Recently I was approached by a colleague who wanted some advice. His company's rate structure wasn't working for them and management wanted some options. We discussed some notions, but I told him that I had said mostly everything I had to say on the topic in my **5-article series** addressing indirect rate structures. Those articles were written six years ago, but (to me) they still ring true today.

(That's the good thing about this blog: when I have a thought, it gets documented and I can refer back to it. The work is done once and once only.)

A client is in the process of rejiggering its indirect costs because it believes it is losing too many competitions because its prices are too high. In the government contracting environment, prices are almost always linked to costs—so if you want to cut your prices you have to cut your costs. Too often, companies think they can solve their cost problems by taking a hard look at their indirect cost allocations. But most of us know that really doesn't work. If you want to cut costs you have to cut costs; there's really no substitute. Companies *should* look at their cost allocation structures from time to time and evaluate whether or not those structures are meeting their needs; but playing games with cost allocations is really a tacit admission that management doesn't want to make any hard decisions about cost-cutting.

It may be the case that costs simply cannot be reduced any further. Personnel are paid what it takes to protect them from the poachers across the street. Facilities costs are what they are. Management costs are what management wants them to be. If that's the case, then what do you do?

You gotta look elsewhere.

If you want your program costs to come down but you can't find any costs to cut within your factory, then you've got to get into your program supply chain and start "helping" your suppliers to cut their costs.

Another client told us about a recent epiphany they'd had. For years—perhaps decades—they had been going to the same supplier for certain critical program services. That supplier performed well: on-time and on-budget and always high-quality output that could be relied upon. Year after year, they kept going back to that same reliable supplier. At a certain point, they realized they were never going to compete the work. It was too critical to program success and this supplier was going to get it done. Period. So now the company had a “single source” situation (which is different from a “sole source” situation) and it was going to have to justify why the supplier’s price was fair and reasonable. (It was perhaps true at this point that the company didn’t actually *care* whether the supplier’s price was fair and reasonable; because using that supplier reduced so much program risk.) To make a long story shorter, the government customer didn’t like the company’s cost/price analyses of its supplier’s proposed pricing, and the company got told to conduct a competition. After much kvetching, the company agreed. And suddenly their long-time reliable supplier’s price dropped. *Significantly*.

The company kept using that supplier, but now the costs had dropped. They were happy. The customer was happy. And the supplier was happy to keep the work.

We were reminded of the foregoing anecdote by recent news articles indicating that Lockheed Martin’s government customer(s) think the F-35 Lightning II Joint Strike Fighter costs too much.

This is not really news, is it? It’s not really *new* news. We’ve been hearing complaints about the F-35 program budget since Day One. For example, in late 2009, we **reported** here that a Pentagon Joint Estimating Team (JET) analysis showed that “the program ‘will require billions of dollars more than planned, and more time.’” We also reported, in that same article, that program critics had asserted—

Those findings address only the known problems; there's a huge iceberg floating just under the surface. With F-35 flight testing barely three percent complete, new problems - and new costs - are sure to emerge. Worse, only 17 percent of the aircraft's characteristics will be validated by flight testing by the time the Pentagon has signed contracts for more than 500 aircraft. Operational squadron pilots will have the thrill of discovering the remaining problems, in training or in combat. No one should be surprised if the final F-35 total program unit cost reaches $200 million per aircraft after all the fixes are paid for.

Remember, those quotes were made back in 2009 – nine years ago. But just a few months later (February 2010) we were back with **another article** on the F-35, quoting another source’s concerns about F-35 operating costs. We quoted –

… over the lifetime of the fleet - the carrier-based and STOVL JSF versions will cost the Navy 40 per cent more, in total operating costs, than the F/A-18C/Ds and AV-8Bs that they replace. … This is despite a smaller fleet and fewer flight hours: the new aircraft are expected to cost more than 60 per cent more to fly per hour than their predecessors.

In May, 2011, we reported that the F-35 program's life-cycle costs were expected to exceed $1 trillion. At that time, certain Senators weren't pleased with that number, and they were not shy about expressing their displeasure. The Pentagon promised to focus on the price problem, and appointed Shay Assad to lead the efforts.

In March, 2012, we reported that F-35 unit costs were now $159 million (according to Lawrence Korb of the Center for American Progress). In that same article, we quoted an AW&ST story that included the following quote: "Higher acquisition costs also drive company growth, as do higher-than-predicted operating costs, particularly this century as more maintenance work was outsourced to contractors. The failure of the Global Hawk Block 30, whose operating costs were higher than the aging, manned U-2, is the exception rather than the rule: Most operators accept the overruns and reduce capability in other areas. …" We also quoted, from another source: "Because of the way sustainment costs are calculated, affordability is still a problem, and that might mean that the number of aircraft bought in the near term might be further truncated or that flight training hours are curtailed, [a senior defense official] said. The numbers are expected to fluctuate during the next five years."

Finally, in a recent (2018) article, we noted continued problems in negotiating F-35 contract pricing. Lockheed Martin was not reducing its unit costs sufficiently quickly, according to government officials.

In other words, the history of the F-35 program is a history of cost challenges, with many critics complaining about program costs and aircraft unit costs and aircraft operating sustainment costs.

(That's another good thing about this blog: when I need to do research I can start with searching my own articles. Some of the links are broken but the juicy quotes remain.)

Which brings us to today, April 2018—and this Bloomberg **news story**, with the catchy title "Lockheed Gets Edict to Cut F-35's $1.1 Trillion Support Bill." The story referenced the recently released Pentagon Selected Acquisition Report (SAR) for the program, which stated that Lockheed Martin "must find ways to reduce the Pentagon's current $1.1 trillion estimate to own and operate the F-35 jet." The story noted that the $1.1 trillion estimate is a 2015 estimate. It's three years old. The story noted—

The report acknowledges that under current forecasts, 'the projected F-35 sustainment outlays are too costly' and 'given planned fleet growth, future U.S. service operations and support budgets will be strained.' Bloomberg reported last week that the U.S. Air Force may have to cut its F-35 purchases by one-third, or about 590 jets, if it can't find ways to reduce operations and support costs by as much as 38 percent over a decade.

In a somewhat unusual move, the SAR also told Lockheed Martin how to cut its program costs. Bloomberg reported: "According to the acquisition report, Lockheed should also 'optimize priorities across the supply chain for spare and new production parts, and enable the exchange of necessary data rights' to the U.S. military of software currently owned by the company.

Which is interesting, right? Somehow Lockheed Martin owning its intellectual property (IP) increases program costs, according to the DoD. Hmmm.

But the other recommendation (to look to the supply chain for cost reductions) is perhaps more in line with reality. After all, Raytheon used supply chain management to help improve its position in the SDB-II competition, as we noted in **this article**. We quoted "[Raytheon picked] suppliers early and then work[ed] directly with them to improve productivity at every step." So yes, if LockMart could reduce its supplier costs, then it could share those savings with its government customer(s).

And speaking of government customer(s), those who remember our article on the lack of collaboration being exhibited between LockMart and its government Program Office negotiators may not be shocked to see **this news story**, in which DefenseNews reported that "The Defense Department plans to dissolve the F-35 Joint Program Office and revert to a more traditional management structure where the U.S. Air Force, Navy and Marine Corps all run their own program offices …" The story notes that "While the changes could make it easier for the services to have oversight over their respective F-35 variants, the eventual dissolution of the JPO could make it more difficult for international customers to interface with the program."

Obviously, I'm not privy to the details that led to this decision. However, I note that if each service is separately managing its own variant as a separate program, then costs will be more accurately reported. For example, aircraft unit costs for the USAF's F35-A program (which are 20-25% lower than the other variants) should not be impacted by the higher aircraft unit costs for the Navy and Marine Corps F35-B/C variants. Similarly, operating sustainment costs will be more granular as well.

I'd like to wrap this one up by going back to the beginning. Everybody, it seems, is under pressure to cut costs. Cutting costs is hard work and requires making hard decisions. Those companies that can successfully make the hard choices tend to see their efforts rewarded; whereas companies that cannot navigate their way tend to experience problems. In today's defense acquisition environment, the path to success tends to be found in the program supply chain and not within the four walls of the prime contractor's integration area. Investing time and resources in the supply chain tends to produce a positive return.