

Product Support Arrangements

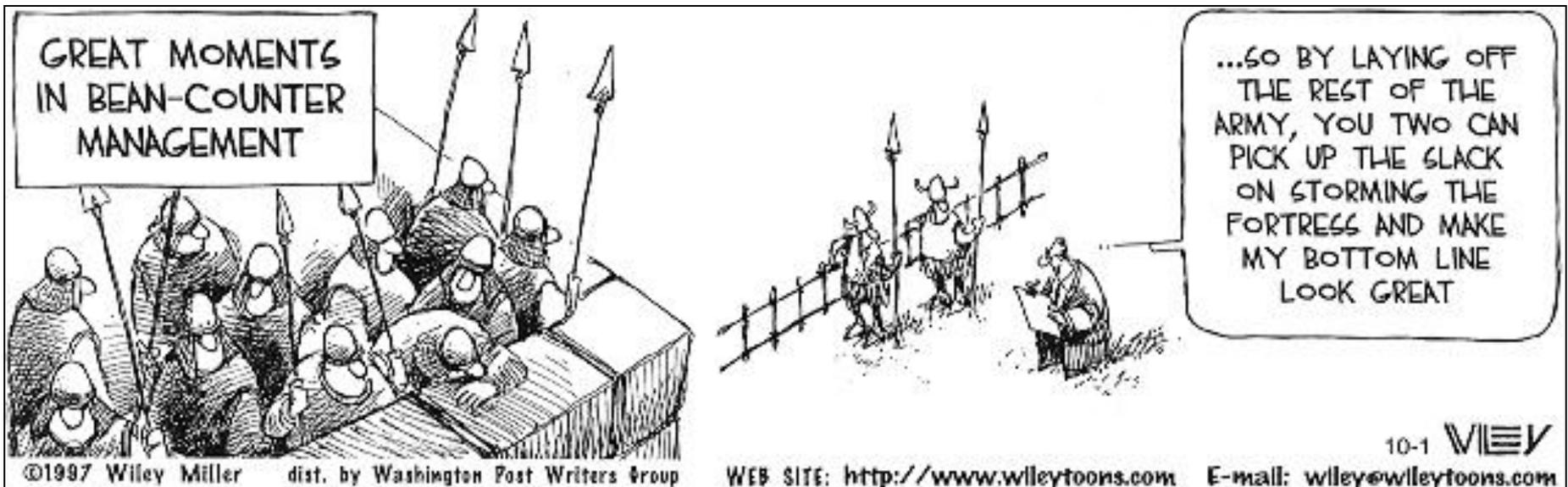
Mr. Gerry Tonoff
CAPT John Spicer



Leveraging Government and Industry Collaboration

Outline

- Game Changers—Doing Business a Different Way
- From Transactional Business Models to Outcome Based Business Models
 - ✓ Performance Based Logistics
 - ✓ Public Private Partnerships
- Competition
- The Way Ahead



Game Changers

Sep 14, 2010



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

SEP 14 2010

MEMORANDUM FOR ACQUISITION PROFESSIONALS

SUBJECT: Better Buying Power: Guidance for Obtaining Greater Efficiency and Productivity in Defense Spending

On June 28, I wrote to you describing a mandate to deliver better value to the taxpayer and warfighter by improving the way the Department does business. I emphasized that, next to supporting our forces at war on an urgent basis, this was President Obama's and Secretary Gates' highest priority for the Department's acquisition professionals. To put it bluntly: we have a continuing responsibility to procure the critical goods and services our forces need in the years ahead, but we will not have ever-increasing budgets to pay for them. We must therefore strive to achieve what economists call productivity growth: in simple terms, to DO MORE WITHOUT MORE. This memorandum contains specific Guidance for achieving the June 28 mandate.

Secretary Gates has directed the Department to pursue a wide-ranging Efficiencies Initiative, of which this Guidance is a central part. This Guidance affects the approximately \$400 billion of the \$700 billion defense budget that is spent annually on contracts for goods (weapons, electronics, fuel, facilities etc., amounting to about \$200 billion) and services (IT services, knowledge-based services, facilities upkeep, weapons system maintenance, transportation, etc., amounting to about another \$200 billion). We estimate that the efficiencies targeted by this Guidance can make a significant contribution to achieving the \$100 billion redirection of defense budget dollars from unproductive to more productive purposes that is sought by Secretary Gates and Deputy Secretary Lynn over the next five years.

Since June, the senior leadership of the acquisition community – the Component Acquisition Executives (CAEs), senior logisticians and systems command leaders, OSD officials, and program executive officers (PEOs) and program managers (PMs) – has been meeting regularly with me to inform and craft this Guidance. We have analyzed data on the Department's practices, expenditures, and outcomes and examined various options for changing our practices. We have sought to base the specific actions I am directing today on the best data the Department has available to it. In some cases, however, this data is very limited. In these cases, the Guidance makes provision for future adjustments as experience and data accumulate so that unintended consequences can be detected and mitigated. We have conducted some preliminary estimates of the dollar savings anticipated from each action based on reasonable and gradual, but steady and determined, progress against a clear goal and confirmed that they can indeed be substantial.

Changing our business practices will require the continued close involvement of others. We have sought out the best ideas and initiatives from industry, many of which have been adopted in this Guidance. We have also sought the input of outside experts with decades of experience in defense acquisition.

Dr. Carter memo to Acquisition Professionals

“...Those who hesitate to go down the road to greater efficiency must consider the alternative: broken or cancelled programs, budget turbulence, uncertainty, and unpredictability for industry, erosion of taxpayer confidence that they are getting value for their defense dollar and, above all, lost capability for the warfighter in a dangerous world.”

Industry Game Changers

Maintenance Service Agreements Transformed Business in the 1990s



- Four MSA Agreements with Honeywell
 - ✓ APU MSA
 - ✓ Mechanical MSA
 - ✓ Avionics MSA
 - ✓ W&B Cost Per Landing
- Terms and Conditions
Common to Each
Agreement***
- One Monthly Invoice
 - Covers 16 HON R&O Sites
 - On-Site Logistics Management
 - Contracts Work to Minimum Allocations (not TAT)
 - Performance Goal of 95% Balance on Hand

Gov't Game Changers—Navy PBL Evolution

- Naval Aviation PBL Efforts and Policy Gained Momentum After Award of Auxiliary Power Unit (APU) Total Logistics Support (TLS) to Honeywell in 2000
- TLS was Based on a Maintenance Service Agreement With Southwest Airlines... Included The First Public Private Partnership with the PBL Provider Held Fully Accountable for Metrics
- TLS Caught Navy Leadership's Attention with Impressive Results, Improving Readiness on Major Platforms (P-3, F/A-18, S-3, C-2):
 - ✓ APUs Awaiting Parts At Depot Reduced From 232 to 0, Backorders 125 to 0
 - ✓ Availability (SMA) 65% to 95%
 - ✓ Logistics Response Time 35 days to 5
 - ✓ Depot Repair Turn Around Time (RTAT) 162 to 38 Days
- TLS Is Fully Embedded in the Supply System, Completely Transparent to the Warfighter

TLS Was A Strong Influence On Then Developing USN PBL Policy

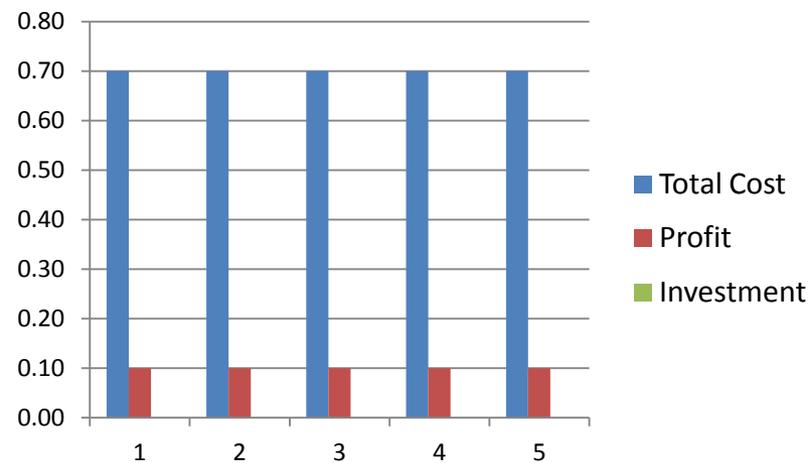
PBL Characteristics

- Win/Win For Gov't/Contractor...Other Services, FMS May Benefit
- Long Term Agreements
- Specified Performance Outcomes
- Availability And Reliability Commitments/Guarantees
- Enabled By The Working Capital Fund
- Robust BCA Must Show Savings Or “Break Even”
- Built In Incentives To Improve Product and Processes
- Commercial Best Business Insertion To Organic Processes
- Leverage Existing Infrastructure... Core Compliant
- Target Firm Fixed Price Contracts (FFP)... Provides Cost Predictability

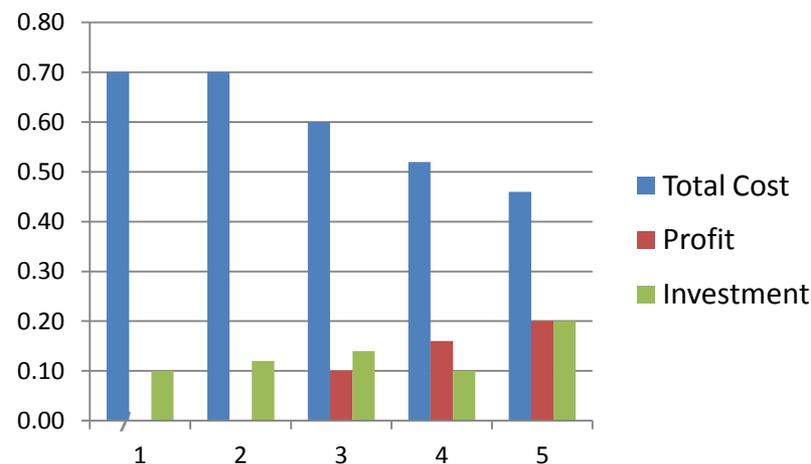
Applicable to all Business Areas—Not Just Aviation

PBL Business Model—PBL vs.. Transactional

Spend, profit and cost Traditional



Spend, profit and cost PBL



Impact of a performance based governance structure

Key points:

1. Price remains the same (or decreases)
2. While profit is low in PBL to start with, it ends up high.
3. There is no investment in traditional
4. At the end of the contract period (year 5) the cost under transactional remains the same (or increases)
5. Cost on PBL decreases
6. Cost is the greatest predictor of future price
7. Cost is related to investment
8. Investment is related to profit

PBL Pricing (Notional Example)

BCA conducted to ensure cost of PBL support equal to or less than legacy parts support

Aggregate Fleet Cost

Unit Cost = \$10 under traditional support

Pre-PBL:



= \$100

OEM executes reliability improvements into YR2...Unit Cost = \$20

PBL YR 2:



= \$80

OEM continues reliability improvements into YR5...Unit Cost = \$30

PBL YR 5:



= \$60

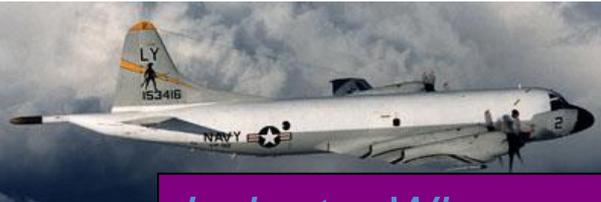
*Industry ROI Based on Increased Reliability/Fewer Repairs
Aggregate Costs are Reduced while Unit Costs Shift with Demand*

Benefits of a Long Term Deal

- Increases Opportunity For PBL Provider To Incorporate Improvements—Incentivizes Investment
- Stability For PBL Provider, Allows For Flow Down of PBLs To Suppliers
- Improves Chances For Savings (Lowers Risk & Price)
- Provides Cost Predictability
- Win-Win For Government And Industry: Affordable Improvements In Support; Investment Incentivized; Opportunity For Increased Profits
- Lowers Cost and Improves Performance

Business Structure Should Target Periods of Performance that are the Most Affordable and Best Support the End User

PARTNERSHIPS PROVIDE WIN, WIN, WIN



Industry Wins

- Business Growth
- Link to Warfighter
- Defensive Business Position
- Customer Teaming



FRCSE Wins

- Supply Chain Management
- Expanded Technical Service
- Technology Insertion
- Best Business Practices



Warfighter Wins

- Improved Availability
- Improved Time on Wing
- Reduced Backorders
- Reduced Cost of Ownership

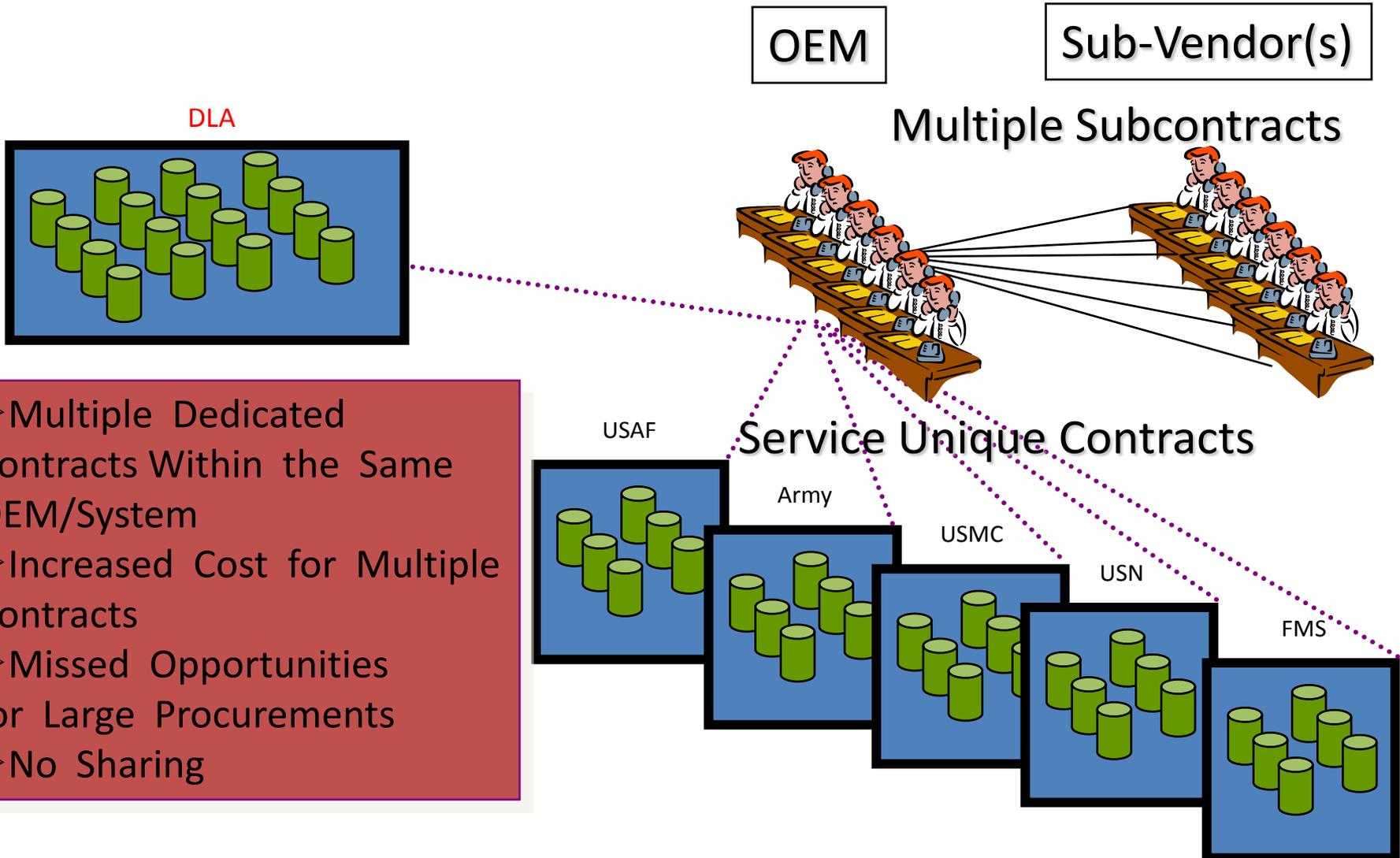


Competition

- Weapon System Acquisitions are Competitive
 - ✓ F/A-18 McDonnell Douglas Won
 - ✓ JSF Lockheed Martin Won
- Once the Winner is Decided We Don't Re-Compete
- For Components, the Competitive Environment is Largely Determined by the Availability of Technical Data
 - ✓ Previous Acquisition Policies Discouraged Buying Tech Data
 - ✓ To Buy it Back After the Fact is Expensive
 - ✓ Repair Processes are Often Proprietary
- Sole Source J&As Require SES/Flag Concurrence (CICA)
- Competition is the Preferred Acquisition Strategy—Given the Appropriate Conditions

*Gov't Entities Should Also be Subject to Competition
The PSM Should Look for Best Value from Industry and Gov't*

What's Wrong with this Picture?

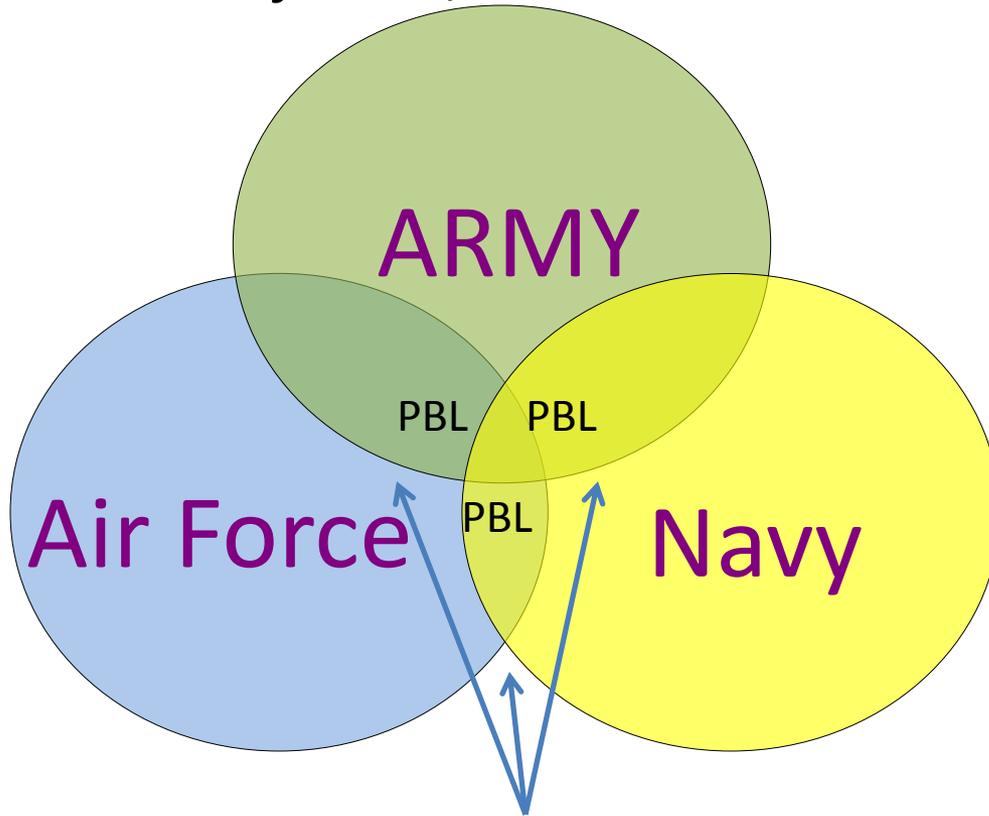


- Multiple Dedicated Contracts Within the Same OEM/System
- Increased Cost for Multiple Contracts
- Missed Opportunities for Large Procurements
- No Sharing

Is this a Business Structure in Need of a Game Changer?

Changing the Game

An Enterprise Approach Would Leverage One Supply Chain, One Set of Rules, One Business Model, and One Overarching PPP



- Rationalize the Business Structure
- Leverage economies of scale & scope
- Garner efficiencies associated with one standard business process
- Move from PBL 1.0 (separate efforts) to PBL 2.0 (enterprise PBL structures that span DoD)

Defense firms have consistently stated that DoD can save 15 to 20% by migrating to a joint PBL structure, while providing better availability and reliability

PBL Current Issues

- Current Issues/Concerns Causing Delays and Gaps In Fleet Support
 - ✓ Profit
 - ✓ Investment
 - ✓ Contract Period of Performance
 - ✓ Competition
 - ✓ Cost Reporting For FFP PBL Contracts
- PBL Renewals; Incentivizing PBL Behaviors In The Last Few Years Of A PBL
- System-Level Vs Sub-System PBL
- FMS Inclusion
- DLA/BRAC PBL Impact
- Lack Of Senior Champions In Industry And Government
- We Forgot About the “Bad Old Days”

Questions?

