

CONTRACTORS IN THE WORKPLACE

Concerns about the Future

Advanced Management Program

29 June 2001



*Tench Francis
School of Business*

Team #6

Bill Boatright Tom Callan

Brian Hudson Art Lopez

Baerbel Prentiss Dave Watt

Contractors in the Workplace

Introduction

The workforce in the Department of Defense (DoD) has changed dramatically over the last two decades. The 1980's left a legacy of enormous budgets and little money management. However, the 1990's witnessed a downsizing of the Department of Defense and an increase in contractor support. Ironically, although the Department of Defense has decreased in overall manpower, and budgets have decreased, the dependence on contractor support has multiplied.

The purpose of this paper is not to argue the relevance of downsizing but to address a common concern currently shared among officers and civilians about the changing characteristics of the DoD workforce. This change is reflected in the significant growth of service contracts within DoD and the resultant increase in the number of contractors in the workplace. "Between fiscal year 1990 and fiscal year 2000, purchases of supplies and equipment fell by about \$25 billion, while purchases of services increased by \$17 billion (24 percent). Consequently, purchases for services now account for about 43 percent of federal contracting expenses-the largest single spending category. Professional, administrative, and management support services, ...rose from \$12.3 billion in fiscal year 1990 to \$21.1 billion in fiscal year 2000."¹

Theory

Originally, outsourcing was seen as another method of filling vacancies that occurred as a result of the previous administration study on reinventing government. It has continued to serve this purpose to this day. The government has downsized, but all too often, the vacancies have been backfilled with contract labor. Although the current emphasis on downsizing is a direct result of the end of the Cold War, the question remains, is it practical? We are reducing the number of civil servants and military, while increasing the amount of contractors - so, where are the savings? Are we not just changing the color of the money being used? "The increase in the use of service contracts coincided with a 21 percent decrease in the federal workforce, which fell from about 2.25 million employees as of September 1990 to 1.78 million employees as of September 2000."² It is estimated that there are over 5.6 million contractors currently working for the government.

On the surface the idea of contractors replacing government workers for non-core functions is sound. The contractors, or *Beltway Bandits* as they are known to some, are mostly retired military personnel. They know the culture and do not need to be trained in the military methodology of business. In many respects, they represent subject matter experts in many technical fields and provide expertise that the active duty military and civil servants do not have. They are conscientious, dedicated and perfectly compliment the DoD workforce.

The contractors bring with them the hope of fresh ideas and practical experience into a staid and bureaucratic workforce. Their military background coupled with newly

developed business skills bring about new life for DoD. “Contractual incentives should target the business relationship between the government and the contractor in such a way as to produce maximum value for taxpayers, for the contractor, for the warfighter, and for the organization in pursuit of its mission. The workforce must not only improve its ability to use existing contractual incentives, but also to develop a range of new and innovative contractual incentives.”³ While the financial advantages of outsourcing services include a flexible workforce that can be increased or decreased as needed and a payroll free from the burden of retirement and health benefits, it also increases the technological edge of our armed forces by, “...creat[ing] a more dynamic environment, a climate of innovation and change that is beneficial...”⁴ (Stan Soloway)

Reality

Despite the similarities between contractors and civil servants, there is a significant distinction. Like the military, contractors are mission focused. However, their mission is unlike the mission of the program office which they support. Instead, their loyalty remains with the company that employs them. Hence, they have a different focus, primarily profit for their corporation. This is readily apparent in their constant desire to “grow the business”.

Contractors are not content to just meet the requirements of the command if they can somehow provide a greater service that will enhance the command’s mission and by proxy, their corporate profit. Often this results in a sales pitch to the program office for a product that provides the latest technology at a higher cost. This practice places the program manager in a difficult position. The success of the program is predicated upon a

desire to produce immediate results with less emphasis on cost efficiency prior to moving on to the next stage of his career. On the other hand, the contractor may have been supporting this same program for some time, and is able to provide a wealth of information. Like a ship's Captain, the Program Manager wants to rely on the Harbor Pilot who has worked this port for many years to keep the program from running aground. As a result, the contractor becomes an integral part of the workplace. Today there exist two distinct workforces, each working under a different set of rules and serving different masters. Unlike the government employees, we cannot assume that all contractors will abide by the ethics defined in Congressional legislature. "What is gained in flexibility and short term savings may result in a loss of institutional knowledge and long term effectiveness on the part of the government."⁵

The reliance on contractor support is apparent at United States Joint Forces Command (USJFCOM) located in Norfolk, VA. This command is leading the transformation of the military in the areas of Joint Experimentation and Joint Warfighting. It is safe to say that USJFCOM could not perform its mission without its highly talented contractor workforce. The command currently has over 1170 contractors, nearly half of the workforce, up from 722 in 2000. These contractors work in numerous locations around the world providing professional, administrative and management support services in leading this transformation. As the mission has grown over the years at USJFCOM, so have the support costs. In many instances, contractors at USJFCOM are providing support that government personnel cannot match in scope or quantity. As a result of the constant turnover of military personnel, the contractors are becoming the corporate knowledge of the command and the stabilizing force.

While follow-on contracts are being developed, the preferred method of contracting at USJFCOM is the cost type contract. This practice is due to the inability of the program office to accurately determine their requirements and develop a Statement of Work that provides metrics for contractor performance. As a result, a cost type contract is developed with requirements that allow the program office and the contractor the flexibility to experiment and investigate areas that have not been explored. This has worked well for a command that is leading the transformation into new areas of warfare. However, the concern is that this practice provides a proverbial blank check to the contractor as they work to meet the requirements of the current contract.

Additionally, there may be unique situations that are not addressed within the contract. For example, there are contractors, who are also Reserve Officers and drill with the same command that their contract supports. This leads to uncomfortable situations as the contractor/Reserve Officer is exposed to budget material, command and program insights that would normally be protected. The command must be especially diligent preserving the program sensitive material while the Reserve Officer is performing his active duty obligation. Although this is an area of concern, it is not meant to denigrate the professionalism of the contractor workforce. As previously mentioned, these men and women have served their country admirably and maintain high ethical standards in and out of the workplace. However, it doesn't preclude the split allegiance that we must recognize.

Finally, there is a concern on the ability of these retired military officers with a Cold War, or Desert Storm mindset to help lead the Revolution in Military Affairs. Their

focus will continue to be the growth of the business, and in a command like USJFCOM, increased outsourcing will incur greater costs.

Recommendations

There is no question that DoD will continue to rely on contractors for a significant portion of the workload in the foreseeable future. It is not practical, nor wise to expect to remove contractors from the workplace. The focus should rather be one of educating the workforce on how to deal with contractors and maintain an arms length relationship with contractors in order to protect taxpayer money. The following are three possible solutions to effectively address some of the concerns previously stated:

Activity Based Costing (ABC). The first and foremost area to attack is the cost growth of the contracts. It has been stated that the Pentagon does not know how much money it has and precisely where it goes. As a result, our current administration is reluctant to open up the floodgates and continue to pour money into a pool that is leaking. Activity Based Costing, identified recently by the Secretary of the Air Force as his first order of business to implement, can be one of many tools that will enhance DoD's ability to get a handle on the costs of programs under its purview. By shining the light on the actual costs of the programs, the administrators can uncover the real cost drivers and be in a position to make informed decisions on which programs are cost effective. Not all areas will be able to utilize ABC on the initial run, but the larger dollar value programs may be the best place to start. Training in the use of ABC may help the smaller commands to master the process and in turn help larger commands get a handle on their

costs. Although ABC may not be the answer to all our problems, it is a long overdue step in the right direction.

Fixed Price Contracts. Another approach to help rein in the costs on our service contracts is an increase in the use of fixed price contracts in areas where costs can and should be defined. Although the issue of fixed price vs. cost type contracts continues to cycle, it is time to let the pendulum swing back to fixing the price of the contract and having the contractor restrict his costs or pay the consequences.

Fixed priced contracts suffered significant setbacks in the Reagan years under Secretary Lehman, but the failures occurred in many highly technical hardware purchases where the technology was not developed. The focus here is on the service contracts that may not be as unique. One example is found in a review by the DoD Inspector General of over 100 contract actions, which found “that contracting officers did not use experience from prior acquisitions of the same services to help define requirements more clearly. In one case, officials continued to award cost reimbursement contracts-and accepted the risk of cost overruns-despite 39 years of experience purchasing the same services from the same contractor.”⁶

The government workforce has relied too heavily on contractors to such an extent that, in some instances, they no longer provide the necessary oversight and independent review that will ensure a fair and reasonable cost to the government. That is the reason that many are concerned that the President’s recent decision to open 40,000 Federal workers’ jobs to competition will only exacerbate an already untenable situation. A fixed price contract, which requires less administration, will help to move us back in the right balance.

Keep What You Save. A third approach that was touched on recently by the Service secretaries deals with the incentive of allowing the service that saves money in cutting costs to keep that money. One such suggestion is that the government develops an incentive that will allow program offices and commands to return funding that they are unable to obligate at the end of the fiscal year. Every command experiences the drill in September as the end of the fiscal year approaches and the program has dollars it cannot spend. Rather than develop creative ways to obligate the money, such as buying new furniture or office equipment, we must provide incentives to reward those who will return money back to the government. Although this idea sounds impractical, it may have merit, especially since service contracts have risen over \$10 billion in the last decade. No business could operate in such a manner and stay afloat. If successful in recouping the savings, we could utilize the funds to shore up our readiness posture.

These recommendations are practical, though some may indeed require an act of Congress to initiate. Our concern is that the contractor force may be increased beyond what is beneficial to the organization. Hence, we cannot allow a situation to develop where the contractor is establishing budgetary needs using taxpayer dollars without government oversight.

Conclusion

Without question maintaining our of DoD core competencies is a priority. The implementation of ABC, Cost Performance Contracts and/or End-of-Year funding incentives will further enhance these competencies by ensuring sufficient funding for operational activities while controlling contractor spending. If contractor growth

continues unchecked we run the risk of contractors over influencing DoD spending. We must be vigilant as we continue to outsource more DoD initiatives to the private sector. At the same time, we must continue to demand the same level of professionalism that we have come to expect from our integrated workforce.

Continuing management programs such as Naval Supply Corps School's Advanced Management Program, is a significant venue to educate today's and tomorrow's leaders on better business practices that will improve efficiency while drawing attention to the growing relationship between contractors and government employees. Like it or not, this will be our future and by utilizing these techniques we can quantify, restrict and recoup our desperately needed funds that can shore up the readiness posture of our military units. Contractors offer a significant enhancement to DoD functions; we must ensure this remains the case.

Our thesis is that the contractor workforce can be increased beyond what is beneficial to the organization. We do not want to reach a situation where the fox is in the henhouse helping himself at the expense of taxpayer dollars. By institutionalizing ABC, cost-performance contracts, and end-of-the-year funding incentives we can improve our ability to accurately predict and manage future program costs. Should contractor growth result in contractors managing contractors, we will be at their mercy with little expertise to protect the government's interest.

¹ Contract Management: Trends and Challenges in Acquiring Services (GAO/NSIAD-01-753T, May 22, 2001).

² Ibid.

³ Department of Defense, Incentives Guidebook (2000), 1.

⁴ Ellen Nakashima, "Bush Opens 40,000 Federal Workers' Jobs to Competition," Washington Post, (June 7, 2001): 3.

⁵ Ibid

⁶ Contract Management: Trends and Challenges in Acquiring Services (GAO/NSIAD-01-753T, May 22, 2001).