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**Acquisition Research:  
Creating Synergy for Informed Change**

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DEPARTMENT OF DEFENSE MANAGEMENT  
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# How Not to Alienate Business Partners: A Framework for Addressing Factors Impacting Retention of Defense Contractors

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## Abstract

The U.S. government and the Department of Defense (DoD) continue to add new social policy, regulatory, and legislative burdens to the federal contracting process, despite growing consensus that these practices have led to a sluggish and inefficient acquisition system that erodes our competitive advantage against adversaries. This dynamic is also driving companies to leave the defense marketplace in droves, despite efforts to recruit new businesses to sell to the DoD and encourage the use of alternative procurement processes. Our research provides a framework for how defense buyers and policymakers can improve retention rates for defense contractors, with specific recommendations for removing requirements that do not support critical national security needs. Fundamentally, defense acquisition should be governed by fewer requirements and checklists, freeing up acquisition professionals and leaders to develop and sustain long-term business relationships that take a win-win philosophy.

## Introduction

Last year we presented a paper at the Naval Postgraduate School Acquisition Research Symposium entitled *The Slow Destruction of the Defense Industrial Base*, where we argued that despite the Department of Defense’s unprecedented and increasing reliance on commercial technologies to conduct military and business operations, the National Security Innovation and Industrial Base (NSIB) is shrinking and “becoming detached from the greater U.S. economic base” because private industry “is choosing not to work with the federal government in general, and the Department of Defense (DoD) in particular” (Schwartz & Johnson, 2022).

We further argued that those companies who remain committed to working with the DoD “are hamstrung by statutes and government policies that inhibit innovation and adaption,” putting these companies at a “severe disadvantage when competing with industry for high-skill talent critical to innovation, dedicating resources to R&D, and staying ahead of the technology and innovation curve.”

The consequences of these two trends, if they continue, will have a significant impact on the DoD’s ability to maintain a technology and capability advantage over potential



adversaries, undermining our national security. The United States is already seeing its military advantage in a range of capabilities erode, to include hypersonics, where certain Chinese and Russian capabilities exceed the United States' (Tucker, 2023). Moreover, China is rapidly eroding U.S. naval overmatch and air superiority in the Indo-pacific region (Congressional Research Service, 2022).

The DoD needs a holistic reassessment of its relationship as a customer and partner with commercial industry, one built on respect, understanding the business needs of industry, open channels of communication, and sensible regulations that support national security without excessive bureaucracy.

This report asks, and identifies data to answer, four simple questions.

1. Is the NSIB continuing to shrink?
2. Are the DoD's efforts to reach out to industry and bring more companies into the NSIB working?
3. What about the acquisition regulations is driving the trend of shrinking the NSIB and hamstringing those companies that remain?
4. What can be done to reverse this trend?

Time is running out to prevent the United States falling behind in the race for technological and operational superiority. The DoD and Congress must heed the words of Reignier in Henry VI, and "Defer no time; delays have dangerous ends."

### The NSIB Is Still Shrinking—But That is Only the Beginning of the Story

Last year we referenced a Government Accountability Office (GAO) analysis showing that from FY2011 to FY2020, the number of small businesses receiving DoD contract awards decreased by 43% even as obligations to small businesses increased by approximately 15% (GAO, 2021). But this is not a small business story—it is an industry-wide story. According to the same report, the number of larger businesses receiving contract awards fell by 7.3% annually over the same period, a more precipitous decline than the 6% annual decline in the number of small businesses receiving contract awards (GAO, 2021, p. 9).

*Not too many years ago, we had five times as many contractors and there was more competition and there was more creativity.*

– Representative Ken Calvert

The NSIB continued to shrink in 2022 across small business and larger businesses, DoD contracting, and government-wide contracting. According to Bloomberg analysis, the number of small and other businesses contracting with the DoD slid further in fiscal years 2021 and 2022, with small businesses decreasing by 5% and 7%, and other business decreasing by 1% and 5%, respectively (Nieberg & Murphy, 2023).

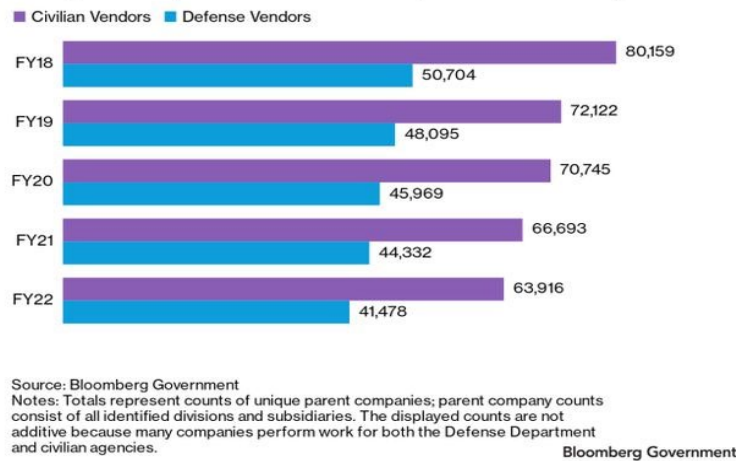
**Table 1. Company Participation in the Defense Industrial Base. (Nieberg & Murphy, 2023).**

	Large/Other Business	Small Business
FY18	14840	40752
FY19	14125	38434
FY20	13431	36705
FY21	13293	35036
FY22	12648	32681



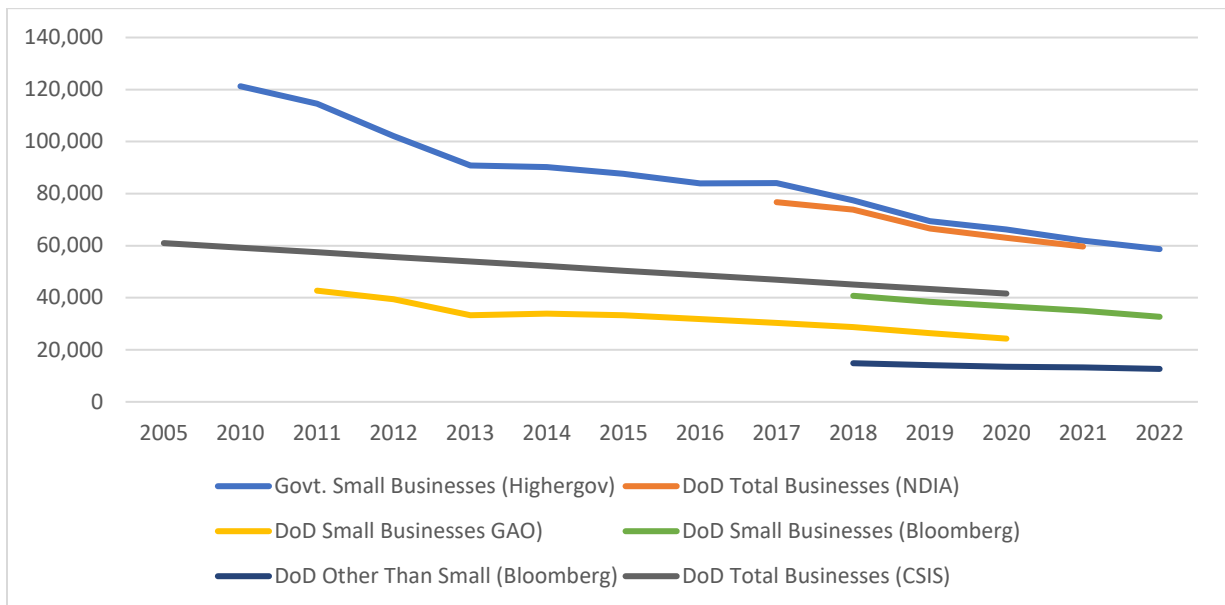
A separate Bloomberg analysis takes a step back to reveal this pattern across all defense contractors, showing a drop in defense of 2,854 vendors from FY2021 to FY2022 (Murphy, 2023). A similar trend is playing out in civilian agencies (See Figure 1).

**Defense Supplier Base Down As Overall Federal Contractor Count Falls**  
 Pentagon's steady decline leads to 18% drop over last five fiscal years



**Figure 1. Defense Supplier Base Down as Overall Federal Contractor Count Falls. (Murphy, 2023).**

Figure 2 depicts data from six different analytical trends of contractor participation in various segments of the government marketplace published by GAO, CSIS, Bloomberg, NDIA, and HigherGov. Each analysis of contractor participation shows a clear downward trend in contractor participation in the government marketplace.

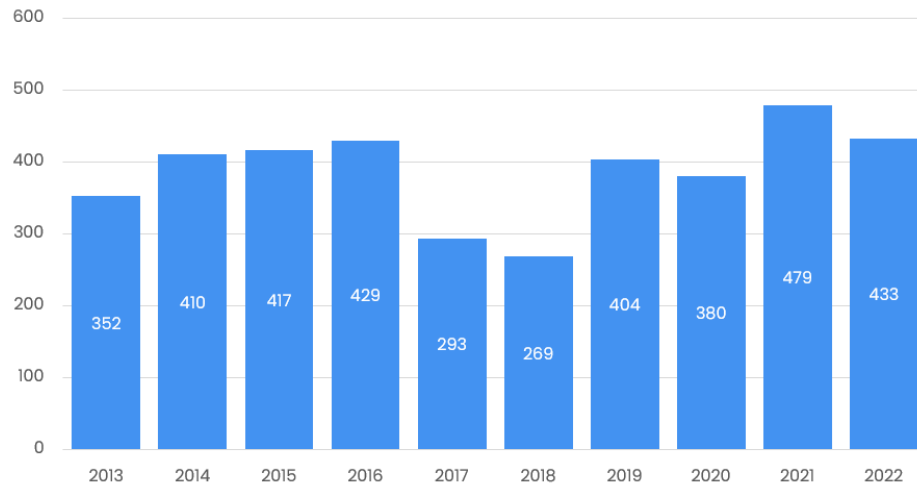


**Figure 2. Contractor Participation in the Government Marketplace—Trends<sup>1</sup>**

<sup>1</sup> See Appendix A for source data. The various data sources referenced in this report do not match. Such inconsistencies appear to be more related to differences in methodology and when analyses



Many analysts, and even the DoD’s assessment of the health of the defense industrial base, have attributed this decline primarily to mergers and acquisitions. (See, for example, the 2022 DoD Report State of Competition in the Defense Industrial Base.) While mergers and acquisitions continue to occur in the defense marketplace, those numbers pale in comparison to the larger trends. A study from HigherGov found 433 mergers and acquisition in the aerospace, defense, and government sector in 2022 (Siken, 2023). Comparing this data to the Bloomberg numbers, this consolidation accounts for approximately 15% of the drop in defense contractors. The other 85% of consolidation would appear to come from vendors choosing to leave the defense marketplace.



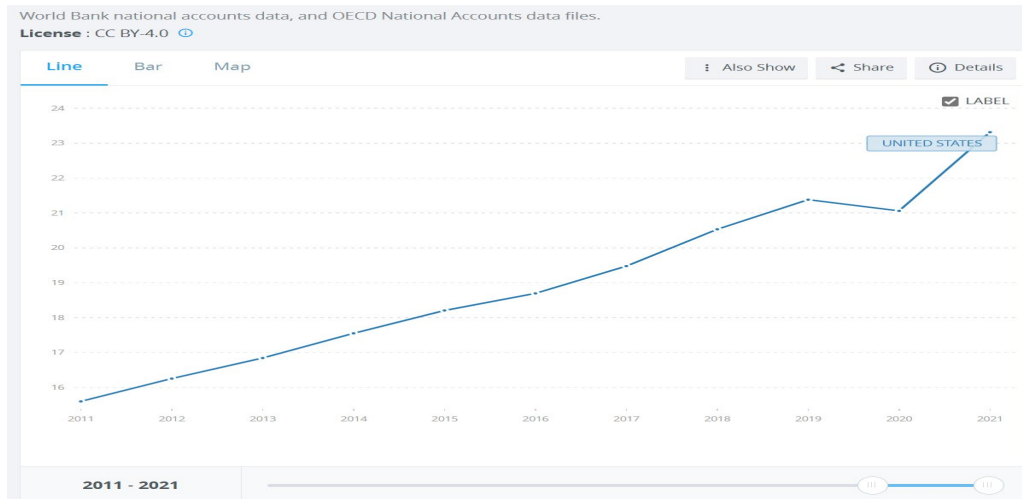
**Figure 3. 10 Year M&A Transaction Volume Trend (Count). (Siken, 2023).**

Furthermore, mergers, acquisitions, and takeovers are not unique to the defense sector. They occur in the larger U.S. economy, which nonetheless continues to see growth over this same time period, both in dollars and numbers of businesses. Figures 4 and 5 convey a clear increase in GDP and the number of new companies joining the economy, respectively. U.S. GDP grew by 49% from 2011 (\$15.6 trillion) to 2021 (\$23.3 trillion), with a significant 10.7% increase (\$3 trillion) from 2020 to 2021 (The World Bank, 2023). The total number of businesses in the U.S. economy increased by 7% from 2010 to 2019 (U.S. Census Bureau, 2021) and the number of applications for new businesses almost doubled from 2011 to 2022, from 2.58 million to 5.1 million new filing.

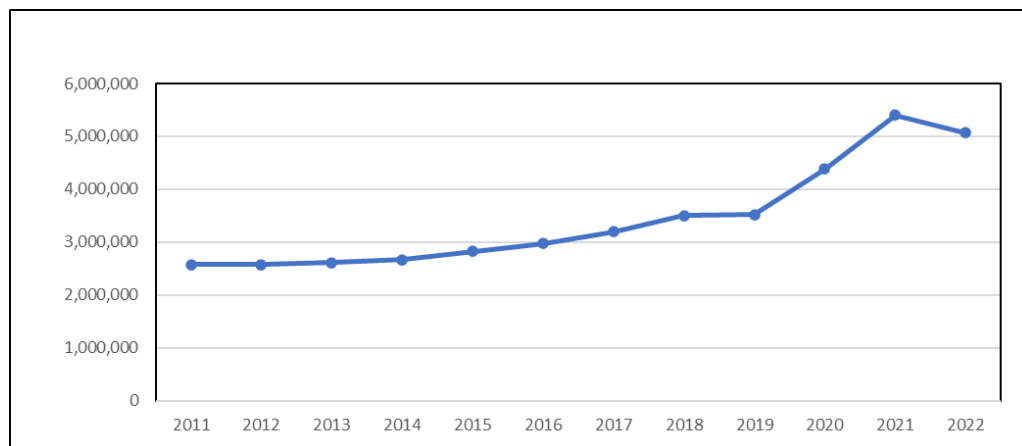
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were conducted than a question of data. For example, because FPDS changed its methodology in 2015, CSIS removed from its analysis small contractors included in pre-2015 FPDS data that would not need to be reported under current rules. The Bloomberg analysis “represent counts of unique parent companies” that consolidates all identified divisions and subsidiaries of a particular entity. In addition, FPDS is a dynamic source that updates data daily, returning slightly different results depending on when the data was run. Despite these inconsistencies, the overall trend identified by GAO, CSIS, HigherGov, Bloomberg, and others are all consistent.





**Figure 4. United States Gross Domestic Product, 2011–2021. (The World Bank, 2023).**



**Figure 5: New Business Formation Filings (Seasonally Adjusted)**

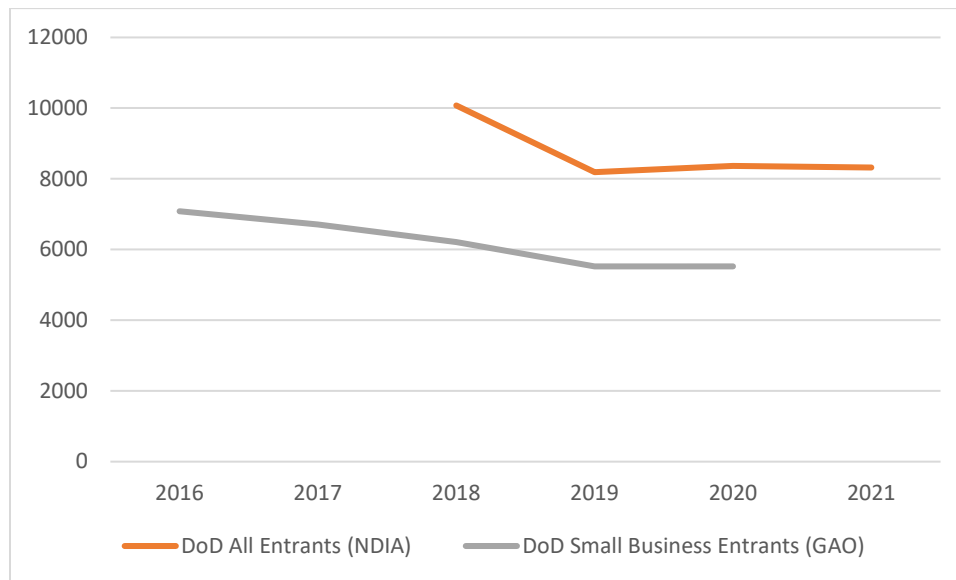
Data from the Small Business Administration reports a net increase of 180,528 businesses from March 2020 to March 2021 (U.S. Small Business Administration Office of Advocacy, 2022). The U.S. Bureau of Labor Statistics (2023) reported a net increase of 618,391 establishments in the United States from September 2021 to September 2022.

### **The DoD’s Outreach Efforts Are Not Changing the Underlying Trend**

Over the past decade, the DoD has made efforts to capture some of this growth in the larger marketplace, with a specific focus on recruiting nontraditional defense contractors and startup companies developing new technologies. In 2015 then–Defense Secretary Ash Carter established the Defense Innovation Unit (then known as DIUx) “as part of the Defense Department’s outreach to America’s innovative technology companies” (DoD, 2016). DIU’s efforts are bearing some fruit. Between 2019 and 2022, DIU awarded 360 OT contracts to 321 unique vendors, many of which we believe are new to the NSIB. DIU, and its sister organization the National Security Innovation Network, are building a foundation for bringing in more companies in the future, generating proposals from companies that are not currently participating in the NSIB. (Defense Innovation Unit, 2022, pp. 8, 12).



But these recruitment efforts are focused on a small subset of the NSIB and are not (yet) reversing the larger trend. In fact, as the latest Vital Signs report from NDIA highlights, the rate of new companies entering the defense marketplace is also slowing. According to NDIA, from 2018 to 2021, the total number of companies entering the DoD marketplace decreased 17%, from 10,076, to 8,322 (NDIA, 2023, p. 13). Similarly, the GAO (2021) found that from 2016 to 2020, the number of small businesses contracting with the DoD decreased 22%, from 7,083 to 5,526 (see Figure 6).



**Figure 6. Fewer Firms are Entering the DIB.**  
(U.S. Census Bureau, 2023).

## What Is Driving Industry Away from the NSIB (and Hamstringing Those that Remain)?

At two recent events we asked attendees “Has your company considered pulling out of any government markets?” Twenty-five percent of respondents said *their companies have considered pulling out of at least some government markets*. What is striking about this response is that both events were geared towards companies in the federal government market.<sup>2</sup> We then asked what factors most influence whether their companies participate in government contracts. Half of respondents cited “government-specific regulations that make it too hard or not worthwhile to work for government” as a strong or very strong consideration in deciding whether to contract with the government. Almost half of respondents cited “concerns over intellectual property integrity,” followed closely by “insufficient levels of cash-flow or profit margins.”

The polls we conducted were not scientific by any means.<sup>3</sup> However, a larger poll conducted by NDIA reinforced our informal findings. When asked by NDIA “What is the most pressing issue facing the defense industrial base,” the burden of the acquisition process and paperwork was cited by 30% of those polled, ranking higher than concerns over budget

<sup>2</sup> The two events were the Practicing Law Institute’s *Government Contracts 2022* (October 26, 2022) and the NDIA Procurement Division Quarterly Meeting (January 10, 2023).

<sup>3</sup> We did not control for any outside factors and our sample size was small, ranging from 121–152 respondents.





stability, workforce, inflation, or any other issue (2023, p. 14). Respondents also indicated that it is much more difficult to do business with the DoD than other agencies. Eighteen percent of respondents said it was “very difficult” to do business with the DoD, compared to 10% for other government agencies, and 8% for non-government agencies (see Figure 7).

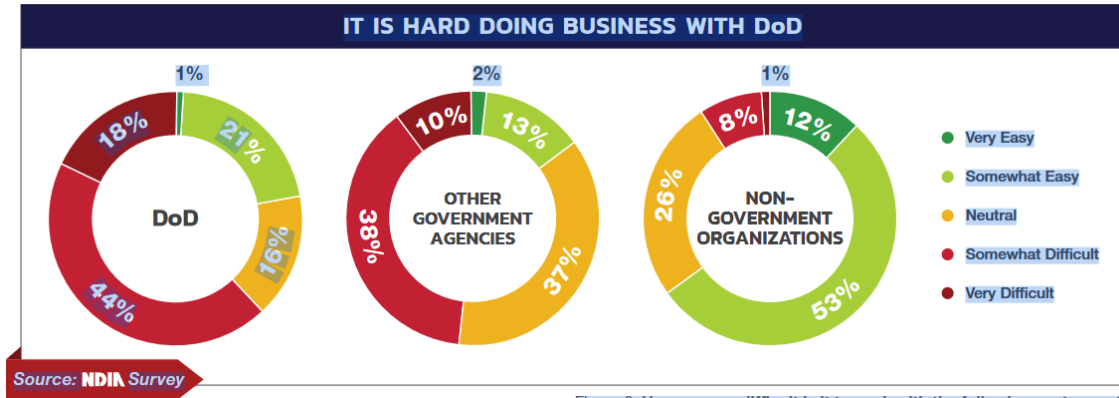


Figure 6: How easy or difficult is it to work with the following customers?

Figure 7. Views on Working with the Government

### Companies Want to Work with DoD—There are Just Too Many Disincentives

There is another business model showing growth in the number of companies selling to the DoD. Data on the use of consortia and other transaction authority convey a sense that when the traditional procurement rules are altered, more companies seek out opportunities to work with the DoD. From FY10 to FY20, total membership in 12 consortia focusing on government contracting increased more than tenfold, from 365 to over 5,600. One consortium’s membership increased from 161 members in 2010 to 900 members in 2020. Another consortium attracted over 900 members in its inaugural year in 2019 (Schwartz & Halcrow, 2022).

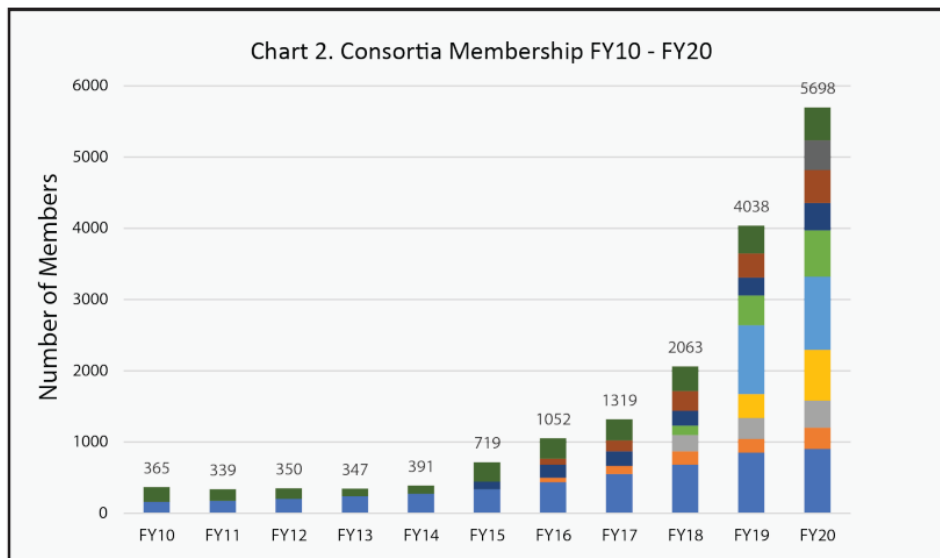


Figure 8. Consortia Membership FY10–FY20. (Schwartz & Halcrow, 2022).



A large percentage of these businesses are nontraditional defense contractors, demonstrating the value of an arrangement that simplifies the process of working with the DoD and enhances the benefits of collaborating with others in similar areas of expertise.

What attracts companies to consortia and other transaction agreements is:

- An expedited and simplified method of contracting with the government—other transactions are not bound by the FAR or many other regulatory and legislative requirements.<sup>4</sup>
- Not having to deal with the government directly. According to the Executive Director on one company with 60 employees, “We would never have had this [contracting] opportunity without the consortia model” (Schwartz & Halcrow, 2022, p. 17).
- More communication and collaboration between government and industry—and within industry.

The benefits of working within consortia are similar to steps and recommendations being made by the DoD’s outreach organization, DIU. DIU’s Director of Acquisitions Cherissa Tamayori (2023) attributes some of their success to their use of simplified acquisition processes, notably other transaction authority and commercial solutions openings. Tamayori also suggests that to continue this trajectory, “We must ensure that government needs align with best commercial practices and do not require a company to create government-specific processes, develop costly proposals, or spend a year waiting to learn if it won a contract award.” If the DoD and Congress simplified existing procurement rules and regulations and applied them more uniformly across the NSIB, a dramatic increase in numbers of defense contractors would likely follow.

### **Are Defense Procurement Regulations Really Different Than Industry Practices?**

Commercial companies seeking to enter the defense market must ensure that their supply chains, software and hardware contents, sourcing, cybersecurity, accounting systems, and pay scale<sup>5</sup> meet DoD and government-wide unique requirements. In combination, conforming to these requirements can be time-consuming and require significant upfront investment. Some of these government-unique regulations (such as domestic content requirements) can drive up the cost of goods and services provided by companies. Given that most companies in the defense industrial base sell into both government and commercial market, government-unique regulations that drive up the cost of products sold into commercial markets can threaten a company’s ability to compete and survive outside of government contracts.

*In purchasing power parity, they [China] spend about one dollar to our 20 dollars to get to the same capability. . . . We are going to lose if we can’t figure out how to drop the cost and increase the speed in our defense supply chains.*

—MG Cameron Holt, former Deputy Assistant Secretary of the Air Force (contracting)

A few case studies illustrate this burden and increased cost. At the April 2023 Sea Air Space expo, a representative from a midsize technology company that sells commercial goods to the U.S. Coast Guard stood up during Q&A to ask DIU’s Cherissa Tamayori how industry can help the DoD better use its rapid acquisition authorities. Despite this company

<sup>4</sup> See 10 USC 4021 and 10 USC 4022.

<sup>5</sup> This requirement is primarily applicable to cost contracts.



providing commercial goods, he claimed that none of his contracts had ever used FAR Part 12 (“Acquisition of Commercial Products and Services”). By his telling, accounting for the extra and unnecessary burden of complying with the full FAR requirements drove up the costs for these supplies by 20%–30%.

Another example comes from a foreign supplier of an underwater camera to a defense prime. To account for the potential risk of accepting FAR clauses, conditions, and requirements they didn’t understand, the sub doubled the cost of the camera from approximately \$200,000 (commercial price) to \$400,000 (Conversation with author, April 5, 2023).

To stay in the defense market, companies must absorb the cost of tracking constantly changing restrictions, prohibitions, and requirements of the procurement system, a task that is difficult for even the most sophisticated defense contractors—and an insurmountable challenge for many medium sized commercial companies. Appendix A is a list of prohibitions or restrictions currently working their way through the rule-making stage or recently implemented (as of March 1, 2023). These include:

Restrictions on contractors using certain goods or services even if the goods and services are not used on a DoD contract:

- Prohibitions on the use of Chinese telecommunications equipment
- Prohibitions on the use of Unmanned Aircraft Systems from certain foreign countries
- Prohibitions on the use of certain semiconductor products or service

Other restrictions or requirements:

- Disclosing to the DoD the source for certain permanent magnets in products or services
- Expanding the prohibition of procuring certain rare earths, strategic and critical minerals, or energetic materials from certain Chinese entities
- Prohibitions on certain items mined, produced, or manufactured in the Chinese Xinjiang Uygur Autonomous Region
- Prohibitions on certain printed circuit boards from China
- Requirements to disclose employees working in China on DoD contracts
- Expanding the prohibition on certain metals, to include materials mined, refined, or separated in China
- Cybersecurity requirements to contract with the DoD (CMMC)
- Gradually increasing domestic content requirements for the Buy American Act, increasing to 75% in 2029.

For private companies, particularly small or mid-sized companies, just tracking these changes requires significant cost, time, and expertise. Some of these regulations date back to legislation passed in 2018. In other cases, Congress passed laws to amend previous legislation whose regulations have still not been promulgated and issued.

These still-to-be-implemented rules are on top of current requirements, including

- The Berry amendment
- Specialty metal requirements
- Truthful Cost or Pricing requirements (formerly known as the Truth in Negotiations Act)
- Cost Accounting System requirements
- Wage caps for certain cost contracts



Incumbent defense contractors are often supportive of the larger goals of many individual requirements and have resources dedicated to complying with government-unique terms, conditions, and business processes. But even these long-term partners are growing weary of the ever-increasing complexity of doing business with the DoD.

In 2021, for example, three industry groups representing technology companies selling to the DoD wrote a letter to Deputy Secretary of Defense Hicks about the uncertainty surrounding CMMC—a requirement that was announced in 2019, evolved into version 2.0 in 2021, and has yet to be implemented. That letter expressed support for improved cybersecurity practices, but noted that this uncertainty of how CMMC will be executed is compounded by “the continued proliferation of federal cybersecurity requirements at the agency level . . . [and] causes operational impacts that result in procurement inefficiencies and contractual modifications that are passed on to the Government.” This complexity also slows or stops efforts to modernize and comply: “contractors, subcontractors, and suppliers may defer substantial investments pending communication and greater certainty about the program’s requirements” (Information Technology Industry Council, National Defense Industrial Association, and Professional Services Council, 2021).

One of the simple suggestions these groups make is better communication: “We believe [the] DoD and industry will achieve the best risk management outcomes when they engage in bi-directional information sharing and act transparently in their decision-making.” Intentional and frequent communication between the DoD and industry has long been recognized as a best practice—yet efforts to embed more transparency in the acquisition process have been inconsistent and not widespread enough.

## **Recruiting and Retaining Companies Present Different Challenges, with Different Solutions**

As with any relationship, the initial excitement of beginning something new can quickly fade as both parties settle into their routines. The steps the DoD has taken to attract new companies are insufficient to reverse the trend of a shrinking NSIB, in part because the Department—and the Federal Government as a whole—does not have an effective strategy for retaining companies once they join the national defense innovation and industrial base. The challenges they face are either unknown or deemed acceptable friction inherent to how the DoD conducts business. Before it can reverse the current industrial base trends, Congress and the DoD would benefit from a foundational change in how government thinks about the industrial base throughout the full life cycle of the acquisition relationship.

### **Acquisition is an Art Not a Science**

Defense acquisition is too often executed as a mechanistic transactional process focused on checklists, regulations, and processes rather than a relational process focused on shared priorities, better outcomes, and mutual respect. Attempts to ensure consistent oversight and accountability across an enormous bureaucracy have produced a mechanistic approach that discourages individualized solutions, creative thinking, teamwork, and trust. But at its heart, acquisition is a human endeavor of building and sustaining relationships. More regulation does not produce greater efficiency and effectiveness. Rather, fewer regulations, more consistently enforced, coupled with empowering acquisition professionals to think, will reap greater acquisition rewards.

### **The DoD Should Get a Relationship Therapist**

The relationship between the DoD and industry is dysfunctional (partly due to the third wheel of Congress—but that’s another paper). While not relationship experts, our research and experiences have indicated that key to a strong relationship is



- Understanding the needs of the other party
- Having open and honest communication
- Seeking a win-win common ground that accepts compromise.

### Understand Industry

The DoD generally does not have a solid understanding of how industry operates, what motivates companies, drives business decisions, and most importantly, prompts companies to leave (or not enter) the NSIB. The first step in developing a more beneficial relationship with industry is for the DoD to better understand their needs and priorities. DIU's Cherissa Tamayori (2023) makes one of her three suggested strategies for improved acquisition to "understand industry partners and align to common business practices." One of the differences the DIU team has found is that "many companies, especially those supplying software-based technologies, have pivoted to a service-based model." Tamayori admits that acquiring technology this way "requires a mindset shift" in defense acquisition.

Research on the differences between business-to-business (B2B) and business-to-government (B2G) processes provides additional some insight:

The inflated cost of B2G exchanges outweigh the scale and efficiency benefits until the firm reaches a critical threshold. Firms with a stronger government customer emphasis also experience more performance volatility (as revealed in idiosyncratic and systematic risk) due to the difficulties of redeploying and safeguarding [transaction-specific investments] from unanticipated changes in government procurement activities. That is, firms face significant asset specificity in B2G exchanges because of the federal government's idiosyncratic nature, so the projected cash flows from B2G exchanges are more volatile. (Josephson et al., 2019)

We noted some of these characteristics of commercial businesses in our 2022 paper and add a few more: an unwillingness to relinquish all IP rights, the ability to operate with unlimited profit margins, and the potential for cashflow that evolves at pace with changing costs or other growth opportunities.

On a very simple level, the risks of selling to the DoD are increasing, while profits are decreasing:

The traditional Wall Street view of the defense industry is that it should demand lower multiples than the technology industry as it possesses less revenue risk having the Department of Defense as its primary customer. However, with year-over-year variations in the defense budget and high-value transaction fluctuations in the Foreign Military Sales program, revenue volatility can actually be much higher than expected. Given that contract revenue volatility can result in lower margins, the major defense contractors seek alternative methods of revenue stability. . . . *Stabilized revenue generation and high margins are limited by fluctuating policies and budgets* while competitive advantages are disrupted by innovative new companies, so the primes utilize their balance sheets and respond with acquisitions and consolidation, *further reducing production capacity to save costs.* (Van der Colff, 2023, emphasis added)

Businesses don't thrive when the primary metric of success is low price. Nor do customers. The current challenge of replenishing supplies sent to Ukraine illustrates that an effective defense industrial base operates with redundancy, flexibility, and surge capacity. Leaders in the DoD and Congress are now admitting the weaknesses of just-in-time



inventory strategies and are employing rapid acquisition strategies, especially for supplies considered necessary for national security. The establishment of the Joint Production Accelerator Cell in March 2023 begins a larger outreach to existing defense contractors to build “enduring industrial production capacity, resiliency, and surge capability” (LaPlante, 2023). As this and other efforts pick up speed, we are starting to see the potential of what it could look like when this relationship is nurtured around a shared commitment to mission. Such enhanced communication should be institutionalized as the rule, not the exception.

### Better Communication

The key to any successful relationship is communication, listening, understanding the other’s needs and perspectives, and working to find the middle ground that meets the needs of all parties concerned. This is not the DoD’s strong suit. Many contracting officers opt not to have robust communication with industry, often out of fear of protest or violating a regulation. More robust communication has many advantages. A number of analysts believe that increased communication has helped reduce the number of bid protests (Konkel, 2022). One senior industry official told us that they prefer other transaction authority contracts because DoD contracting officials tend to be more communicative in negotiations.

The benefit of enhanced communication between industry and government/DoD is no secret. OMB’s Myth-Busting memo #4 reminds acquisition professionals of all the channels of communication available to them and asks each agency to appoint an industry liaison (Field, 2019). More frequent and ongoing communication between industry and the DoD will help the DoD better understand commercial business processes and make clear where compromise can most effectively achieve the shared mission of ensuring national security priorities.

### Build a Win-Win Relationship

Too often, in an overzealous effort to drive down cost, conduct oversight, protect DoD interests, or improve performance, the DoD takes a win-at-all-cost-on-every-issue approach. Such an approach may save some money, garner more IP rights, or facilitate a far-reaching oversight regime in the short-term, but the long-term consequences have contributed to a less robust, less resilient, and less dynamic NSIB. The DoD should embark on a win-win approach that focuses on nurturing its relationship with industry, recognizing industry needs, and being a more supportive partner with industry.



### **Progress Payment Rates: The Bigger Context**

Progress payments help companies finance their work on long-term contracts without having to go to public markets for financing. The DoD increased progress payments rates during the pandemic to increase the velocity of funds flowing through the industrial base. Some officials have recently suggested that progress payment rates may be brought down to pre-COVID levels. In Congress, legislative proposals have sought to drop progress payment rates as low as 50%, with the possibility of increasing the rates if certain requirements are met.

Understand Industry: Cash flow is the lifeblood of industry. Elevated progress payments for work already performed is important to industry and does not increase cost to the government.

In March 2023, Bloomberg reported that small business are shedding jobs, in part due to higher interest rates, stating “U.S. businesses with less than 20 employees have eliminated 594,000 jobs since December 2021, while firms with 20 to 49 workers shed jobs for a second-straight month.” This was attributed in part to interest rates because “Small businesses are often more sensitive to higher rates than larger ones, since they don’t have the ability to lock in borrowing costs on the bond markets” (Tanzi, 2023).

Seek a Win-Win Approach: In a high-inflation economic landscape with increasing interest rates and an FY2024 budget request that does not have meaningful increases in spending (and likely does not keep up with inflation), the DoD should maintain progress payment rates at current levels. Maintaining the current rates is an easy way for government to support industry and pursue a win-win approach, giving industry incentives and benefits where it can.

As the current efforts from the Joint Production Accelerator Cell show, a healthy relationship with the defense industrial base involves compromising—here giving up some efficiency to get greater resilience. The White House has also invoked the Defense Production Act liberally since 2020, waiving many statutory requirements to meet national security imperatives. This productive relationship must continue.

### **Streamline the Relationship to Make it Less Beholden to Regulations and Easier to Navigate**

The DoD should undertake a comprehensive analysis of what statutes, regulations, and policies are driving industry to leave the NSIB. Armed with such information, the DoD could then submit legislative proposals to Congress and initiate regulatory changes to the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement that are aimed at rebuilding industry participation in the government marketplace while still maintaining the necessary oversight



### **Balancing Oversight with Industry Needs**

We pulled all FPDS data that had “Certified Cost or Pricing Data” requirements for FY 2021. The current threshold is \$2 million. Raising this threshold to \$10 million would cut the burden on half the companies while still capturing 81.6% of dollars. The number of companies under the current \$2 million threshold is 1,106, which reduces to 653 companies under a \$7.5 million threshold and 557 companies under a \$10 million threshold. A \$10 million threshold would also drop the number of contracts affected by 62.6%.

If you moved the threshold down to \$7.5 million, which is actually reasonable because that aligns with the threshold where companies would receive modified Cost Accounting Standards coverage, then the dollars covered is about 86% while contracts covered is 46%. Again, focusing time and auditing resources on where the biggest risks are (dollars) makes sense. Making this change would streamline business relationships while still maintaining important cost oversight.

*Note: The data are not perfect; for example a competitive contract that then gets a sole-source modification >\$2 million is actually TINA-covered but doesn't appear in the FPDS data. Moreover, there are contract values below \$2 million that appear but are excluded from this analysis, perhaps because they are grandfathered in from a 2018 rule.*

This review of existing statutes, regulations, and policies should become a routine process that reevaluates requirements against the latest National Defense Strategy. Requirements that do not directly support these NDS priorities (such as domestic public policy priorities) should be removed. If this review occurs every four years, the effectiveness of this process would be inherently assessed and modified as necessary. If the loss of certain requirements created problems, that challenge would be resolved in the next iteration. This dynamic approach would solve the current bloated regulatory environment, which only adds requirements without taking a holistic view to the entirety of the compliance burden and the unclear priorities these diverse requirements convey to defense contractors.

As Pete Modigliani (2023) suggested, the DoD should survey the approximately 60 Program Executive Officers on the most significant bureaucratic barriers and regulatory impediments to operating with greater speed and agility and figure out how to remove these barriers (while maintaining absolutely necessary oversight). Such an effort could focus on repealing or eliminating those statutes and regulations whose value does not significantly outweigh the cost of an overly complex acquisition system, conducting a cost/benefit analysis to determine if certain thresholds should be raised.

Finally, the DoD should continue the progress made in reorganizing Title 10 and take the next step: harmonizing the cluttered notes that make a holistic understanding of the codified defense acquisition regulations nearly impossible.

### **The Times They Are a-Changin’**

Bob Dylan wrote “Come senators, congressmen Please heed the call don’t stand in the doorway don’t block up the hall.” He may not have been talking about defense acquisition but Congress has heeded the call and provided the DoD with acquisition authorities such as other transactions, commercial buying procedures, and expanded use of multi-year procurements. For its part, the Department is starting to change, driven in large part by the experience of Ukraine and by the commitment of current leadership. As Secretary of Defense (Acquisition & Sustainment) Bill LaPlante recently testified, “the Department continues to evolve our policies, processes—and most importantly—our culture” (LaPlante, 2023b). The DoD is also dedicating funding to address the industrial base





challenge, including its use of Defense Production Act authorities and funds, and in the FY2024 budget request, “continuing widespread investment to strengthen the industrial base” to include roughly \$6 billion into “foundational sectors such as microelectronics and castings and forgings to facilitate overall industrial base resilience.”

These moves are setting the stage to reverse the trends in the industrial base outlined above. But this change must continue and expand to create a fundamentally new way of doing business.

## Conclusion

In 1968, Robert Keller, the general counsel of GAO, provided his views of industry incentives and a particular regulation, the Truth in Negotiations Act. He testified:

It has been said by some that the act will destroy contract incentives. I do not believe this for a moment. At the risk of repeating myself, the act was designed to achieve full disclosure at the bargaining table. Is such a purpose adverse to traditional contracting concepts? Will full disclosure at the bargaining table destroy the incentive of a contractor? We think not. In fact, it should increase a contractor’s incentive to perform more efficiently. . . . GAO, for one, welcomes increased profits for the contractor if they are the result of efficiency in performance. (Keller, 1968, pp. 24–25)

In one sense, Mr. Keller is correct. The Truth in Negotiations Act, in and of itself, will not destroy the overall incentives to work with government. But in a larger sense, he is wrong. Taken in combination with all the other laws, regulations, and policies, the incentives have been significantly harmed. The current incentive structure (including the current formulation of the Truth in Negotiations Act) is driving vendors out of the government contracting market and discouraging new entrants. Current government acquisition rules are depriving the DoD from consistently getting the benefits of the best industry talent, the best commercial capabilities, and rapid transition and deployment of needed capabilities. If the regulatory burden and negative incentives are not addressed head on, no amount of outreach or training will bring businesses back into the defense marketplace—or keep them from leaving.

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## Appendix A.

Contractor Participation in the Government Marketplace—Trends (Source data).



HigherGov (Siken, 2023). All Federal		NDIA, 2023		GAO, 2021		Bloomberg (Nieberg and Murphy, 2023)			Bloomberg (Murphy, 2023)		CSIS		
Small businesses	dollars (in billions)	DoD Total	DoD total entering DIB	DoD Smalls	New entrants small	small DoD	Other DoD	Total DoD	DoD	Civilian	Total DoD	DoD small	DoD Other
											61,000		
121,270	205.10												
114,618	102.20			42,723									
102,140	97.90			39,408									
90,767	90.20			33,312									
90,255	97.00			33,911									
87,570	96.10			33,270									
83,987	104.10			31,839	7,083								
84,029	109.10	76,723		30,360	6,709								
77,459	123.90	73,820	10,076	28,711	6,212	40,752	14,840	55,592	50,704	80,159			
69,490	132.50	66,576	8,189	26,364	5,523	38,434	14,125	52,171	48,095	72,122			
66,223	148.80	63,022	8,369	24,296	5,526	36,705	13,431	48,750	45,969	70,745	41,600	26,600	15,000
61,886	153.80	59,678	8,322			35,036	13,293	48,329	44,332	66,693			
58,681	158.70					32,681	12,648	45,329	41,478	63,196			
-52%		-22%	-17%	-43%	-22%	-20%	-15%	-18%	-18%	-21%	-32%		



## Appendix B.

List of all prohibitions or restrictions currently working their way through the rule-making stage or recently implemented (as of March 1, 2023).

Source: Open FAR Cases (<https://www.acq.osd.mil/dpap/dars/opencases/farcasenum/far.pdf>), Open DFARS Cases (<https://www.acq.osd.mil/dpap/dars/opencases/dfarscasenum/dfars.pdf>), Unified Regulatory Agenda, and an analysis of legislation.

Prohibitions and Unique Requirements in Process								
Prohibition	Description	Public Law	US Code	Statute Implementation Date	Rule Status	FAR/DFAR	Case	Regulation Effective date
Chinese Telecommunications Equipment and Services	Prohibits agencies from procuring covered equipment and services from Huawei, ZTE Corporation, Hytera Communications, Hangzhou Technology, or Dahua Technology (including subsidiaries or affiliates). Prohibits procuring from an entity that itself uses the covered items and services. No flowdown clause.	Sec. 889, FY19 NDAA	<a href="#">41 USC chapter 39: front matter, note</a>	Subsection (a)(1)(A)—1 year from enactment [8/13/19] Subsections (a)(1)(B), (b)(1)—2 years from enactment [8/13/20]	Interim rule, drafting final rule for both	FAR	(a)(1)(A) - 2018-017 (a)(1)(B) - 2019-009	Subsection (a)(1)(A) - 12/13/2019 Subsections (a)(1)(B) - second interim rule, 10/26/20
Foreign-Made Unmanned Aircraft Systems	FY20 NDAA—Prohibits the DoD from operating or contracting to procure a UAS manufactured in China or from an entity domiciled in China; using flight controllers, radios, cameras, software, network connectivity and other specified items FY23 NDAA—Expands prohibition to include Russia, N. Korea and Iran; prohibits the DoD from contracting with an entity that operates equipment in performance of a DoD contract from specified sources or in/controlled/influenced by China, Russia, N. Korea, or Russia.	Sec. 848, FY20 NDAA Sec. 817, FY23 NDAA	<a href="#">10 USC 4871, note</a>	FY20 NDAA—180 days after the FY23 NDAA enacted (as amended) issue policy FY23 NDAA—180 days after enactment issue policy	FY20 NDAA—Drafting proposed rule FY23 NDAA—no case yet	DFARS	2020-D020	FY23 NDAA – N/A
Certain Semiconductor Products and Services	Prohibits agencies from acquiring or contracting for electronic parts, products, or services that include covered semiconductor products or services, or procuring from an entity that itself uses electronic parts or products that include covered semiconductors. Covered semiconductors are from specified Chinese companies of are identified by the DoD.	Sec. 5949, FY23 NDAA	not placed yet	Five years from enactment	No case yet	FAR	N/A	N/A



Rare Earths and Strategic and Critical Materials	1) Requires contractors to disclose to the DoD sources for permanent magnets containing rare earths or strategic and critical minerals in delivered systems. 2) Expands the DoD prohibition of procuring from Chinese companies by expanding the Chinese entities included and by adding goods and services that are on the commerce control list that contain rare earths, strategic and critical minerals, or energetic materials used to manufacture missiles or munitions.	Sec. 857, FY23 NDAA	1) Provenance— not yet assigned 2) Prohibition— 10 USC 4651, note prec.	1) Provenance—30 months after enactment and after the DoD certifies that gathering the data does not pose a relevant national security risk 2) 180 days after the DoD certifies that there are sufficient number of commercial providers outside China that can provide quality and quantity of needed goods or services, when needed and at U.S. market prices	Drafting proposed rule	DFARS	2023-D003	N/A
XUAR Region in China	<u>FY22 NDAA</u> : Prohibits procuring items mined, produced, or manufactured by forced labor in XUAR using funds made available for FY22 <u>FY23 NDAA</u> : Codifies and makes permanent the prohibition of the DoD to procure certain items from the XUAR and removes the certification clause.	Sec. 848, FY22 NDAA Sec. 855, FY23 NDAA	<u>FY22 NDAA</u> — 10 U.S.C. 4651, note prec. (repealed in FY23 NDAA) <u>FY23 NDAA</u> — 10 USC 4661 prec.	<u>FY22 NDAA</u> —90 days after enactment <u>FY 23 NDAA</u> —DoD to issue policy within 180 days of enactment	<u>FY22 NDAA</u> — Interim rule published 12/16/22, public comment period ends 2/14/23 <u>FY23 NDAA</u> —no case yet	DFARS	2022-D008	<u>FY22 NDAA</u> - interim effective 12/30/22
Printed Circuit Boards	Amends 10 USC 2533d by changing date of implementation, changing definitions of covered PCBs, and authorizing the DoD to issue exemptions.	Sec. 851, FY22 NDAA	<a href="#">10 USC 4873 (old 10 USC 2533d)</a>	January 1, 2027 (extended from the previous date of January 1, 2023)	Drafting proposed rule	DFARS	2022-D011	N/A
Worker Transparency for Individuals Performing Work in China	Covered entities must disclose to the Secretary of Defense if employees will work in China on a covered contract—including the number of individuals and work locations. The Secretary will brief Congress semi-annually on these disclosures.	Sec. 855, FY22 NDAA	<a href="#">10 USC 363, front matter</a>	1-Jul-22	Draft final rule under review	DFARS	2022-D010	N/A
Certain Metals	Amends 10 USC 2533c by replacing "material melted" with "material mined, refined, separated, melted" and by replacing "tungsten" with "covered material."	<a href="#">Sec. 844, FY21 NDAA</a>	<a href="#">10 USC 4872, amendment</a>	Five years from enactment	Drafting proposed rule	DFARS	2021-D015	N/A
CMMC (Cybersecurity Maturity Model Certification)	Measures a company's maturity and institutionalization of cybersecurity practices and processes.	Sec. 1648, FY20 NDAA	<a href="#">10 USC 2224, note</a>	180 days from enactment of the FY22 NDAA (as amended by sec. 1526 of the NDAA)	<u>2019-D041</u> — Drafting proposed rules <u>2022-D017</u> — Drafting final rule	DFARS	2019-D041 2022-D017	N/A
Greenhouse Gas Emissions	Requires contractors to publicly disclose their greenhouse gas emissions and climate-related risks and to set science-based emissions reduction targets.	n/a— proposed by the DoD, GSA, and NASA	n/a—proposed by the DoD, GSA, and NASA	Two years after publication of final rule	Drafting final rule	FAR	2021-0015	N/A







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