




Challenges Facing Non-traditional Contractors

Communicating With a Redefined Industrial Base

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AS THE DEPARTMENT OF DEFENSE (DOD) FOCUSES ON reforming its acquisition system to move “at the speed of relevance,” one critical goal is to better recruit and engage with “non-traditional contractors” to deliver the weaponry and services necessary to maintain our technological edge and national security. The DoD must understand why these firms are not interested in or aware of supplying and supporting new and cutting-edge products and services. What do we now need for the DoD to increase its business partnerships with non-traditional contractors, and thus bring more ideas, entrepreneurial spirit, and new products and services to the defense market sooner to maintain our military edge?

Today’s defense acquisition system is under tremendous pressure to improve performance. Threats to national security change rapidly. As has been the case with many disrupted, former Fortune 500 and brick-and-mortar firms, business and consumer preferences in all forms of services and products continue changing for DoD, upending old economic models.

In this case, the customer is the U.S. citizen and the product is continued, unparalleled national defense. Success historically has depended on a powerful defense industrial base, which has been changed dramatically. The federal government formerly was a very significant contributor to research and development (R&D), including that leading to new weaponry. However, according to a National Science Foundation report, published by the American Association for the Advancement of Science, between 1965 and 2017, government’s share of R&D spending dropped from 65 percent to 22 percent in constant dollars. The DoD therefore is not the same big player it once was in the overall economy.

Adversaries are making rapid progress. This means that America’s best minds, who develop the technology that powers advances across our economy, increasingly must include national defense in their area of responsibility and work. DoD must reset how it conducts acquisition and learn to thrive by tapping into this new “industrial base” to find

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solutions from non-traditional contractors for providing the capabilities necessary to meet present and future security challenges.

Former Defense Secretary Ashton Carter highlighted this issue in a speech in Silicon Valley, California, in which he indicated that hardware and software being developed could support the DoD. Carter wished to reduce bureaucracy and increase research investment, by using the technical and entrepreneurial brains of this recent American technology success story. While those brains are not as involved in government-funded research as they used to be, partly because government does not invest in research as much as in the past, they are still patriotic. "They feel they too are public servants," Carter said, "and wish to have somebody in Washington they can connect to."

What issues surround this challenge, and what progress has been made? One view held by many is that existing acquisition rules and barriers to entry are too high. Government and the DoD acquisition regulations are cumbersome and complicated, discouraging non-traditional firms from competing for business against traditional defense contractors, as well as inside the Beltway think tanks and trade associations. Complicated contracting rules favor those who already understand and are established within the system. Other issues include the perception that the market is not large enough, that the effort isn't worth the hassle, that firms must give away their intellectual property, that new cost accounting and compliance systems are required, and that government personnel simply don't understand how industry works.

However, the defense market is increasing in size, which may at some point become more attractive to non-traditional contractors. The 2020 spending bill authorizes \$738 billion in military spending, a \$22 billion increase over 2019. While defense spending does not match the levels of past years, it is significant. These increases may make the DoD a more attractive, lucrative market for innovative, non-traditional commercial contractors, including those previously wary of federal contracting obligations and risk.

What exactly is a non-traditional contractor? As defined in statute and in the Defense Federal Acquisition Regulation Supplement (DFARS) 212.001, a "non-traditional defense contractor" is:

an entity that is not currently performing and has not performed any contract or subcontract for DoD that is subject to full coverage under the cost accounting standards ... for at least the 1-year period preceding the solicitation of sources by DoD for the procurement (10 United States Code 2302(9)).

In addition, the Federal Acquisition Streamlining Act (FASA) of 1994 intended to lower procurement barriers by giving preference to commercial firms, products, and services, which the DoD includes in the DFARS definition of non-traditional contractors, including the reasons for it:

iii) ... contracting officers may treat supplies and services provided by non-traditional defense contractors as commercial items. This permissive authority is intended to enhance defense innovation and investment, enable DoD to acquire items that otherwise might not have been available, and create incentives for non-traditional defense contractors to do business with DoD.

With current increased funding and statutory changes encouraging commercial contracting procedures, there is renewed interest in use of "Other Transaction Authority (OTA)," a contract method seen as a means to get the complicated and restrictive Federal Acquisition Regulation (FAR) out of the way under certain circumstances. OTA creates a "blank slate," as few statutes and rules apply. The Fiscal Year (FY) 2016 National Defense Authorization Act (NDAA) allowed transitioning of DoD programs from R&D and successful prototype to production by using OTA non-competitively. Contracting risk may increase for individually developed OT mitigating terms and conditions. The FAR conversely prescribes various solicitation provisions and contract clauses to use, depending on the circumstances.

The DoD typically awards OTs to companies directly, or through a consortium, which are then subcontracted to a member company or companies. Recent data indicated that, of \$5.8 billion thus obligated, a third (\$1.9 billion) went to individual companies and the remaining \$3.8 billion went to consortia or consortium management companies. These figures look very small compared with total DoD annual contract obligations of more than \$300 billion, but OTA is increasing rapidly. The Government Accountability Office (GAO) Report 20-84 documents OTA use increasing from 248 in FY 2016 to 618 in FY 2018.

However, the evidence is inconclusive thus far whether OTA use is increasing non-traditional contractor participation. OTA spending increased from \$845 million to \$3.98 billion between 2015 and 2018, with 93 percent of that from the DoD. Growth came from extending DoD's OTAs and redefining non-traditional contractors, including doubling prototype project ceilings from \$250 million to \$500 million. Of 148 awards from 2015 to 2017, non-traditionals received 98, but only \$7.4 billion of \$21 billion in funding. The nonprofit Rand Corporation expressed concerns about OTA results and risks back in 2002, concluding that it was unable to quantify OTA results. Most recent Government Accountability Office data (GAO 20-84) indicates that

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“companies that typically did not do business with DoD participated to a significant extent on 88 percent of the transactions awarded during this time.”

OTs limit DoD’s ability to access financial records to verify properly stated contractor costs and limited intellectual property rights from projects. In 2017, Defense Innovation Unit Experiential (DIUx, now DIU) awarded 48 prototype contracts, of which two went to production, with no fieldable systems, according to a congressional staff member.

Without data about the use of OTAs and the results as compared to typical FAR-based contracts, there is no assurance that OTAs are working as intended. Are agencies working with truly non-traditional contractors, are innovative products and services being produced, is the government saving money, and are the deals involving the intellectual property rights protecting the appropriate party?

The Trusted Capital Marketplace (TCM) is a new DoD initiative under the current administration with similar goals of enlisting non-traditionals, in response to Executive Order 13629 (signed in 2012), calling for public-private partnerships; and Sect. 1711 of the FY 2018 NDAA, calling for a “Pilot program on strengthening manufacturing in the defense industrial base.”

The SecDef [Secretary of Defense] must carry out a pilot program whose activities include: contracts, grants, or OTAs to support capabilities of small and medium sized firms; purchase goods or equipment for testing; “purchase commitments... including cost sharing with funding from nongovernmental sources”; issuing or guaranteeing loans; and “giving awards to third party entities to support investments in small and medium sized manufacturers working in areas of national security interest, including activities to support debt and equity investments. ...

As discussed in an article by Lt Col Mark Massaro, USAF, TCM intends to connect innovative defense and technology companies with trusted investors, helping them find capital and funding to continue research, development, or operations, thus precluding their engaging with “adverse

actors.” TCM would aim to bring together innovation sources and investors without incurring adverse foreign influence.

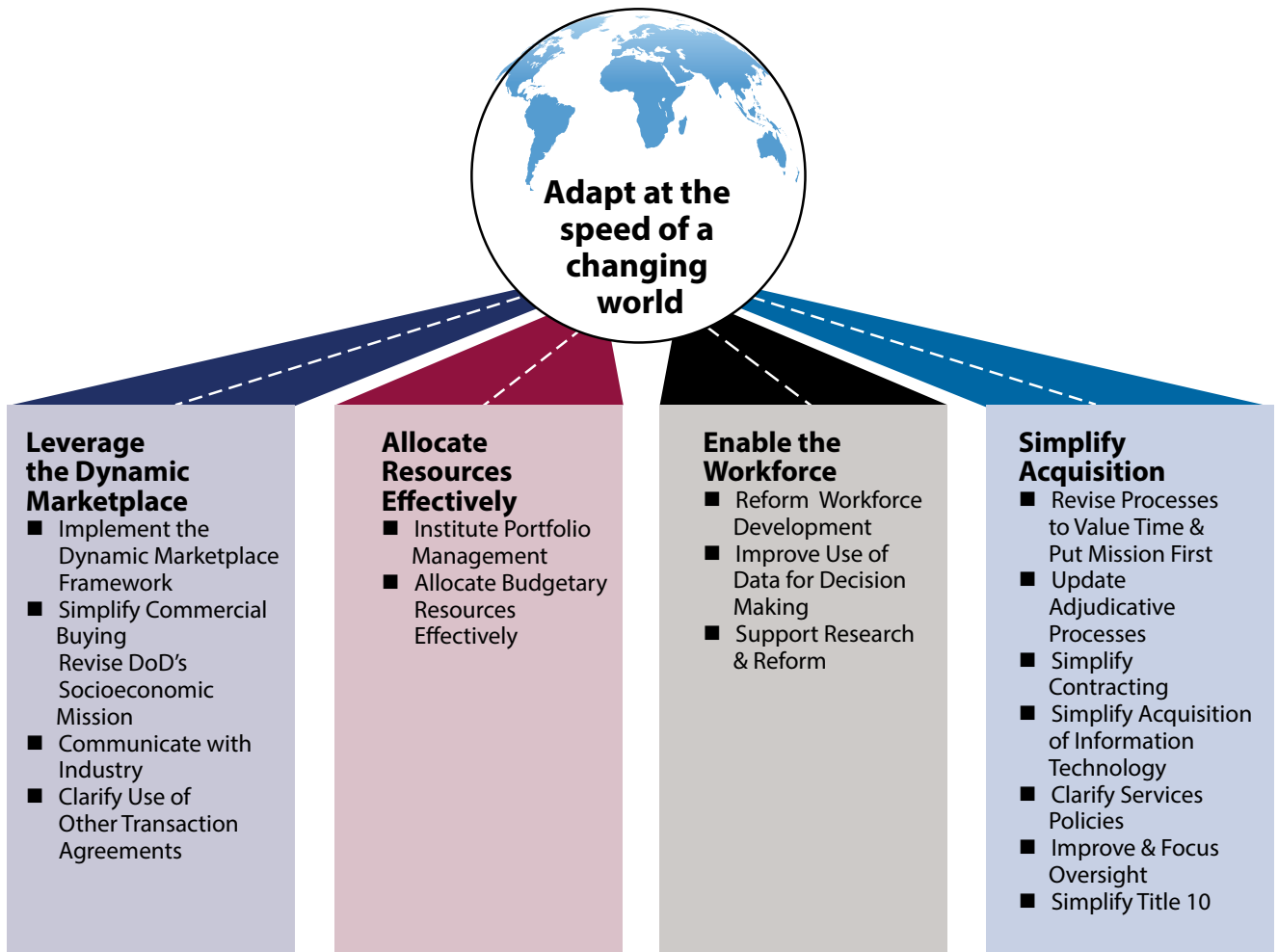
Recently, the Commerce Department added Chinese telecom Huawei Technologies to the “Entity List,” making it harder for Huawei to buy and sell with U.S. companies. Last year’s NDAA banned government Huawei and ZTE product use. Those two firms are among other banned high-profile Chinese companies. TCM might allow non-traditional firms to identify investment sources without worrying about their origins.

However, why is venture capital not already investing in firms that the DoD finds important? Many emerging technologies come from lower-tier subcontractors to major prime contractors. As in large weapon systems contracts, primes normally find components and suppliers to integrate with, matching a trusted source of capital investment, like TCM. Will primes buy up promising firms or not fund emerging technology if ineligible for use on a weapon system, focusing instead on protecting their current programs?

Any efforts to attract non-traditionals must also include a reexamination of the FAR itself as an impediment. Are expanded definitions of non-traditionals within commercial contracting and FAR Part 12 enough? The recent Section 809 Panel covered this in their July 2019 Final Report, under “Dynamic Marketplace Framework.” The panel believes that the DoD’s commercial buying is flawed, starting with its narrow commercial product or service definitions, and recommended replacing those authorities with new ones.

The panel believes that competition improves through documented market research (not currently required), because readily available market products and services exist through existing private-sector tools. The market already sets consumer prices, since they are publicly available for comparison and evaluation. Replacing public advertising, contracting officers (COs) could use market research and competition and waive some requirements for small and

Figure 1. The Section 809 Panel's Roadmap to Success



Source: The Section 809 Panel. (See <https://section809panel.org/>)

non-traditional contractors, which would make it easier to do business with the DoD.

The panel recommended removing some FAR-based government commercial buying clauses, asking instead that Congress clarify which laws apply to commercial prime and subcontracts, therefore reducing the commercial subcontractor burden on DoD prime contracts, as intended by FASA.

The report adds that today's domestic-origin requirements are not aligned with modern, global supply chains, resulting in increased costs, barriers to entry for some U.S. businesses, and innovation disincentives. Products bought under both the Buy American Act and the Berry Amendment can result in high pricing for DoD. Exempting domestic purchasing preferences for commercial goods could permit innovative products regardless of origin, yet still protect a defense-unique supply base.

Additionally, DoD buying-offices are hard to find, physically and organizationally, making it difficult for potential new suppliers to create customer relationships. A recommended "Market Liaison" would help non-traditional and other suppliers navigate the process and improve accessibility by answering questions and connecting industry to the right officials.

While existing FAR market research guidance is not an impediment, it should go further to create effective DoD-industry communication according to the panel. Clearer definitions and improved guidance would ensure that DoD employees better understand and use tools to enhance industry coordination in developing market research. A current reluctance to communicate creates an information barrier impeding the use of technological opportunities to expand industry participation. As a result, the DoD lacks knowledge of emerging industry technologies and capabilities.

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Finally, the panel believes that many contracting officers are comfortable using FAR Part 15 source-selection procedures, versus Simplified Acquisition Procedures under FAR Part 13, a preference that creates unnecessary complexity. Simplified procedures provide far more flexibility to solicit and contract non-traditionals for the right products and services.

A 2013 University of Maryland report, *Non-Traditional Commercial Defense Contractors*, authored by the late Jacques S. Gansler (former Under Secretary of Defense for Acquisition, Technology, and Logistics) and scholars William C. Greenwalt, and William Lucyshyn, documented similar barriers to non-traditional participation. One example given was a reliance on cost data for determining price reasonableness, versus commercial pricing. Commercial items are exempt from Cost Accounting Standards and the Truth in Negotiations Act because those firms do not have government-unique accounting compliance systems. The authors also documented various domestic source restrictions, which create a complicated process misaligned with today's commercial supply chain. A 1996 Logistics Management Institute study stated that such domestic preference mandates are not in the commercial world.

The report also discussed the increase in FAR (and DFARS) Part 12 contract clauses applicable to commercial contracting since FASA. These government-unique regulations cause commercial companies either to expand compliance costs or refuse prime contracts.

Non-traditional commercial contractors have played a significant role in supporting U.S. national security ... despite initial successes, commercial acquisition has not become ingrained in the DoD acquisition culture and faces severe pushback on many fronts. ...

The report recommended:

- Combat instances of requirements "gold-plating" ... military-unique requirements, standards, and practices. ...
- Re-establish incentives to ... use existing authorities to access commercial firms for more than just COTS [commercial off-the-shelf] solutions.

- Ensure that the DoD rapid acquisition organizations ... are maintained and fully utilized as a means to field solutions (especially commercial ones) faster.
- Identify and implement "best commercial acquisition practices" (by commercial sector and DoD application) ...
- Encourage the establishment of "non-traditional commercial entities" in private sector firms that are exempt from unique government and DoD rules and oversight.
- Expand the use of Other Transaction Authority (OTA) agreements ... and to access non-traditional commercial subcontractors under a FAR Part 15 contract with a traditional defense prime contractor.
- Improve market research ... to better understand what commercial capabilities are available ...
- Plan for a path to commerciality for non-traditional contractors when leveraging the commercial market for DoD-unique requirements.
- Establish a new Section 800 Panel to recommend specific ... changes that inhibit the acquisition of commercial items.
- Periodically benchmark costs of compliance with government and military-unique requirements, laws, regulations, practices, certifications, and standards.

Thus far, DoD has had mixed success in gaining the participation of non-traditional contractors to improve its acquisition outcomes:

- Increased acquisition funding has not yet created a significant increase in DoD contracting participation by non-traditional contractors, beyond OTA.
- Statutory encouragement for commercial sources and expanding the commerciality definition to non-traditional contractors has failed to achieve the anticipated success.
- The TCM initiative is new, so results do not yet exist. Given its limited use of investor financing, a dramatic increase in non-traditional contracting participation is not expected.
- Increased use of OTA is still small compared to overall DoD contracting obligations, and it remains specialized in nature. Data indicate traditional contractors may realize most financial benefits, nonquantifiable program outcomes, and potentially higher contract risk compared to FAR-based contracts.

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- Cited report recommendations, particularly related to market research, are most meritorious moving forward. As the DoD relies increasingly on commercial products, services, technology and experts, we must learn and engage with industry, particularly non-traditional contractors.

Next Steps

There must be increased proactive DoD engagement and wider communication and understanding of business practices and motivations through improved market research of an expanded view of industry. Current interaction between government and industry is often between the DoD and DoD-unique (traditional) contractors—but not today’s non-traditional, commercial industry. Necessary continuous monitoring of existing and fast-changing industry products and services by defense program and contracting officials is largely limited to government’s traditional contractors. This may leave out those firms developing technology for commercial or non-defense markets. DoD program and contracting officials, from top to bottom, must learn through all available means to continuously and routinely apply strategic and tactically oriented market research practices from industry. Existing commercial contracting authorities and market research tools to meet mission needs must be disseminated and reemphasized to DoD’s acquisition workforce. We must all learn how to appreciate market research to achieve short-term results, as well as the long-term program acquisition strategies necessary to acquire DoD technological and mission superiority.

Understanding who and where they are and their motivations is crucial to developing requirements and acquisition strategies that will attract participation by non-traditional contractors. Traditional contractors supporting the DoD are far different from those in the commercial sector. Contracting officers today learn about the FAR and contracting principles, policy, and procedures, but little about industry best practices. Only very recently have terms such as “category management” or “supply chain” entered the lexicon of government contracting officers.

It may be simple common sense to realize that, just as most of us in our personal lives generally acquire products and services from firms that did not exist just a few years ago, the DoD acquisition system must expand its sources beyond the same (and ever-decreasing and consolidating)

traditional contractors it has come to rely on. This requires a cultural change and reorientation for DoD acquisition professionals. But it also requires giving DoD acquisition professionals the resources, including the time to learn, adjust, and engage with an expanded view of industry in aligning DoD requirements to the best technological war-fighter tools that American industry offers.

The sources of market research relied on today requires reconsideration. For example, the professional associations of government acquisition members are themselves segmented along government and industry sectors, leaving little cross-communication. Attend each of them (as I have done) and you realize that no overlap exists between their members or expertise. The various association communities are oriented along defined niches, for government and its contractors, with other forums designed for commercial firms and their supply chain. Similarly, supply chain managers within industry know very little about and have little interest in how government works. The cultures and eco-systems, from entry-level to chief executive in both industry and government, too often have little understanding of each other’s practices and motivations. To the extent that there is government-industry cross-training or communication, it occurs between government acquisition staff and, typically, prior government staff now working for a traditional contractor. This internal, closed system has limited the view of potential capabilities offered by the wider commercial sector. The DoD must learn how to recruit the many new, commercial firms potentially capable of meeting defense needs.

Statutory and regulatory change may be necessary to optimize the integration of commercial industry, including small business, and open the door to today’s non-traditional contractors. But DoD program and contracting officials must expand their view of national capabilities and proactively engage with industry communities with which they are unfamiliar.

Defense program outcomes will improve, as always, through better market research prior to acquisition planning. We must increase robust market research to find true commercial, non-traditional providers, and then align government requirements to leverage their developments. Let’s get started!

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