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# DoD's "Cost Premium" 30 to 50 Percent

By

George K. Krikorian, PE

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The Department of Defense (DoD) pays a premium from 30 to 50 percent more for products than the same or similar items sold to a commercial enterprise. In some cases, the costs may be 100 percent higher. Those are the findings of a survey conducted among 12 companies that do both government and commercial business. The survey was conducted between March and May, 1992.

The major finding of the survey is that doing business with DoD adds cost without adding commensurate value. Other findings include the necessity of setting up separate entities within a company to do business with DoD and commercially.

During the deliberations of the Acquisition Law Advisory Panel in November 1991, it was recommended that cost impact information from U.S. industry be obtained in order to quantify cost savings resulting from streamlining acquisition law. ADPA was asked to assist. ADPA solicited from selected industrial firms objective parametric data which would determine the cost of commercial products when applying the unique laws required to provide these products to the DoD vice commercial enterprises, and conversely to determine the reduced cost associated with elimination of restrictive DoD laws regulating the defense industry. This difference is sometimes referred to as the "cost premium or penalty" for doing business with DoD.

Participating firms were selected based on their volume of sales mix between DoD and commercial business, especially as the sales related to the same or similar product or service. These products included aircraft engines, radar systems, satellites, avionics systems, and communications systems, among others. In order to enhance the maximum degree of voluntary cooperation, all firms selected were corporate members of ADPA.

## STUDY FINDINGS

The results revealed that the cost of a product when selling to DOD increases from 5 percent to 100 percent as compared to the same or similar product cost to a commercial (non-DoD) enterprise. Most of the cost increases are in the 30-50 percent range. The range variances are functions primarily of the product itself and the degree of company exposure to DoD laws, regulations, military specifications, standards, and procurement practices.

DOD regulatory issues which make a major contribution to the higher costs are:

- *Truth in Negotiations Act (TINA)*
- *Cost Accounting Standards (CAS)*
- *Federal Acquisition Regulation (FAR)*

- *Defense Federal Acquisition Regulation (DFAR)*
- *Competition in Contracting Act (CICA)*
- *Material Management Accounting System (MMAS)*
- *MIL-SPECS and Standards*
- *P.L. 95-507, Small and Minority Business Reporting*
- *Cost Schedule Control System Criteria (C/SCSC)*
- *Overly Elongated Bid and Proposal to Award Process*
- *Technical Data Rights and Warranties*

Companies had a difficult time distinguishing among laws, rules, regulations, military specifications, standards, and policy guidance. Industry tends to describe this as the regulatory pyramid where some 840 acquisition laws cascade to some 1500 FAR/DFAR clauses which cascade to 30,000 mil-specs and standards which cascade down to countless long established practices differing not only from service to service but by each buying command and directorate.

### MILITARY SPECIFICATIONS/STANDARDS

The mil-specs and standards came in for special recognition during the study. Government specs and standards have grown to stress the “how to” in all aspects of business operations and technology innovation versus that which is customary on the commercial side where contracting for “what” and “when” while avoiding the “How to” is commonplace. In addition, government oversight provides compliance and validation of the “How to.”

### COST IMPACT RESULTS

An attempt was made to quantify costs and the cost drivers on the basis of company operations. Each organizational unit within the firm could analyze their cost and relate to the equivalent organizational unit on the commercial side.

The [following] table displays the results. The cost impact data is based on responses from the 12 companies.

<b>COST IMPACTS ON COMPANY OPERATIONS*</b>	
<u>Company Operations</u>	<u>Added Costs</u>
1. Purchasing, subcontracting, vender and supplier contractor, raw material purchases	5-19 %
2. Manufacturing, production and assembly labor (hands-on labor)	2-8 %
3. Testing, inspection and quality assurance	10-13 %
4. Contract administration, finance management, oversight compliance and verification	6-17 %

\*Includes impact of military specifications/standards, laws, regulations, and practices. Study responses do not permit further breakout of cost impacts.

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## RECOMMENDATIONS

Stories like the 14-page fruitcake spec have given way to the 20-page hot chocolate and 8-page dog comb specs. This makes for good humor in the media, but it undermines the real purpose for military specs and standards.

1. The buyer-seller relationship in our monopsonistic defense business requires major overhaul towards the integration of commercial and military technology. We need to remove those barriers which cause American industry to separate their DoD business and commercial business. New procurements should be required to demonstrate the necessity of using mil-specs and standards in place of commercial practices. It's time for "zero-based mil-specs."

2. We need to embrace a cultural overhaul to harmonize the relationship between government and industry from its current adversarial relationship to one of mutual trust and cooperation. Statutes need to be repealed to make true believers.

3. The implementation of Acquisition laws regulations, specs and standards need to be sterilized of their "how to" emphasis. DoD should focus on "what is required" and permit the resourceful ingenuity of our nation's very able technical community to discover "how."

## ABOUT THE AUTHOR

George K. Krikorian occupies the John H. Richardson American Defense Preparedness Association Chair at the Defense Systems Management College as Professor of Program Management since October 1991.