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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

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MEMORANDUM FOR ACQUISITION PROFESSIONALS

SUBJECT: Better Buying Power: Mandate for Restoring Affordability and Productivity in Defense Spending

I have written to you previously to emphasize, with President Obama and Secretary Gates, that your highest priority is to support our forces at war on an urgent basis. Over the last year, the Department has also worked to reform its acquisition system, including implementing the Weapon Systems Acquisition Reform Act. Today I write to give direction on another important priority: delivering better value to the taxpayer and improving the way the Department does business.

We are a nation at war, and the Department does not expect the defense budget to decline. At the same time, we will not enjoy the large rate of growth we experienced during the years after September 11, 2001. We must therefore abandon inefficient practices accumulated in a period of budget growth and learn to manage defense dollars in a manner that is, to quote Secretary Gates at his May 8, 2010 speech at the Eisenhower Library, "respectful of the American taxpayer at a time of economic and fiscal distress."

This reality, combined with a determination to take care of our service members and avoid major changes in force structure, has led the Secretary and Deputy Secretary to launch an efficiencies initiative in the Department. The initiative requires the Department to reduce funding devoted to unneeded or low-priority overhead, and to transfer these funds to force structure and modernization so that funding for these warfighting capabilities grows at approximately three percent annually. This is the rate of growth needed historically to continue to give the troops what they need.

Some of these savings can be found by eliminating unneeded programs and activities; and, indeed, the Department's leadership has already taken strong action in this area and will need to do more. But other savings can be found within programs and activities we do need, by conducting them more efficiently. Deputy Secretary Lynn expects that two-thirds of the savings transferred to warfighting accounts should come about this way. Pursuing this kind of efficiency is the purpose of my message today to the Department's acquisition professionals. We need to restore affordability to our programs and activities. I would like

us to embark upon a process today to identify and then act on steps we can take to obtain two to three percent net annual growth in warfighting capabilities without incurring a commensurate budget increase by identifying and eliminating unproductive or low-value-added overhead; in effect, doing more without more.

The Department is spending approximately $700 billion per year for our nation's defense. Approximately $300 billion of those funds are spent within the Department's walls – on the salaries and benefits of military personnel and civilian employees, and on the buildings and facilities within which they work. But the remainder – $400 billion – is spent on contracts issued to entities outside of the Department of Defense. This $400 billion is divided about equally between products (e.g., weapons, electronics, fuel, and facilities) and services (e.g., IT services, knowledge-based services, facilities upkeep, and transportation). We, the Department's acquisition officials, agree to these contracts on behalf of the taxpayer. Each of these contracts contains a statement of the services or products it is procuring; an arrangement between the government and the contractor for how the costs of those items will be paid; and the overheads, indirect charges, and fees that complete the business transaction and make it possible for the defense industry to be economically viable.

The guidance memorandum I plan to issue will require each of you, as you craft and execute the Department's contracts in coming years, to scrutinize these terms to ensure that they do not contain inefficiencies or unneeded overhead. The guidance will give you specific features to examine and targets to hit in the pursuit of greater efficiency. The guidance will focus on getting better outcomes, not on our bureaucratic structures. But it must also take note of where the government's processes and regulations contribute to inefficiency in our business relationships.

Today I want to share with you the preliminary outlines of this guidance, so that I can have the benefit of your experience and perspective before I issue it in final form. I am also asking our partners in industry for their thoughts and input. I am also sharing these plans with the Congress. A process of analysis and dialogue is necessary to make sure our actions are effective and soundly based.

I want to emphasize two points about this initiative:

First, the savings we are seeking will not be found overnight. It has taken years for excessive costs and unproductive overhead to creep into our business processes, and it will take years to work them out. We will be concentrating on new contracts as they are awarded in coming years, to ensure that they reflect new efficiencies. Some of the targets and objectives we decide to pursue will only be able to be achieved on a timeline of several

years. On the other hand, Secretary Gates has explained clearly why we need to embark now. And the earlier we embark, the easier it will be to succeed.

Second, we in the Department cannot succeed at this task alone. We need the input and involvement of industry, and I will be actively seeking their support and ideas. We do not have an arsenal system in the United States: the Department does not make most of our weapons or provide many non-governmental services essential to warfighting – these are provided by private industry. Our industry partners are patriots as well as businessmen. 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. Increased productivity is good for both industry and government. So also is avoiding budget turbulence and getting more programs into stable production.

We also need the help of Congress. Members of Congress observe with dismay as they are asked to approve ever-increasing funding for the very same product or service. We will need their input and support to make necessary adjustments that will in some cases be difficult.

What is contained in the attached charts is an initial framework for restoring affordability to defense. I will be refining this framework over coming weeks, in full consultation with you, with industry, with Congress, and with outside experts and leaders. I plan to issue a final version of this mandate later this summer.

Realizing the objective of this initiative will be a formidable endeavor. But it is imperative. Secretary Gates, Deputy Secretary Lynn, and I have concluded that we cannot support our troops with the capabilities they need unless we achieve greater efficiency.

Ashton B. Carter

Objectives

- Deliver the warfighting capability we need for the dollars we have
- Get better buying power for warfighter and taxpayer
- Restore affordability to defense goods and services
- Improve defense industry productivity
- Remove government impediments to leanness
- Avoid program turbulence
- Maintain a vibrant and financially healthy defense industry

Obtain 2-3% net annual growth in warfighting capabilities without commensurate budget increase by identifying and eliminating unproductive or low-value-added overhead and transfer savings to warfighting capabilities. Do more without more.

Providing Incentives for Greater Efficiency in Industry

- **LEVERAGING REAL COMPETITION:** Avoid directed buys and other substitutes for real competition. Use technical data packages and open systems architectures to support a continuous competitive environment.
- **USING PROPER CONTRACT TYPE FOR DEVELOPMENT AND PROCUREMENT:** Phase out award-fee contracts and favor fixed-price or cost-type incentive contracts in which government and industry share equally in overruns and underruns, and overruns have analytically-based caps. Use cost-reimbursement contracts only when either government requirements or industry processes cannot be adequately specified to support pricing. Adjust sole-source fixed-price contracts over time to reflect realized costs. Work down undefinitized contract actions. Seek authority for multi-year contracts where significant savings are possible.
- **USING PROPER CONTRACT TYPE FOR SERVICES:** Phase out Time and Material and sole-source ID/IQ contracts wherever possible. Utilize fixed-price performance-based contracts when requirements are firm and can be measured, with payments tied to performance. Utilize fixed-price level of effort or cost-plus-fixed-fee contracts (with profit/fee tied to weighted guidelines) when requirements are still being defined. Award fees should be used only by exception. Maximize the use of multiple-source, continuously competitive contracts.
- **ALIGNING POLICY ON PROFIT AND FEE TO CIRCUMSTANCE:** Align opportunity to earn profits/fees to both value to the taxpayer and risk to the contractor. Apply weighted guidelines to profit/fee levels. Reward higher productivity with higher profits. Incentivize investment in innovation.
- **SHARING THE BENEFITS OF CASH FLOW:** Ensure that taxpayers receive adequate consideration (price reductions) for improved cash flows. Progress payments must reflect performance but can be increased above customary levels in return for consideration by the contractor. Reduce over time the gap between proposed and actual rates in forward price rate agreements.
- **TARGETING NON-VALUE-ADDED COSTS:** Identify and eliminate non-value-added overhead and G&A charged to contracts. Limit fees for subcontractor management to reflect actual value provided (risk assumed by prime and continuous subcontractor risk reduction). Limit B&P allowable costs in sole source contracts and encourage effective use of IRAD.
- **INVOLVING DYNAMIC SMALL BUSINESS IN DEFENSE:** When establishing multiple award contracts for services, make every effort to provide for small business participation. If at least two small businesses are deemed capable of performing on such a contract, consider setting aside that work for competition among them.
- **REWARDING EXCELLENT SUPPLIERS:** Emulate the Navy's pilot program to provide special benefits to consistently excellent industrial performers.

Adopting Government Practices that Encourage Efficiency

- **ADOPTING "SHOULD-COST" AND "WILL-COST" MANAGEMENT:** Use historically informed independent cost estimation ("will-cost" estimates) to inform managing of programs to cost objectives ("should-cost" estimates).
- **STRENGTHENING THE ACQUISITION WORKFORCE:** Achieve SECDEF goal of adding to government acquisition workforce with increased skill levels. Leverage unique qualities of non-profit FFRDCs and UARCs to augment acquisition workforce capability.
- **IMPROVING AUDITS:** Improve consistency and quality of government audits, and focus them on value-added content.
- **MANDATING AFFORDABILITY AS A REQUIREMENT:** In new programs such as the SSBN-X nuclear missile submarine, the Presidential Helicopter, the Ground Combat Vehicle, and the Air Force/Navy Long Range Strike Family of Systems, cost considerations must shape requirements and design.
- **STABILIZING PRODUCTION RATES:** To ensure more programs are in stable, economically favorable rates of production and avoid cost escalation, program managers may not adjust production rates downward without head of component authority.
- **ELIMINATING REDUNDANCY WITHIN WARFIGHTING PORTFOLIOS:** Emulate the Army's Precision Fires Capability Portfolio approach to identify where multiple programs are pursuing similar objectives.
- **ESTABLISHING SENIOR MANAGERS FOR PROCUREMENT OF SERVICES:** Follow the Air Force lead in establishing a Program Executive Officer for services in each DOD component to focus on improving policy and practice in this high-dollar-value area.
- **PROTECTING THE TECHNOLOGY BASE:** Protect the future by sustaining investment while focusing on high value-added work.