

# Phil Jasper Acq Talk audio

[00:00:00] **Eric Lofgren:** I'm pleased to be speaking with Phil Jasper, president of mission systems at Collins aerospace. He's recently written an interesting piece on commercial item acquisition. And that's what we're here to talk about today, Phil. Thanks for joining me on acquisition. Talk.

[00:00:32] **Phil Jasper:** Great to be here. Thanks for

[00:00:33] having me.

[00:00:34] **Eric Lofgren:** let's just start off and can you introduce us to the commercial item procedures that were passed in 1994 with a federal acquisition streamlining act? What was that all about?

[00:00:43] **Phil Jasper:** So, you know, Eric for over two decades now, Congress and the department of defense have recognized that there's real value in leveraging commercial technology. And they realize that the acquisition system that traditionally existed in the department of defense really wasn't fit to buy in commercial technology in a commercial way that would really entice companies

[00:01:05] that are providing leading edge technology to want to participate in the defense business. And so that was a, the impetus behind the federal acquisition streamlining act that was passed in 1994 by Congress. And over the years there's been additional acquisition reform accident past. There's also been language that's been put in several the national defense authorization acts over the years to continue to encourage.

[00:01:31] The department of defense to recognize the value from commercial technologies and to reform the acquisition processes that make it easier to get that leading edge capability into the hands of the war fighters in a faster, more efficient and more cost-effective way. I think there's been a broad recognition.

[00:01:52] As I mentioned from Congress about this. There's also been broad recognition from the department of defense that there's real benefits to acquiring this commercial technology. And they've tried to encourage that through the acquisition process over the year.

[00:02:06] **Eric Lofgren:** gave some really good examples of how kind of commercial items at your company and actually others as well have really saved the government time and money.

[00:02:14] So can you just give us, you know, an indication of, what is a commercial item? And like, how does it actually help the government out? Because a lot of times we think of a government kind of buying unique items of separated from the commercial marketplace,

[00:02:26] **Phil Jasper:** right? Yeah.

[00:02:27] And I think there's a lot of great examples that we can provide from across the aerospace and defense industry. About examples of technology that can be leveraged. One great example that we have within Collins, aerospace has been, avionics systems, early being able to apply those from our commercial customers in the air, transport and business in regional communities, into military customers.

[00:02:49] A great example of that is several years ago. We saved the Pentagon. There were, they were looking for a common avionics heart protect your system for black Hawk helicopters and ch 47 Chinook helicopters. And through that acquisition process, we were able to leverage. The millions of dollars, hundreds of millions of dollars that we invested in our core avionics products in order to tailor them to fit the military admission of those helicopters.

[00:03:14] And we saved the government just in that one acquisition, alone over \$160 million by being able to leverage that commercial technology and we were able to deliver the capability in about 13 months to the customer. Ran a normal defense acquisition starting with unique requirements, unique products can take anywhere from 24 to 36 months and sometimes even longer in that regard in order to feel that under a traditional defense acquisitions.

[00:03:40] But the benefits of buying commercial really don't stop there because now you get to leverage that entire tail of a commercial business. If you will, where there's obsolescence management, there's continued upgrades and enhancements that go on. And our estimate is that we've invested over \$300 million in that continuing investment.

[00:04:01] Into that capability for those avionics architectures. And those have all been at the company's expense because we're leveraging that broad commercial line. We're leveraging the ability to spread that cost in and take advantage of the innovation that's happening in the commercial. And historically those would be funded by the government under a typical far apart 15 acquisition.

[00:04:25] So those are some of the benefits, a few of the examples, we've we've we can save tax payers, money, fuel systems, for example, the nozzles that go into fuel valves uh, fire protection system, even landing gear. The core technology is the same but it's the specific application.

[00:04:43] That, that needs that slight tailoring in order to make it fit. But it's that tailoring that applies to no matter what aircraft we're putting in landing gear on every aircraft has to have landing gear and every landing gear is tailored for that specific application that goes into that particular aircraft.

[00:04:59] And then other examples, I mentioned fire protection, for example, head-up displays. The head of display that C-one 30 J is the same underlying technology and capability that's flying inside of 737 aircraft around the world. And there's tremendous benefit to our customers by what I call when we, as a company are able to invent once and apply it many times that application costs is much lower than that invention costs.

[00:05:25] **Eric Lofgren:** Yeah. So you brought up the far part 15, which is the classic kind of negotiated way. The government goes after these things, with their bespoke requirements. And of course we've been hearing over time, Hey, the government used to be like half of all RDT and the expenditures in the United States.

[00:05:41] And over time it's really falling into like 3% or less. And now I think that was actually of the world as opposed to just the U S those figures, , So in the past, like the government had like national security requirements and they were unique. They have this non-market process, the government would negotiate with the companies. But then w we've seen, of course the commercial kind of pick up in terms of research and development. And that's exactly what you're saying. We have our commercial R and D that we're already doing. We want to be able to leverage that.

[00:06:11] So can you just talk a little bit about, the factors overall have led to commercial products, actually being more related to national security. What is it? Literally just, the government was the big spender, so that's just the way they did it in the past. And now that they're a smaller spender, they need to leverage commercial or is there something else?

[00:06:28] **Phil Jasper:** Yeah, I, I think that's a big part of it, Eric, in terms of the research and development expenditures, you referenced some numbers there as well. I'm familiar with a study that was done in terms of in the United States, federal R and D expenditures. And, for example, in 1953, federal R and D by research and development by the federal government was roughly \$1 billion while domestic commercial research and development is about \$2 million.

[00:06:52] So about, again, 50% as you say it, fast forward to 2019, the federal research and development, it was roughly \$63 billion. And the commercial R and D is over \$380 billion. So the commercial sector is investing about six times more in recent search and development. Then federal R and D is so right there that just implies.

[00:07:16] The commercial innovation cycle in the engine that's driving innovation in technology has really shifted to a large focus on commercial. And we see that in our everyday lives, just think of all the technology and all the advancements that continue to happen that affect every aspect of our lives.

[00:07:36] And now that technology is available and I think there's also so been a second factor I would say is a shift in the mindset. , I would say there always used to be a mindset that prevailed that the military requirements or the national security requirements are so demanding and so unique that you have to design a system from the ground up in order to meet those particular requirements and systems.

[00:07:59] And I think over time, we've seen the thinking shift in and we need to continue the shift in our thinking if we want to continue to be effective and equipped to warfighter with the best capabilities. And that shift really needs to be that. It's the national security requirements are demanding unique applications of the technology that's available in industry in order to go solve those problems.

[00:08:24] So again, you're shifting away from, you have to invent, you need technology to, what I've got great technology. How can I apply that technology in unique ways in order to go solve some of those very challenging problems? And if you look at some of the challenging problems, those problems exist all over an industry.

[00:08:42] How do I make sure my radio signals, whether it's to a cell phone or a military commander get through to the intended receiver at the intended time? That commercial technology is there in all of our handheld devices. How can we apply that to go solve that military communication problem as well, to make sure that communications are robust in very challenging environment.

[00:09:03] And there's many other examples like that in industry or, or in technology development where you could really refine and apply that technology to go solve unique challenges for the military.

[00:09:14] **Eric Lofgren:** some people have been saying, and I've been hearing this recently that commercial items determinations have been abused to us to a degree they're kind of, of the opinion that only the exact same items sold in similar quantities to the commercial customers should be considered commercial items, other ones.

[00:09:31] They're like requiring this extensive customization and we need insight into what that is and everything. So can you respond to this? And aluminiate this kind of gray area of commercial of a type.

[00:09:42] **Phil Jasper:** Yeah. That's and I think you're hitting on Eric one of the challenges in acquisition of commercial items is that of a type. Where I'd like to start is people who are saying that.

[00:09:53] Commercial items are being too broadly interpreted or maybe in their view, abused a little bit. I'd encourage him go read the language in the federal acquisition regulations around far part 12 and go look at the congressional intent as they, we're putting these requirements in the national defense authorization act around commercial acquisition.

[00:10:15] They intend the definition to be very broad. Because there's recognition throughout Congress, throughout the department of defense, that it's very hard to take an exact commercial item and apply it to go without modification, to go solve a challenging military operational problem.

[00:10:35] Getting back to what I just talked about in terms of using the good technology to go solve challenging military problems, but what they do recognize. That there is got to be some level of modification to that commercial technology in order to make it fit into the environment and to solve some of those challenges at the military school.

[00:10:57] For example, you put electronics on a tanker aircraft. For example, you have to go through an explosive atmosphere testing because obviously you're carrying a lot of fuel in that aircraft and you want to make sure your electronics aren't going to cause an explosion on the airplane. You typically don't see a requirement like that in a commercial area.

[00:11:15] Was there a couple of circuits that maybe needed to be redesigned in order to put avionics. Sure. But does that make the unit any less commercial than what it is? No. It's still of a type and that's what the federal acquisition regulation says is these are products or services that are of a type.

[00:11:33] Customarily available in the commercial marketplace and that they really have a similar function. They've got the same performance characteristics, and it can be applied across a myriad of industries. It doesn't necessarily have to be aerospace and defense. And so, as you look at that commercial technology and solving those problems, there is a recognition that there has to be some level of modification and the federal acquisition regulation for FARpart 12 really does reinforce that around commercial of a type acquisitions.

[00:12:05] Now that's not to say that every problem or acquisition can be far part 12, there's far 15 things that are out there. I mean, Think about missiles. Missiles are inherently a defense article, but it's some of the underlying technology that gets applied to go solve that a GPS navigation system. It's this it's the same or similar function and capability that we're all using in our cars for people to navigate it's that, that GPS navigation capability, it might be some actions the way should systems or some, some visualization systems that are going on to some of these weapons systems.

[00:12:40] No. Another example, stealth technology. Again, that's usually only applied in a military setting, but that doesn't mean the entire aircraft and everything that goes on. It has to be military from the grounds up. That's where you get the leverage from the commercial technology and that balance of the business, if you will.

[00:12:58] **Eric Lofgren:** Yeah, definitely. I guess there's one kind of view here. If you have competition, right then you don't really necessarily have to worry so much about is the government getting a good value, getting the right price for this commercial of a type, because you assume that the competitive forces will drive that price down to where it's.

[00:13:19] Zero economic profit, or just like a good value for both sides. Whereas, sometimes it seems like a lot of these headaches have been, in kind of sole source environments down the supply chain that for one reason or another, there doesn't seem to be the competition. And then the government in this other type of.

[00:13:38] Doesn't really understand the variation, the modification costs were actually relatively large relative to the base cost of the commercial item. How do I know whether I'm getting gouged on that or not, if I don't have these competitive pressures, so can you just talk a little bit about this kind of requirement?

[00:13:54] Cause we know that contracting officers, even with commercial items, they still have a requirement in the far to do price reasonableness analysis. And that could result in, necessities of cost or pricing type information.

[00:14:06] **Phil Jasper:** Yeah. Yeah. That's a great discussion. We get that a lot, Eric, in terms of questions around this particular topic and, there's actually a couple aspects to this.

[00:14:15] So first of all, even that question implies a little bit, when you use commercial technology, that it's not a competitive environment. And I got to tell you a commercial environment is extremely competitive. That's out there. Our commercial businesses, whether that's in our company, whether that's in any commercial industry, you're always trying to outpace the competition to out, innovate them, to come up with the next great app or function or capability that everyone's going to want to have in the use.

[00:14:48] That's why commercial companies invest billions and billions of dollars in these products, because if they score a hit the paybacks and that business case can be tremendous. Where we run into a problem, sometimes in the acquisition system though, is when you leverage that commercial technology, the acquisition system for defense articles, even if they're based on commercial technology.

[00:15:13] Is set up to look at a single point in time. And when you're a commercial company and you're looking at embarking on developing some innovative technology or product. You're going to invest. As I mentioned, hundreds of millions of dollars in that technical and you build out a business case and you realize that for the first time, several years of that business case, it's all investment.

[00:15:35] There's no revenue coming in. Then at some point you're going to get a break, even point, you're going to start selling it and you're going to finally recover all of that investment. And then beyond that, you're going to be able to make a profit and it's that profit. Then that generates the ability to reinvest and continue to innovate for a commercial company.

[00:15:52] When you look at the defense acquisition system though, they look at a point in time and they say, okay, I, I selected you to go put this on the aircraft. Now it's time to negotiate the next lot of the production contract. And I don't want you making too much. And so the too much money at that point in time, as they look at it and they've got the weighted profit guide, right. what that doesn't take into account is all the investment that goes into that and the entire life cycle of that product. And you hit on it here. It really needs to shift the discussion away from what price am I paying to? What value am I getting by leveraging that commercial technology? You're not just, you're getting the benefit of all that investment in the foundational technology.

[00:16:39] You're getting the benefit of the obsolescence management, the continued enhancements and functionality that you're getting by buying in to that commercial technology. You know, It's a very similar concept to what we all experienced with our personal devices, like iPhones or Android phones, where there's an app store.

[00:16:57] Anybody can go develop an application. And put it on the app store. It's how do you out innovate everyone else? And then as an owner of one of those devices, you always want the latest and greatest app. So how can I go get that effectively? How can I put that in my personal device and really use it to great effect because there's value for me in doing that.

[00:17:17] And I might, I might pay a price for that because of the value that I'm going to get. And that's where we really need to shift a lot of the discussion with the department of defense around this, is not the price, but the value that's being created around that entire product and that entire life cycle.

[00:17:34] **Eric Lofgren:** Yeah. This gets to like a, I don't know, like an interesting concept for me because it seems. We get into these situations where a contractor has a commercial item that has a modification, and then it's in a sole source environment. And I'm wondering like well, if it's commercial, aren't there multiple companies willing to do business with the government where the contracting officer doesn't really need, but like the value is being derived from that competitive process, as opposed to them actually understanding the production process and the cost involved in all of that.

[00:18:06] I guess I'm just wondering, is it really this. I guess in my mind, it goes back to what you were talking about. Like that point in time, first overtime, because the company in a commercial sector has to make these investments. That was at a period of time, it's hard to trace those investments to specific outputs of revenue, that are in a future period of time. And the government like accounting system requirements, wouldn't recognize those cost us like allowable or applicable to this type of product and potentially, yeah. Pushes its contractors away from being in this competitive process that would have otherwise existed.

[00:18:41] So I don't know, is it like expanding this idea of commercial of a type would actually bring in more competition and then relieve the government of these types of pressures to be able to define value outside of that competitive process? Yeah.

[00:18:55] **Phil Jasper:** So I don't think it's expanding the definition of the type.

[00:18:58] I think it's embracing the definition that's in the federal acquisition regulation today, and really applying that as well as congressional intent. Around, if something was commercial and purchased it as a commercial item, then it should be commercial going forward, in that environment.

[00:19:15] And that's where we're seeing a lot of challenges right now in, in some of our products is they've been purchasing. I mentioned some of these display things for **avionics that we've applied to various military platforms. They've been bought for a decade, in some cases as a commercial item, yet every year we have to go through a process to recertify that there's still commercial of a type item.**

[00:19:38] And that's wasteful for us. It's wasteful for the tax payers in the additional time that's required in order to go do that. Th the other thing around this that we get is the sole source argument and say if I buy it from you and I'm locked in, now I have to have all that cost and pricing data, because I don't know the value.

[00:19:56] And, oh, by the way, that's not the way the commercial industry works. But particularly in aerospace industry, that is exactly how the commercial industry works. I mean, **Look at major transport jets that Boeing and Airbus do. When you secure a position on those platforms, You're part of the build of that particular aircraft.**

[00:20:17] And so in essence, it becomes a sole source environment. But what we do as partners is we work out what is the value that we can create for that end customer, so that they feel that the price they're paying is fair and they're getting a good value for the price they're paying. You don't have commercial airline customers, for example, necessarily digging in and saying how much profit are you?

[00:20:41] They're looking at it from what's the value to me of buying that particular aircraft. And if that puts them in a sole source yet I'm reaping the value from that. I think that's great. And it, again, gets back to the concept of, there is competition in that commercial market. You can't just charge whatever you want because you won't be successful commercially, and you're not going to be successful militarily when you do that.

[00:21:05] Now to the point of how do you determine what is fair value for that? There's lots of tools at the disposal of the accuracy community that industry can help with in terms of sales of similar items looking at sales history, looking at other similar products in the environment, unfortunately, though, The system, the acquisition system still struggles in order to go do that.

[00:21:29] And I think part of that is, the commercial item group is a group that's been stood up by the defense contract management agency with the intent of helping to have a centralized process, to make these commercial determinations, whether it's pure commercial, whether it's commercial of a type or whether it's a far apart 15 item in particular.

[00:21:51] And the concept is absolutely great. I think that the concept and the idea is go have a central group of experts who are knowledgeable in being able to make these determinations. Unfortunately, what we're you see too often is that becomes an engineering only analysis. That they look at the specifications and they're not identical to one another back to one of the earlier questions you pose.

[00:22:13] Therefore, it can't be commercial because it's not identical to their commercial items. And really what we need in the environment is not just a strict engineering assessment. I think that's one aspect. But there's gotta be then brought to the perspective. You know what I mentioned around the business case, how businesses operate, how do you determine and what data is available in the market that you look at and analyze around the value, establishing the value that you're getting for any particular price that you're paying?

[00:22:43] **Eric Lofgren:** the value question is it seems to be like the key concept, but also a very nebulous concept because it's so context specific. In, in every case. And so whenever, like people always bring up this point like that there's this tension, like government really wants to make sure its contractors don't make excessive.

[00:23:02] Right or more origins that tend to be over like 10 to 15% on base cost of actually the actual cost of performing that work for the government. And, you know, there's nothing new about this Harvard researchers in 1962 package chair, they said, quote, there's a tendency to equate efficiency in the weapons acquisition process with the absence of high profits.



[00:23:23] And so they actually talk a little bit about. Profits are a little bit easier to measure because it's really hard to understand that this value thing where it's like, Could we have done it cheaper? What are the other alternative actions that we could have done?

[00:23:35] But of course, like this profit question, I think in, you were hinting at. In the commercial sector, profits are reward for innovation, right? If I can drop costs 50% but prices by 25%, we both do very much better. Both the customer and the seller. And then that invites additional competition.

[00:23:53] Can they get in there and do the same thing, and then they can compete a waste, some of those profits, which are reward for that innovation and provide some of this excess capital really to go out, build new things and then provide that next source of innovation for the government. So can you just talk about the profit mode of, from like your view, as a commercial supplier, as well as a commercial supplier to government and how that kind of differs.

[00:24:17] **Phil Jasper:** Yeah. Again from our standpoint, if we try to overcharge and make too much profit, we're not going to be competitive. We will not. And so it becomes down, it comes down to it's in our best interests to manage our cost basis, to manage the price points

[00:24:33] And at the end of the day, I think everybody recognizes that business needs to make a profit, right? That's what we're in business for. We've got to serve our shareholders. We've got to serve our employees and we've got to serve our customers at the end of the day. And it's that profit that we're using to reinvest in generating continued innovation, continued technological advances.

[00:24:58] That's where that investment comes from. So I think everybody understands the level of profit that's there in that, but then you really got to get back to that and it is nebulous is the value that's being created in terms of, the process or the product that's being provided. And that's why the federal acquisition regulations have set up a two-step process.

[00:25:21] And sometimes we see these processes want to be co-mingled by the government. And the first is to make a determination of is the product commercial or not. The second step is then what is a reasonable price that I should pay for that particular product? Oftentimes what we hear as well. I need to make sure that the price is consistent with commercial items before I would say it's a commercial item, but that's really not.

[00:25:49] **What's written in the acquisition regulations.** It really is. not. You can make a determination of is this commercial or commercial, all the type independent. And then based on that determination, Then you can go determine price reasonableness that's are you paying a reasonable price? And the great thing about the environment we're living in is there's so much information and market research data that's available in terms of similar items, but it requires a little bit of work and requires a group like the SIG commercial items in order to go find and dig through that information.

[00:26:24] But it's gotta be more than just on the engineering side. And obviously at the end of the day, even in a sole source environment, we know our customer has choice. And I think now what we're trying to see is maybe customers saying if I don't feel like I have a choice and maybe I want you to intellectual property to go compete you against someone else in a future acquisition.

[00:26:44] And certainly they can do that, but there's a price to pay for doing that, continuing to change as well for that particular commercial item. But that's really not the answer. It really has to get down to once I fixed something, there are stacks. And even in that federal acquisition regulation, they talk about steps, fruity terminate, what that reasonable price is.

[00:27:05] It's market research. There's the data that's available, whether it was a competitive source selection or whether it was other competitive source selections that are similar in nature that are out there. And even if it's non-competitive, the offer has an obligation to provide information on information that could be useful to that contracting officer to determine a reasonable price.

[00:27:29] And we find in general, we do that, but it becomes to your point, it requires a lot of training. It requires a lot of knowledge beyond just an engineering assessment.

[00:27:38] **Eric Lofgren:** One of the things here. You're basically saying using the value judgment and the commercial item and the competition that's inherent within the system, you'll arrive at like a price that's independent of our ideas of what the margins of the profit would be. But if I'm thinking just like from a broader perspective, **if government.**

[00:27:59] **Goes even further into the commercial item world. Does that mean, companies are really, self-funding more research and development and then the government really has more like procurement or O and M funds.** And then each of the systems, they are kind of. a little bit more margins than 10 or 15% to cover the cost of that investment of that enterprise tooling and everything else.

[00:28:22] If we drive commercial items even further, does that actually mean like the federal government is doing less R and D or it's reimbursing R and D on the back end rather than the front end?

[00:28:32] **Phil Jasper:** **Yeah. I think that's correct there and I think we're seeing that play out in industry today.**

[00:28:36] If you look at it, **For example around the joint, all domain command and control the Jad C2 environment right now, that's out there. And each one of the services has demonstration and experimentation events where they're saying the industry, bring us your technology and demonstrate to us how you can go solve some of these specific problems that we have that we're facing against some potential near peer adversary.**

[00:29:01] Because we know the technology is out there. And if you can demonstrate that, then we can start talking about it. Okay. How do we go acquire that particular technology?

In order to get the technology up to the TRL level five or six, that it needs to demonstrate that's investment that we make as a corporation.

[00:29:19] And we're making those decisions each and every day as to what are we going to invest? Because we want to be able to innovate, to provide that latest innovation to our customers demonstrate that it's solving their very complex and challenging problems with the hope that then they're going to go acquire that.

[00:29:37] So in essence, you're absolutely right. That money comes from the profits that we, as a company are making that we can invest in developing that technology. As we lay out our roadmaps, we see the challenges our customers face. We prioritize our investment in developing innovative solutions to solve those challenges we demonstrated to the customer.

[00:29:59] And then the hope is that the customer buys it and pays us a reasonable price for the value that we're providing. So that then we can take the the profits that we do make and reinvest that again, going forward for the next generation.

[00:30:12] **Eric Lofgren:** Yeah, I'll just put it on my like 1950s hat, because it feels back in those days, a lot of the aerospace companies actually did make those investments themselves.

[00:30:22] And then they tried to sell it on the backend. And a lot of that was like the profit area, right? Like you, you take a loss leader is what they call it, a loss leader upfront. And then you hope to like, make it up on the backend. And I think one of the reasons that they moved to this kind of a.

[00:30:36] Government led systems analysis where they pull the innovation and they separated out was because they're like isn't that like creating duplication and overlap. I have a bunch of companies they're investing and then I'm only going to buy one, right? So someone's going to be losing money and there's overall, there might be waste where the government.

[00:30:57] Pick the right one from the start. You're right. So that was like my view of some of like how we got along this planning mindset that we've gotten in the last several decades. But what would you say to that? Hey well, if if we just let the market go, they know that there's only this much total accessible market.

[00:31:14] How would they know what's the right investment or are they just going to be spewing and wasting money and then people will be failing and we didn't really need it.

[00:31:21] **Phil Jasper:** I again, I think what the environment is when he looked into companies to invest that implies that the government is investing less for their dollars.

[00:31:28] So that means they're probably going to be quote unquote, wasting the last, if you will, for those, because they won't be funding the, those that aren't successful in the marketplace, it's the market dynamics that are going to . Take out those competition competitive players and winnow the field if you will, a little bit.

[00:31:45] And I think we see that in the commercial technology market we constantly see companies that come up with great ideas. Many of the companies have the same ideas, but not all of them five, because you've gotta be able to have the right discriminating element of your technology in order to be successful.

[00:32:05] And it's not always that there's one discriminating element of that technology. There might be many, and you might have several companies that that realizing and address certain aspects of that. And they can, multiple companies can survive in that environment. But I think the key, yeah. How do you entice commercial companies to want to do business with the department of defense and leverage that technology from the commercial market to solving some of those military problems.

[00:32:34] And there's some headwinds that are out there to companies wanting to go do that. First of all, volumes for defense customers are much smaller in nature than for a commercial customer. So obviously if you can't necessarily count on defense sales to help close a business case, as you're looking at inventing technology, you really have to look okay.

[00:32:55] I got it for a commercial market and a really well, I want to do the right thing and be able to provide it to the military, but. Realize that those volumes are probably going to be lower than they are in a commercial market. And then I have to look at the cost of doing business with the government. And if I can do business with the government under the commercial terms with commercial requirements, it becomes much more efficient for me because I can use all my existing manufactured systems, my existing cost accounting systems.

[00:33:23] And I don't have these unique requirements that I have to oppose to do military cost type businesses. And particularly then if you're a smaller supplier in the industry, you have to make some decisions about, do you really want to get involved? If there's owners, contractual flow downs coming relative to some of these requirements from.

[00:33:47] Doing business with the department of defense and frankly, that's a headwind that we see in the business is some of the overhead that comes with acquisition and doing business with the military market keeps commercial technologies and commercial companies from doing business with the department of defense.

[00:34:03] They simply can't afford to invest in the resources needed in order to go do that. And that's, unfortunately, that's an environment that exists, not just within far apart, 15 acquisitions, but also far apart, 12 acquisitions. As I look at the supply base, and if you look at a flow downs to do business with the government you have to have six business systems that are required in order to have truth and negotiation or Tina compliance.

[00:34:34] Those are cost estimating systems and earned value management system, material management systems, accounting systems, purchasing systems and property management systems and small companies, commercial companies. They look at the cost of putting those systems in. They weigh that against the incremental volume that they'll get through being a defense supplier, and that equation doesn't always work out for them.

[00:34:59] And so that may keep them out of the business. And then if you look at far part 12 were commercial acquisitions, the amount of flow downs that we're required to put on our supply base are. Onerous as well, in the early nineties, early to mid nineties, when you did a far part 12 acquisitions, there were, I think, 13 contract clauses that were required to be flowed down for commercial items.

[00:35:23] That's over 60 today in terms of contract clauses that are required to be flown down. That's just another headwind. I think that we have in the acquisition system about enticing commercial companies to want to do business with the department of defense.

[00:35:38] **Eric Lofgren:** And that's that was a really good statistic there from 13 to over 60 flow down requirements.

[00:35:44] I want to ask you, have any companies like refuse to do business with you? Because of these flow down requirements or yeah, they'll do business with you on the commercial side, but they'll like, they will refuse to like government contracts. And is this like pervasive or is it just like hearing?

[00:35:58] **Phil Jasper:** No I would say that it's much more than here and there. I don't know that I would necessarily say it's pervasive. But there's absolutely instances where our supply base says uh, you know, what, if you're going to flow these, all these requirements to me, I can't do business in that because I can't afford to go put those systems in place or the return that I would get on my investment in that is too small for me to go do that.

[00:36:22] And honestly, there are instances in our business where our customers are in the past have tried to procure commercial items as non-commercial, they're trying to procure it from our commercial businesses and we've no bid it because they were insisting. We had to put in the cost accounting systems in that it had to be at far apart 15, or it wasn't a commercial item.

[00:36:44] And we said, you know what? We can't make that business case close. And so we no-bid some some of those across our company. As we continue to fight through some of the challenges here around commercial item acquisition.

[00:36:55] **Eric Lofgren:** So are you saying that. You like as a commercial company, also doing business with the government, don't have a fully compliant accounting system, like down to the deforest clauses that you said on the business systems, plus, the cost accounting standards or everything else.

[00:37:12] And so you've actually turned some of that away.

[00:37:15] **Phil Jasper:** Yeah, I would, again, that's not a global statement there's we certainly have all those approved systems in our businesses. But there are elements of our business that deal with commercial technology exclusively. And they aren't required to have all of those government cost accounting systems and or earned value systems in place.

[00:37:35] And although generally they do, we, obviously we all have cost accounting standards from a corporate perspective and our value that we have from it or perspective,

but they may not What's required in order to do business with them and their cost to go get them up to the level of DFARS compliance.

[00:37:54] From what a commercial business does may not be a business case that that pans out.

[00:37:59] **Eric Lofgren:** Yeah. That's interesting. I wanted you to talk a little bit about that business case for deciding when a company should just create a subsidiary, right. and put a big wall between the commercial and government business versus when they should be commingled.

[00:38:12] You are trying to keep the co-mingling so that you leverage those kinds of enterprise capabilities and cost controls. But when does it just become to the case where it's just fine, I'll just create a new subsidiary that might have higher costs back to the government, but it's just easy.

[00:38:27] It just makes it easier for me to do business with them on those terms.

[00:38:31] **Phil Jasper:** Yeah. I think it really comes down to a question of, is that business case sustainable. With the government by standing up a a unique defense element, if you will, in terms of being able to do business with the defense customer under those particular terms, the way I look at it from industry perspective is, you can be a commercial contractor and then also sell items to the defense department.

[00:38:56] Or you can be a pure defense contractor. It's that gray area that gets hard. Where are you? Where are you? Commercial? You've got some defense articles, but you really want to leverage that commercial technology into your defense articles. And at times that becomes a a unique challenge for companies such as us, as I mentioned, because you've got some elements, some divisions of our business.

[00:39:18] That's strictly do commercial. And if you approach them with, look, I want to buy that. But here's the flow downs. They'll say, look, I can't handle those level of flow downs. And so then it becomes just that internal cost benefit analysis of do we want to go make that investment, but then, so there has to be on the government side, a recognition that it's going to cost.

[00:39:38] And they have to be willing to pay more in order to have you unique factory test equipment for some of this or that they're going to be supporting obsolescence management that the enhancements that are made to the commercial product line, aren't going to come for free because you've separated them off on a different branch where the technology is moving at different rates, from the commercial environment.

[00:40:01] Yeah. You know what we've seen instances where a customer is taking a product from commercial. They determined it's no longer commercial. They, They wanted it to be a pure far apart, 15 acquisition. And uh, their costs went up dramatically because they got separated from that commercial line and they now have to pay, as the rates went up, they had to pay for some of them.

[00:40:24] Investments in facility, in the factory test equipment, they had to invest in some of the enhancements, the obsolescence management, things that under a normal business environment, we take care of it from a commercial.

[00:40:38] **Eric Lofgren:** You said this, Hey, we have this commercial side of our business.

[00:40:42] We don't necessarily want to run these, all these systems. We have some of the systems that move might run right. For kind of defense stuff, but we don't want to turn everything on throughout the system. In order to make sure costs are allocable and the government's only getting. This percentage of the overhead costs, right?

[00:40:58] That's whatever it is, but even if they are incurring extra cost just by the demands that they put on you, but it seems this whole idea of enterprise. One of the things that, I've read from several like accounting theorist is well, overhead rates are going up over time, it used to be the world. most of the costs was actually direct. It was in this repetitive labor and raw material down in assembly line. And this was the bulk of the cost and we could trace it to particular order. Oh, the government should just pay for those kinds of costs and a fair share of overhead, but then it turns out most of the value of the product is actually in this kind of overhead. The business systems, the training, the the software, the enterprise tooling, the company culture, all this stuff, that's up here and the government should be able to take advantage of that. It seems like it's processes want to trace every cost.

[00:41:51] And by doing that creates these silos and those silos are actually less efficient than understanding that there's a bunch of overhead costs. We don't really know how it gets absorbed, but ultimately you get a better value for that by being able to take take advantage of like these economies of scale.

[00:42:08] Did you have any kind of like reaction to this kind of shift in and since you guys are actually like a manufacturing. But also, intangibles heavy also doing software stuff. Have you seen this kind of shift from that kind of. Assembly line view to more of this enterprise overhead intangibles view.

[00:42:26] **Phil Jasper:** I would say I don't know that we've seen a substantial shift yet Eric, in that regard, but I think it has to start happening because to your point, part of what we're, where we're seeing technology to continue to migrate is around open systems. Where it becomes more about the software becomes more about the continued innovation and enhancements, where there's value in some of that overhead that gets applied to these products and capabilities that are being provided to the defense customers.

[00:42:56] I talked about obsolescence management, for example, if you look at Moore's law and the pace at which memory and processors double in capacity, every 18 months, for example, and then you look at the life cycle of defense articles, airplanes flying 30, 40, maybe even longer years.

[00:43:14] And think of how technology evolves over that time. And you really have to look at the value that's provided right from the company, assuming that redesigning obsolescence as part of a commercial business model versus me. Yeah. Having to pay each and every time one of those processors gets upgrade. And now I've got to go pay the

reintegration costs and the recertification costs and update the software and make sure the drivers work with the new processors and things like that.

[00:43:42] And so I think it's technology, that's going to be forcing more and more of that discussion to happen over the coming years.

[00:43:48] **Eric Lofgren:** Yeah. The DOD just came out with their new. Diminishing material sources, the obsolescence guidance. And we just had an event on that, but yeah, it definitely seems like the commercial.

[00:43:59] The commercial item kind of path is actually designed to minimize our reliance on those types of procedures, because we should be able to keep pace with the technology cycle time in the commercial industry, rather than, potentially lagging it by decades and then having to leapfrog up to the next one and then lag and then leapfrog again.

[00:44:19] **Phil Jasper:** Yeah. You're, You're exactly right. And I think that's a great way to describe it. The commercial innovation cycle just keeps coming and historically the defense department has been one of leapfrog. I'll go put it in place. I'll use it for a while now I've got to leapfrog to the next generation.

[00:44:35] So I think that's a great way to describe

[00:44:37] **Eric Lofgren:** it. Yeah, one of the, one of the other things that seems to be a trend in the economy that I think, maybe it has some relevance in, in this discussion on commercial items in government, it's like what Peter teal talks a lot about in terms of, you know, the economy is moving away.

[00:44:52] Perfect competition of commodities that are exactly alike and towards, more product differentiation. So like competitive monopolies almost right where you create these monopolies, but there's still competition of different types of things that are substitutes to a degree. But I wonder if you have any kind of views on this commodity versus differentiation, perfect competition versus, competitive monopoly kind of view of the.

[00:45:20] **Phil Jasper:** Yeah. You

[00:45:21] know I tend to see some of that happening in the industry as well that the products may not become commoditized. I think maybe some of the underlying technological components will become commoditized, but then it's how do I go take and put those components together in a unique way for me, that my competition isn't doing.

[00:45:41] That I can solve a problem better, faster, cheaper than the competition can. Or maybe I can solve two or three problems with that application of that technology versus maybe one or two that my competitor could. So I definitely see that playing out and it's that's what we're trying to do as a commercial company playing in the defense environment is how do I take all of that commercial technology and combine it in a way.

[00:46:09] That gives me a competitive advantage while at the same time solving our customer's very demanding national security problems using that commercial technology.



[00:46:20] **Eric Lofgren:** Great. So is there anything else that you'd like to leave our audience?

[00:46:24] **Phil Jasper:** I think the, what I'd like to leave the audience with again, is we talked a lot about maybe some of the challenges and issues here. The great thing is there's broad recognition of what commercial technology can do.

[00:46:35] And there's a desire on the part of Congress as well as the DOD. Cause I, I think it's like the last three secretaries have continued to espouse the benefits and the need to leverage more commercial technology. And so we're on this journey. We've been on this journey for the past 20 years and I think we need to continue on that journey and continue to make progress. Now with any journey you're going to have.

[00:46:59] Stumbles and roadblocks along the way. The important thing is how we react together between industry and government to go solve those. And as I mentioned in my webinar on DAU that I did in August, there's some real key, I think, opportunities for us to continue to enhance the process around commercial item acquisition and really work together with between industry and the government around regulations and recognizing and embracing the broad definition of commercial of a type by looking at value versus price determination.

[00:47:32] Training acquisition workforce, not just on the meaning and the importance and the intent of FASA and far part 12, but around commercial business practices, market research how to determine price reasonableness. , we didn't talk about it. There's a lot here, but I think the next area to continue to look at it then is intellectual property and how to value intellectual property and be able to allow how our customers and enabled them to feel that they're not in a sole source.

[00:48:02] Environment where they're powerless, but they're in an environment where they can do the right thing for the war fighter in, and frankly, at the end of the day, that's what this is all about industry and the government are aligned in common purpose and that's to get the best technology door warfighters as fast as possible at the most affordable price for the government and the best value for the taxpayer.

[00:48:25] And man, when we can do that we're going to be a force to be reckoned.

[00:48:29] **Eric Lofgren:** I think that's a statement we can all agree with. Phil Jasper. Thanks for joining me on acquisition talk.

[00:48:33] **Phil Jasper:** Thanks. Great to be here.

[00:48:35] This concludes another episode of acquisition. Talk, if you have comments, interview recommendations, or just want to chat, please contact us@acquisitiontalk.com. Thanks again. And until next time. .