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## Why Should We Care About **Outsourcing**?

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**Outsourcing:  
Practice used by  
companies to reduce  
costs by transferring  
portions of work to  
outside suppliers  
rather than completing  
it internally.  
(Investopedia)**

Outsourcing is a common practice in several industries in today's global business environment. The concept is fairly simple. A company often will buy or outsource products and services (as depicted in Figure 1) from other companies if doing so is in its best corporate interests. In the defense industry, outsourced work has trended upward and can be as much as 70 percent or even 80 percent of the total work content.

Companies typically address several factors in assessing an outsourcing decision, sometimes also referred to as a make-versus-buy decision. First and foremost, outsourcing (buying) can improve the financial bottom-line returns. Not having to carry the capital equipment, facilities and labor needed to make a product frees up invested capital for other uses in the company. Outsourcing reduces inventory and gross

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investment requirements, both of which improve the balance sheet and Return on Invested Capital (ROIC). In some contracts where data are available, less than 5 percent of all the touch labor on the program actually was being performed by the prime contractor. The rest of this labor comes from the prime's tiered supplier network that is outsourced at several layers or tiers of other companies.

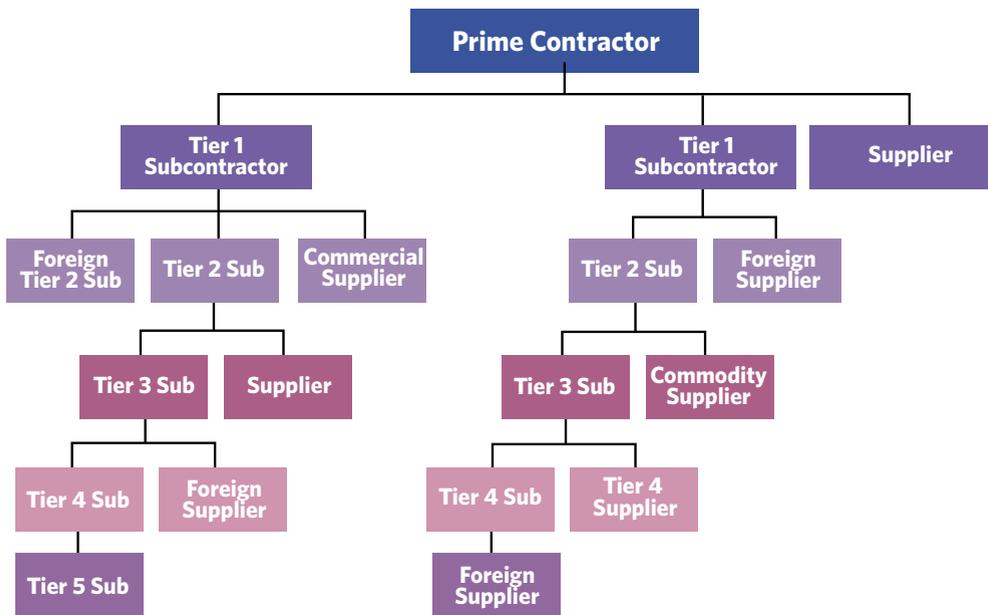
Companies also outsource work for nonfinancial reasons, including focusing core competencies in other business areas, developing strategic partnerships, ensuring alternate sources, and enabling greater innovation. In today's fast-changing business landscape, companies can quickly change their business models by leveraging the capabilities of others and finding new ways to increase value to their customers and shareholders. The rapid response and flexibility aspects of outsourcing can make it an attractive and efficient option as businesses strive to stay competitive.

The concept of a tiered network of suppliers is important for industry and for Department of Defense (DoD) program managers (PMs). See Figure 1. While we can expect visibility into the prime and subcontractor work efforts, this visibility can rapidly diminish as work is outsourced from one tier to the next lower one. Understanding this flow-down of money and work efforts can shed light on significant risks related to poor quality, late deliveries, cost overruns and technical performance.

The following discussion addresses some examples of outsourcing considerations in overall acquisition strategy planning and contract execution, including some specific techniques PMs can employ to address supplier risks:

**Market Research:** Robust market research is a great way to get knowledge of the potential subcontractors and suppliers. Depending on the mission area, products and services can change quickly in today's global markets, so it's

**Figure 1. Tiered Network of Contract Suppliers**



a good practice to maintain an ongoing market surveillance effort. Asking potential offerors to identify their potential major subcontracts, typical supplier base, and their assessment of supplier risks can yield lots of useful data. DoD Instruction (DoDI) 5000.02 provides the expectation that industrial capabilities will be addressed as part of the acquisition strategy and that market research will help provide the data on supplier as well as prime contractor capabilities necessary for this part of the strategy.

Ensuring a good understanding of how the potential prime contractor(s) plans to outsource work content was a big lesson from my PM experience. This knowledge often requires market research and may not be apparent unless there is some examination of the company’s practices on similar efforts. For example, if I had known in advance that my prime contractor planned to outsource a risky subsystem sensor to a supplier with questionable past performance in this mission area, I would have developed an acquisition strategy to address this risk. That strategy would have incorporated some specific contract requirements to ensure adequate insight into this work, including potential use of a consent-to-subcontract clause.

The consent-to-subcontract clause (Federal Acquisition Regulation [FAR] subpart 44.2) can be used for subcontracts of critical and risky subsystems as well as for reviewing the contractor’s purchasing system. The clause does not relieve the prime of any performance responsibility associated with the approved subcontractor but enables greater DoD insight and oversight of critical sourcing decisions.

**Acquisition Strategy Development:** With greater insight into contractor supplier management and outsourcing

practices, PMs can consider carefully how to manage the supplier risks and get and maintain the needed visibility. The industrial base considerations section of the acquisition strategy should include some consideration of how the strategy will address supplier risks in addition to other industrial base concerns. For example, contract clauses like the previously mentioned consent to subcontract could be included in the Request for Proposal (RFP).

For sole source contracts, PMs should consider use of a Make or Buy Plan as part of the contractor proposal. This plan provides the government the right to review and agree on the contractor’s make-or-

buy program to ensure the negotiation of reasonable contract prices and to provide additional insight into the planned supplier scope. This plan also provides insight into the amount and scope of competition at the subcontract level. Other tools that should be considered include a subcontractor management plan (deliverable after contract award), inspections clauses, and use of earned value management flow-down to critical suppliers.

Contractual incentives could stress the importance of an effective subcontract and supplier management program. Appropriate incentives also should be part of the prime’s plan to incentivize key subcontractors and suppliers. Finally, if this area poses significant risks, the source selection evaluation criteria should include it as part of the evaluation process.

**Integrated Prime and Supplier Management Reviews:** The prime and key suppliers should participate in management reviews of the program status, issues and risks. One of my previous weapon system program offices routinely included the three major subsystem subcontractors at important execution and planning meetings. This practice served the team very well and helped establish good communications and teamwork.

Dealing with supplier issues can be frustrating for the DoD PM since he or she must rely on the prime to resolve the issues. Several years ago as a DoD PM, I conducted a joint prime contractor and subcontractor review of program status on an important subsystem development effort. This effort was plagued with several technical issues and schedule delays. At the review, the prime contractor PM was very critical of the subcontractor’s performance and seemed to be satisfied that

his negative critique of the development status update and plan ahead was all he needed to do.

That dynamic changed when I asked him what his company was going to do to resolve all these issues. I also made it clear that this particular supplier management area would be a contract performance assessment report (CPAR) item. Now the focus shifted to the prime contractor, who was ultimately responsible, instead of focusing on the subcontractor. This set the tone for subsequent actions, and the prime contractor PM now clearly understood how the prime's performance in managing this subcontract effort would be in the spotlight. Not long after, the prime contractor sent some of its technical experts in this area to the subcontractor facility to provide more proactive assistance and help get the program back on track.

assist in this area and provide needed contractor purchasing system reviews. Finally, some DCMA offices have industrial and supply chain experts who can help the PM work with the prime contractor to oversee subcontractor quality requirements compliance.

#### **Trusted Suppliers and Processes for Critical Components:**

Cybersecurity and other malicious threats must be addressed as part of the supplier management effort. DoD as an enterprise is dealing with significant challenges associated with the globalization of the defense industry, including access to foreign technology and trusted microelectronics. For example, China recently announced new regulations requiring that companies selling computer equipment to Chinese banks turn over software source code, submit to invasive audits and build back doors into hardware and software. More recently,

**“A wise human would have an understanding of the supply chain and how the pieces fit together. But it’s against our nature to think about it.”**

**—Paolo Bacigalupi, science fiction writer**

**DCMA Post-Award Surveillance:** PMs should be aware of the services and assistance that the Defense Contract Management Agency (DCMA) can provide, including post-award surveillance. Working closely with DCMA to assess supplier risks and performing surveillance on appropriate work efforts can provide critical visibility into high-value and high-risk activities, especially with limited program office staff. The dialog with DCMA and early planning should help ensure that resources can be allocated effectively.

What suppliers will warrant surveillance? Given the large number of subcontractors and suppliers at various tiers below the subs, it's important to identify early which of these will require some level of visibility into their work progress. Developing a supply chain map that identifies suppliers at each tier can be useful in following the flow-down of money and work content.

Depending on the amount of proposed outsourcing and the associated risk, PMs may need to include specific RFP requirements that ensure the appropriate level of insight and oversight into this network of suppliers. The DCMA can

the issue of a back door to get into the Apple iPhone, bypassing encryption to access user data, has generated a big debate about whether potential hackers and adversaries also could leverage this back door.

Addressing the malicious threat risk should be part of a robust program protection and system security engineering plan. The PM's system engineer should have access to the latest tools, including criticality, vulnerability and threat assessment methods, sample contract language, etc., to assist in working with the prime contractor. While some of these techniques are relatively new, the potential impacts are significant enough to warrant careful consideration.

The risk of counterfeit parts in the supply chain also should be addressed. The current guidance of the Defense Federal Acquisition Regulation Supplement requires a risk-based counterfeit electronic part detection and avoidance system. But a proposed new rule adds significant sourcing restrictions in addition to the detection and avoidance approach. This issue is growing in the level both of interest and practices to deal with the threat. The significance of the threat can be seen in a new

DoD rule that enables the DoD to exclude companies assessed as supply chain risks involving information technology products and services related to National Security Systems (NSS).

**Supplier Benchmarking and Screening:** Supplier benchmarking and screening relates to company past performance and the capabilities of various companies under consideration. At the prime contractor level, DoD has instituted a superior supplier incentive program, ranking the top 25 companies in each service based on their performance as assessed in CPARs.

Companies can and should institute a similar approach with their suppliers, providing incentives for the suppliers to become well qualified and recognized as top performers in their business areas. The potential for a contractor purchasing system review also can be discussed with the DCMA, based on past performance of the contractor, subcontracting volume, complexity of subcontracts and dollar value of the subcontracts.

I believe that, if some of the contractors I worked with had a more robust supplier benchmarking and supplier qualification screening process, many of the subcontractor performance issues would not have occurred because a better-qualified

company would have been selected. There are many industry initiatives in this area, and companies should be willing and able to discuss their process for selecting and rewarding qualified suppliers.

### Final Thoughts

The amount and complexity of outsourced work in DoD programs has grown over the last few decades and has changed the dynamics of program planning, execution and oversight for many PMs. This new business model can present significant risks, thus often necessitating a more proactive risk management and oversight approach. Use of appropriate techniques in market research, acquisition strategy development and RFP development, program governance, and risk and opportunity management processes will help PMs manage the risks.

On the opportunity side, let's not forget that outsourcing and supplier management can help reduce costs and increase value to industry and the DoD. It also allows for new and innovative suppliers to offer technological solutions that otherwise may have not been considered. 

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- **BBP Public Site (<https://acc.dau.mil/bbp>)** is your forum to share BBP knowledge and experience



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