

Top 10 Survey Questions Provide Evidence of Procurement Success Utilised for "Make-Or-Buy" Decisions With Product Support Providers

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DoD functions as web of contractual relationships, for example provision of Spare Parts to sidelined aircraft. Each relationship—the acquisition of an input, Job Site work order assignment to product support agent, the exchange of a product or service between supplier and customer—is a transaction. Understanding the basic characteristics of a transaction is the key to answering the “make-or-buy” decision.

As DoD comes under increasing pressure to cut expenses and improve their return on assets, the dilemma of whether to keep key functions in-house or outsource them has taken center stage. What does this mean for Site Visit Executive? Reviews of business units must be designed that thoroughly evaluate the costs, benefits, risks, and rewards of outsourcing and the implications of keeping the activity in-house.

Strategies leading to mission success include strategic importance to DoD of the product or service that is being considered for outsourcing, as well as the process, technologies, or skills required to make the product or deliver the service. These factors must be considered in the context of current competitive conditions and also in anticipation of how conditions might change in the future.

Here we examine factors involved in Make-Or-Buy decisions-- transaction costs e.g. search & information costs; bargaining, decision & contracting costs; and monitoring & enforcement costs.

Transaction costs typically faced by DoD dealing with outside suppliers include costs associated with: source selection; periodic competition & renegotiation; contract administration; and measure/monitor performance.

Close examination of Make-Or-Buy decision making process leads to two important policy recommendations. First, one size does not fit all. To declare a victor in DoD competitions with suppliers, different decision rules must be applied to different classes of transactions. Second, if outsourcing is favoured, contract type must be chosen based on understanding of key characteristics defining the different classes of transactions.

Site Visit Executive must be proficient in supplier oversight to generate the highest possible level of quality and mission success rates and determine the right questions to ask to make these determinations. Among them: If DoD capabilities are below benchmarks, can they be improved to reach maximum performance and efficiency, and would the benefits of those capabilities surpass the benefits that we would obtain from outsourcing?

If so, Site Visit Executive must determine what resources are required, and how long it would take to reach noticeably improved performance? Are technology innovation and alignment necessary for DoD to have a competitive edge? Do field level units expect a high level of service and response?

Make-Or-Buy decision emphasis is placed on four key characteristics of transactions: 1) complexity, 2) uncertainty, 3) frequency, and 4) asset specificity. In cases where construction transaction is easy to define and measure—i.e. there is little complexity, and only a few minor changes are expected—i.e. there is little uncertainty, fixed type contracts tend to dominate.

In reality, the tradeoff as it applies to out-sourcing might be stated as follows. On the one hand, efforts to suppress contract opportunities are limited by the costs of writing and enforcing contractual agreements, and rise with the complexity, uncertainty, and asset specificity associated with the transaction. This works against out-sourcing.

On the other hand, while integration within DoD mitigates such problems, internal contract agent issues arise that sacrifice the high-powered incentives of the market and consequently requires greater monitoring and administrative costs. This works in favor of out-sourcing.

If, after these questions are answered, outsourcing is chosen, Site Visit Executive can work with field-level unit to find the right partner. Pivotal indicators such as business strategies, engineering capabilities, design & innovation skills, labour costs/skills, ability to scale, and capacity utilisation, of the potential partner must be assessed. In addition, the risks in outsourcing must be accurately gauged, whether they relate to the supply line or to proprietary technology and intellectual property

Of course, outsourcing is worth considering under certain conditions. If a product or function has essentially become a commodity or is derived from factors other than unique or differentiating capabilities, and the possibility of moving operations to another party does not give rise to significant risk to DoD strategy, outsourcing could be the perfect solution.

Moreover, when outsourcing is called for, Site Visit Executive can use knowledge of the supply base to compare potential outsourcers' technologies, product innovation and ability to work in partnership. And Site Visit Executive can evaluate whether DoD has the skills and resources needed to keep track of outsourced business so continuous quality and cost improvements over the life of the contract are realised. Without that, the outsourcing arrangement will probably deliver disappointing results.

Risks include lower quality, reliability, and predictability of outsourced solutions as compared with in-house product services, as well as risks inherent in the process of identifying and selecting the right supplier and structuring a workable ongoing relationship.

Site Visit Executive has multiple roles to play in mitigating risk. DoD must be encouraged to view the supply line or service providers as partners that deliver an entire product or execute an entire function. Site Visit Executive must oversee risk assessment during a make-or-buy

evaluation with much more diligence than would be necessary in traditional sourcing, and must also supervise the writing of the contract so that it protects DoD from contractor deficiencies.

When there are multiple suppliers, a single failure in supply line links is not necessarily disastrous. And when suppliers are making components rather than finished products, Job Site errors will likely be caught during assembly and not be passed on to the DoD directly.

But because outsourcing introduces such a wide array of new risks, Site Visit Executive must be aware of any potential pitfalls with suppliers, and evaluate outsourcing partners on the basis of their importance to bottom line of DoD. Failure of service could be devastating in an outsourced critical operation, such as part component design/deploy, whereas a glitch in a training programme might be less of a problem.

Ideally, contracts can be written that specify measures of performance, conflict resolution procedures, and conditions under which the contract can be modified, as well as provisions for sharing gains from transaction-specific investments.

Fixed type contracts are usually prescribed in later stages of product life phase when complexity and uncertainty have been resolved, and performance work statement is well defined-- resulting in relatively low risks to DoD. Note that while these prescribed contracts focus on the characteristics of complexity and uncertainty, usually overlooked are the vital roles of frequency and asset specificity—two key components to consider.

But the more complex the transaction—the more difficult/costly it is to define and measure performance, and the more uncertain changes in the contract will be required, result will be more tension between DoD and suppliers.

Crucial to the mitigation of risk is the supplier selection process. It must be based on a clear understanding of the supplier's strategy, operations, and cost structure. Choosing the lowest bid is not sufficient. Only a supplier that has a compatible business strategy and will maintain an advantaged cost position over time can offer competitive prices in the long term.

In addition, when outsourcing partners are not chosen properly, DoD usually attempts to protect itself from failures or delays by duplicating in-house some of the effort that was originally contracted out. This results in multiple costs for the same project, potential expenses that are often not considered when the outsourcing deal is made.

Outsourcing a broken process — for instance, spare parts component dispatch call center that is not equipped with the right answers to the most prevalent questions — will end up costing much more than it would if the function were fixed before being handed off to an outside provider. The contractor will likely charge a significant amount to repair the process, and as an outside operation it will probably not know enough about DoD requirements to repair it properly.

Considering all this, relying on a one-time quote to gauge the competitiveness of an external supplier is generally not sufficient. Site Visit Executive can save DoD from this mistake by factoring into the outsourcing equation the economic effects of relative Job Site labour

productivity, equipment and staff utilisation, functional processes, capacity for process and product innovation, and relative purchasing power.

Expectations must be clearly articulated so DoD can avoid surprises with potential to compromise missions once the supplier feels the business is locked in or becomes complacent in assuming its current performance will be sufficient in the future. It is vital to provide up front the appropriate specifications and current and future deadlines, to the extent that they are known. Any misunderstanding about the scope of the outsourcing program will surely be costly and damaging to DoD.

Once the outsourcing decision has been made and suppliers have been selected, it is essential to agree up front on balanced factors to include productivity improvement, cost reduction expectations, and the required degree of responsiveness to design, service, or delivery changes.

As demonstrated by the variety of factors and risks that need to be taken into account by DoD in its dealings with product support providers, the decision of in-house versus outsource should not be made without careful consideration. Site Visit Executive attention is essential to making sure that review of options is initiated and conducted diligently and objectively.

The weight of decision making process will put some strain on DoD, and new capabilities will be required. But by viewing the process as a logical extension of the procurement role, both Site Visit Executive and the purchasing department will be able to handle the new responsibilities with a high level of skill.

We based our structured interviews with DoD and contractors demonstrate working experience with Make-Or-Buy procurement applications for weapons system programmes on an extensive questionnaire. The overarching themes investigated by the questionnaire are summarised here:

1. Is there evidence using application has shortened procurement process and produced efficiencies in DoD interactions with contractors?
2. Is there evidence cost of major DoD weapon systems or items have been reduced through advances in procurement applications?
3. Is there evidence DoD use of application increased contractor incentives to focus on cost reduction during design phase?
4. Is there evidence DoD procurement workload has been reduced through the use of application?
5. Is there evidence that additional competitors at prime, subcontractor, or supplier levels interacted with DoD as direct result of application?
6. Can contractor participation in DoD contests facilitated by application be linked to lower prices paid and/or better products acquired?

7. Are there specific examples of innovative tech incorporation to improve product capabilities for DoD because of application?
8. How are cost/benefits to DoD operations estimated and application processes evaluated?
9. Is there evidence procurement application has reduced contractor overhead rates or charges to DoD?
10. What are lessons learned by DoD for future applications driving advances in procurement process for weapons systems?