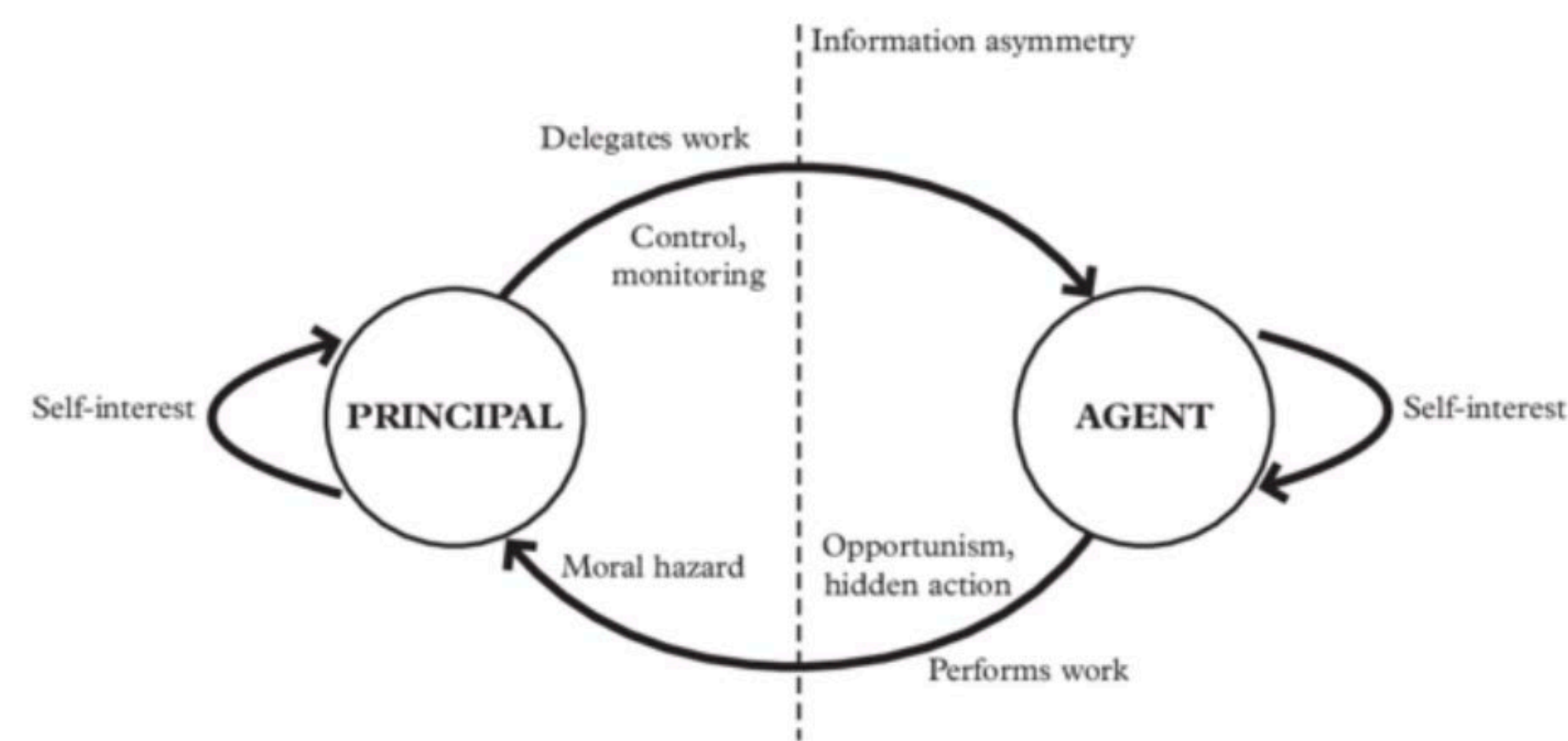


Abstract

- This thesis examines the root causes of misaligned risk-sharing and conflicting incentives between the government and the Defense Industrial Base in Major Defense Acquisition Programs and evaluates a range of risk-management and incentive-alignment approaches, including enhanced program-management practices and redesigned incentive structures. Drawing on economic theory, particularly agency theory involving information asymmetry and moral hazard, it analyzes current acquisition programs and relevant literature on incentive design and industrial-base resilience. The thesis proposes an alternative profit function and contract-design framework that better aligns firms’ profit-maximization incentives with the government’s objectives of cost control and truthful cost estimation. The findings suggest that a more balanced approach to risk allocation is essential to sustaining the competitiveness and strategic effectiveness of the U.S. Defense Industrial Base.

Methods

- Qualitative analysis of program management risk-sharing techniques
- Assessment of current risk allocation methods in MDAP contracts
- Literature review of economic principles focusing on incentive schemes
- Examination of Agency Theory and the implications for contract management



Results & Impact

- Using a contract incentive scheme informed by agency theory, firms can be incentivized to self-regulate with regards to information asymmetry and moral hazard
- Contract incentive schemes can serve as an oversight mechanism for under-resourced program offices
- Failure to adequately distribute risk between firms and the government could result in a no-deal scenario

Firm's Profit		C (actual cost incurred)			Firm's Expected Profit
		50 (p = 1/3)	100 (p = 1/3)	150 (p = 1/3)	
\overline{TC} (budget target cost)	50	N/50	0	-N/50	0 (under-reporting)
	100	3N/200	N/100	N/200	N/100 (The highest profit is achieved by telling the truth)
	150	N/90	2N/225	N/150	2N/225 (over-reporting)

Future Research

- Quantify Firm-Fixed-Price risk premiums priced in by firms absorbing acquisition program risk
- Evaluating the Government’s ability to effectively and accurately conduct cost estimation and the consequences on acquisition programs



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Kelley Poree