

Leveraging the Working Capital Fund

to Scale and Sustain Innovation

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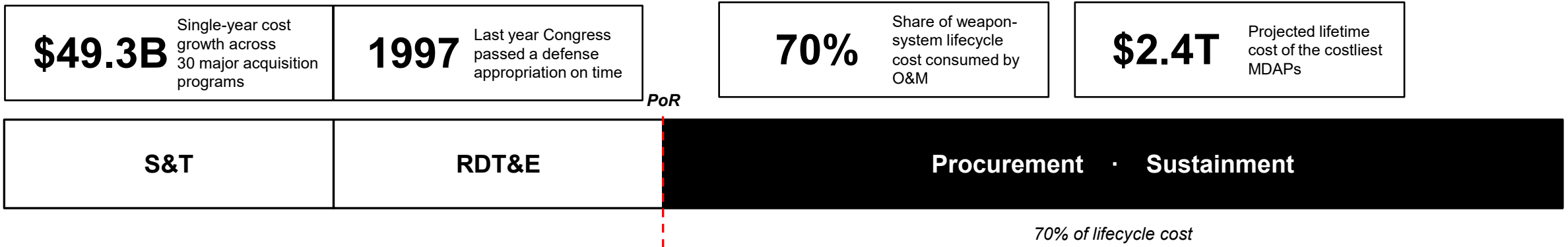
U.S. Army

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Acquisition reform has outpaced fiscal architecture

The Planning, Programming, Budgeting & Execution (PPBE) is structurally incapable of supporting post-production innovation. Once a system reaches program-of-record status, annual appropriations, color-of-money restrictions, and continuing resolutions combine to lock 70% of lifecycle cost into sustainment with no self-financing mechanism to modernize it.

The “ditch of death” is post-production



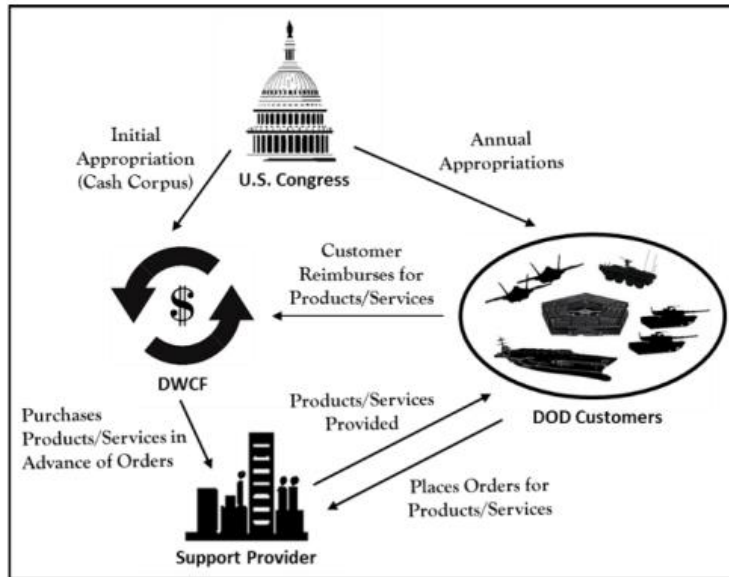
Color of money silos: Post-production improvements compete in the next PPBE cycle 18–24 months out, not in-period when the need is identified

Program-of-record incentives flip toward consumption:

- Achieving PoR status moves the contractor from competitive bid environment into a structural sole-source position
- Sustainment contracts are predominantly cost-plus or time-and-materials — provider revenue scales with hours billed, not capability delivered. Net effect: the incentive architecture rewards consumption of government dollars, not delivery of warfighter capability

Can the Working Capital Fund model bridge the sustainment-to-modernization gap?

The Working Capital Fund (WCF), authorized under 10 U.S.C. § 2208, is an underutilized instrument of incentive architecture that — without new appropriations or legislation — can deliver the patient capital that the defense innovation ecosystem requires.



*Defense Primer: Defense Working Capital Funds
Congressional Research Service*

STRENGTHS WORTH PRESERVING

- Multi-year execution survives appropriation lapses
- Demand aggregation across services = purchasing leverage
- Stabilized published rate gives ordering activities certainty
- Full-cost visibility on overhead and depreciation
- External Sales Authority - FMS revenue

STATUTORY CONSTRAINTS

- Break-even mandate: no retained margin
- Surplus must be returned to customers via rate reduction
- Mandatory-use environment: no market price discipline
- Cash floor: LOR breach = Anti-Deficiency Act violation
- FY24→FY26 cash position has fallen \$2.6B (FY24-FY26)

Defense vs. Commercial Working Capital Funds

CURRENT DWCF

$$\text{Rate } (\$/DLH) = \frac{\text{Direct Labor + Indirect Overhead + Capital Surcharge } \pm \text{ AOR}}{\text{Projected Direct Labor Hours (DLH)}}$$

STRUCTURAL WEAKNESSES

Wrong unit: *DLH is an input* · **All cost-recovery:** *no margin, no return window* · **Forecast denominator:** *18–24 month correction lag*

COMMERCIAL MANAGED SERVICES BENCHMARK

$$\text{Rate } (\$/output) = \frac{\text{Cost Floor + Operating Margin + Reinvestment Premium + Risk Reserve}}{\text{Contracted Output Volume}}$$

STRUCTURAL ADVANTAGES

8–15% margin: *retained earnings fund reinvestment* · **2–5% premium:** *innovation built into rate* · **3:1–6:1:** *private leverage on retained capital*

The Innovation Working Capital Fund (IWCF)

IWCF RATE-SETTING FORMULA

$$\text{Rate } (\$/OU) = \frac{\text{Direct Labor + Indirect Overhead + Capital Surcharge} - \text{Offsets} \pm \text{Innovation Premium} / \text{AOR}}{\text{Projected Output Volume}}$$

FOUR LEVERS THE PAPER PROPOSES

1

Output denominator

Replace direct labor hours with availability unit. OU replaces DLH, driving performance over consumption

2

Equity offsets

Recognize four government-contributed assets as explicit rate offsets: TDP rights, real property, government furnished equipment and materials, statutory IP

3

Innovation premium

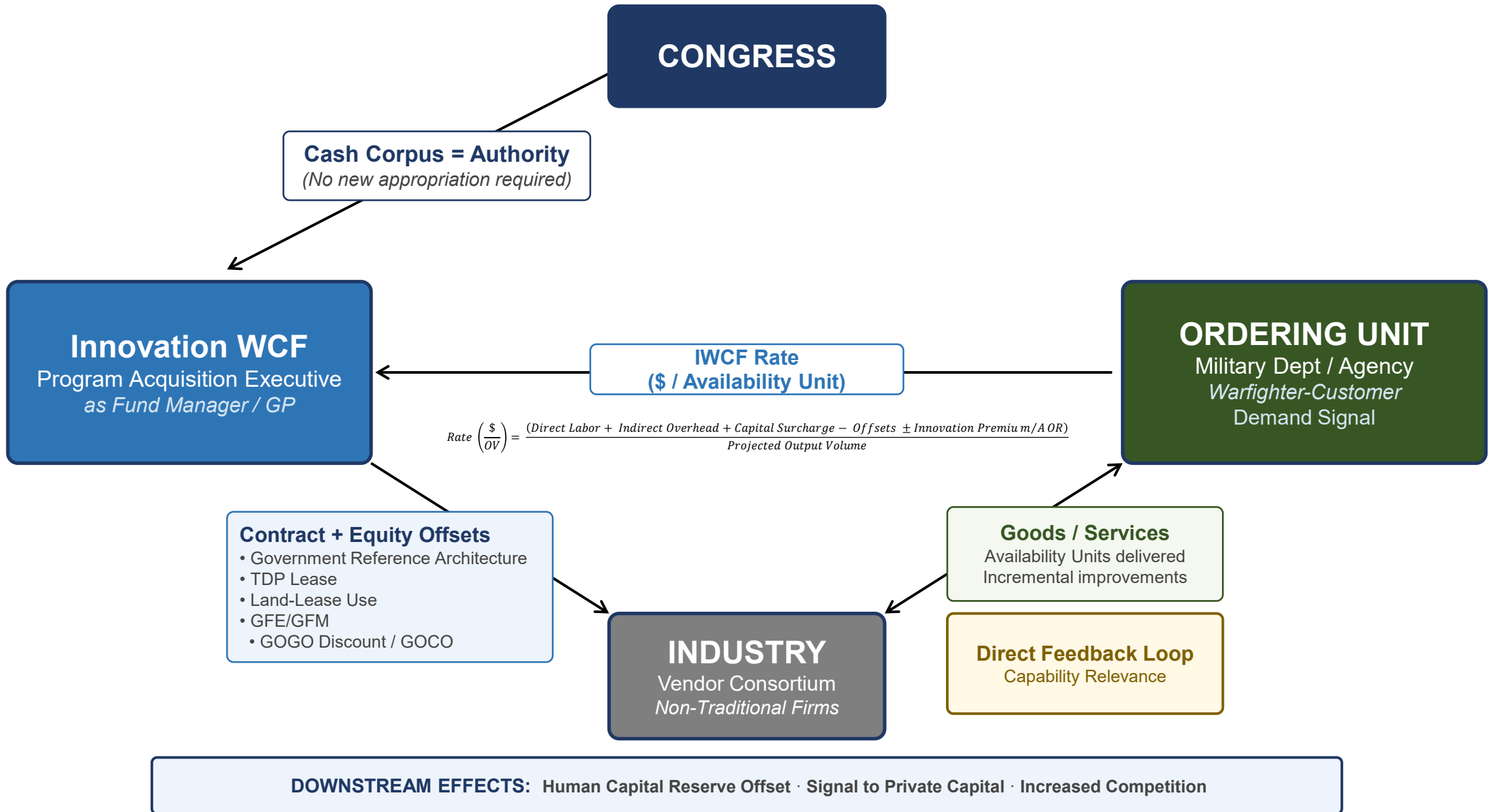
Embed 3–5% premium under § 2208(c) and § 2208(e)(1) authority

4

PAE as fund manager

Portfolio Acquisition Executive operates the fund like a GP and sets the WCF rate

THE IWCF ARCHITECTURE: A SUSTAINABLE FUNDING AND INCENTIVE FEEDBACK LOOP



A reimagined capability-based Working Capital Fund

More than a funding mechanism — a market-aligned feedback loop that streamlines demand, attracts private capital, and ensures the warfighter is met by today's industrial base, not the budget cycle of two years ago.

IMPLEMENTATION CHALLENGES

Output-unit definition

Establishing defensible availability metrics auditable to FMR Vol. 11B standards

Equity offset valuation

Annual independent appraisal of TDP, real property, GFE, and IP rights at portfolio scale

PAE governance authority

Codifying portfolio-level decision rights without triggering a new statute

Cultural inertia

Service comptrollers, OSD CAPE, and OMB must accept rate restructuring within break-even mandate

DOWNSTREAM EFFECTS

- **Performance-keyed feedback loop**
- Output units (system-mission-capable-day)
- Equity offsets + 3–5% innovation premium
- Innovation funded in-period at the rate level
- Provider profits from reliability, not consumption
- 3:1–6:1 leverage on private infrastructure capital



Streamlines demand

Warfighter-to-industry feedback in-period



Promotes collaboration

PAE-led consortia under shared GRA



Maximizes industry partnership

Equity offsets + premium attract capital



Meets today's battlefield

Capability matches operational tempo