while in another the same people are direct (base labor). This may be a way to find savings.
• Buying outcomes instead of parts or man hours means reducing costs, decreasing cycle times, improving performance and accurately predicting demand.
• Properly structured, Matl Availability results in, Logistics Response Time decreases, depot efficiency increases. A shorter Repair Turn Around Time, less time spent Awaiting Parts, Work in Process, Mean Time Between failures (all improve).
• All managers of ACAT ID programs are now required to provide USD/ATL, as part of their acquisition strategy, the reward and incentive strategy behind their profit policy, including consideration of breakout alternatives where appropriate
• CAEs have been directed to do the same in programs for which they have acquisition authority



- "Pay for performance" contracts motivate vendors to reduce failures/consumption.

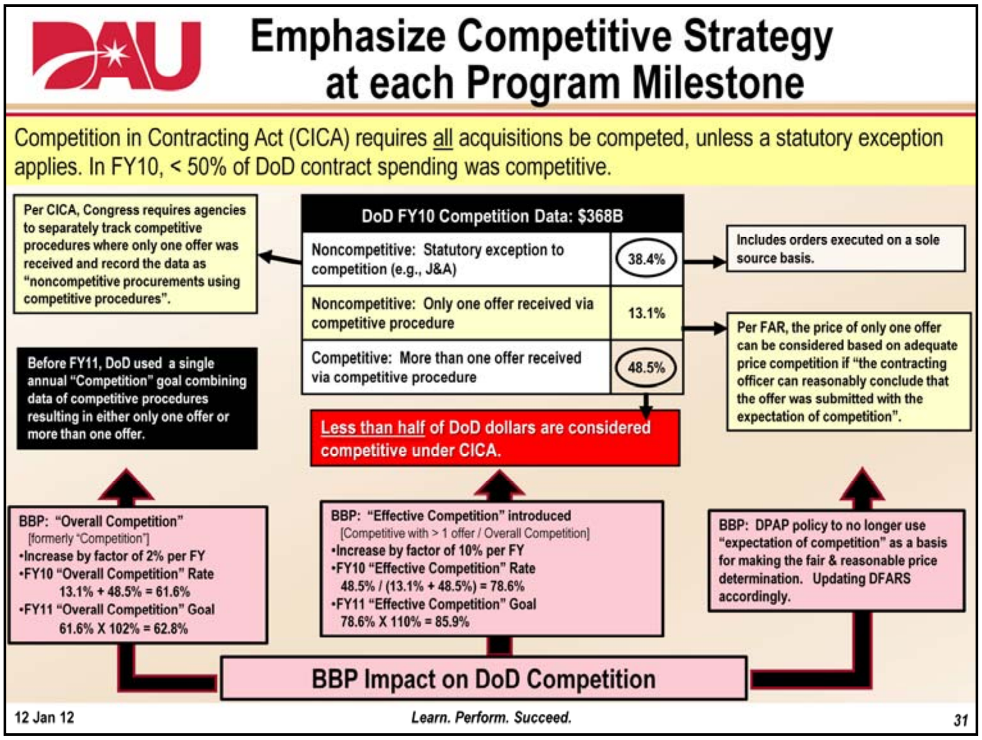
Reward Contractors for Successful Supply Chain and Indirect Expense Management

Additional Actions Continued:

Milestone Decision Authority:

- Require PMs to comment on non-use of performance based strategies and address /discuss at Milestone Reviews
- Encourage multiple award contracts that allow future competitions at the task level among qualified suppliers.
- Objective is to robustly compete among a large group of qualified providers, to reduce costs and maximize other competitive benefit

All the different parts of the BBPi are interrelated and support each other. The following slides provide additional information on the competition part of BBPi that, if properly executed, will support supply chain management.



DAU
Emphasize Competitive Strategy at each Program Milestone
Competition in Contracting Act (CICA) requires all acquisitions be competed, unless a statutory exception applies. In FY10, < 50% of DoD contract spending was competitive.
Per CICA, Congress requires agencies to separately track competitive procedures where only one offer was received and record the data as "noncompetitive procurements using competitive procedures".
DoD FY10 Competition Data: $368B
Noncompetitive: Statutory exception to competition (e.g., J&A)
38.4%
Noncompetitive: Only one offer received via competitive procedure
13.1%
Competitive: More than one offer received via competitive procedure
48.5%
Includes orders executed on a sole source basis.
Per FAR, the price of only one offer can be considered based on adequate price competition if "the contracting officer can reasonably conclude that the offer was submitted with the expectation of competition".
Before FY11, DoD used a single annual "Competition" goal combining data of competitive procedures resulting in either only one offer or more than one offer.
Less than half of DoD dollars are considered competitive under CICA.
BBP: "Overall Competition"
[formerly "Competition"]
•Increase by factor of 2% per FY
•FY10 "Overall Competition" Rate
13.1% + 48.5% = 61.6%
•FY11 "Overall Competition" Goal
61.6% X 102% = 62.8%
BBP: "Effective Competition" introduced
[Competitive with > 1 offer / Overall Competition]
•Increase by factor of 10% per FY
•FY10 "Effective Competition" Rate
48.5% / (13.1% + 48.5%) = 78.6%
•FY11 "Effective Competition" Goal
78.6% X 110% = 85.9%
BBP: DPAP policy to no longer use "expectation of competition" as a basis for making the fair & reasonable price determination. Updating DFARS accordingly.
BBP Impact on DoD Competition
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Emphasize Competitive Strategy at each Program Milestone

SEP 14 2010 USD(AT&L) memo directed a review DoDI 5000.02 documentation required to support the acquisition process. On April 20, 2011, PDUSD(AT&L) issued a streamlined, annotated outline for the Technology Development Strategy/Acquisition Strategy (TDS/AS):

"Competition Strategy. Explain how a competitive environment will be sought, promoted and sustained throughout all program phases."

- Program Managers should have a competitive strategy even if classic head-to-head competition does not exist
- What a Competitive Strategy should emphasize:
  - Related program serve as partial substitute for program
  - A plan to regain competition in an unproductive sole source situation
  - Breakout of subcontract work
  - Adapting commercial products

TDS/AS Template: https://dap.dau.mil/leadership/pages/bbppolicy.aspx

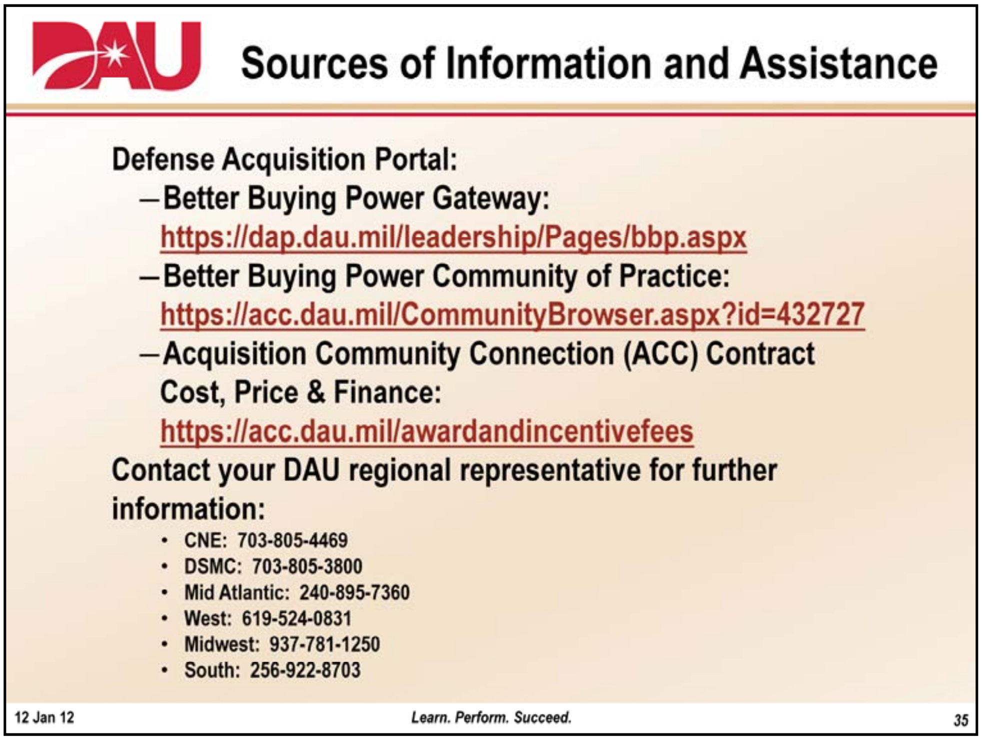
Additional Resources

DAU Courses

Logistics: LOG 340 (Life Cycle Product Support)
Contracting: CON 232 (Overhead Rates)

Improving Tradecraft Thrust Area:
ACQ 265 (Mission Focused services)

Continuous Learning:
- CLL011 Performance Based Logistics
- CLC 056 Analyzing Contract Costs
- CLC 014 Analyzing Profit and Fee



For additional information, consult the Defense Acquisition Portal for the latest guidance. Address requests for assistance to your regional representative.