

The Move To “Insourcing” ...Proceed with Caution

**FAIR Institute’s Recommendations for Insourcing to Agencies,
Congress, and Federal agency management**

June 2009



**FEDERAL ACQUISITION INNOVATION
AND REFORM INSTITUTE**

www.thefairinstitute.org

About this Paper

This paper was prepared by Raj Sharma, President of FAIR Institute, with contribution and input from FAIR Board members.

To receive notice of other upcoming papers, opeds, and content, please register at:

www.thefairinstitute.org.

About FAIR

The FAIR Institute is a nonpartisan, nonprofit* organization being led by several leaders in acquisition and supply management. The Board of Directors consists of the leaders in acquisition and supply management from private industry, government and academia including:

- Raj Sharma, President/CEO of Censeo Consulting Group, President of FAIR and Co-Chair of the FAIR Board
- Dr. Allan V. Burman, Co-Chair of the FAIR Board, former Administrator of the Office of Federal Procurement Policy and President of Jefferson Solutions
- David Nelson, former Senior Executive in Procurement with Honda of America and chair emeritus of the Institute of Supply Management
- David Litman former Senior Procurement Executive for the U.S. Department of Transportation, and;
- Joseph Sandor, Hoagland-Metzler Professor of Supply Chain Management at Michigan State University, one of the leading supply chain programs in the world.

The Institute's priorities include providing input and recommendations to decision makers within OMB, Congress and federal agencies on comprehensive acquisition and workforce reform as well as implementation of the stimulus funding.

The Move To “Insourcing”...Proceed with Caution

No matter how you slice it, the use of contractors (or the more appropriate term “suppliers”) within the federal government has soared over the past decade. Contractors are not only performing tasks that require specialized expertise, but are also performing mission critical functions and day-to-day program management and staff support roles. In the Department of Defense (DoD) alone, the number of private contractors has nearly doubled from 21 percent of the Pentagon’s workforce to 39 percent in just eight years.

Contractor use has risen for a variety of reasons:

- Inattention to “right sizing” and “right skilling” the government workforce to support the growth and complexity of its workload.
- The antiquated and uncompetitive government personnel system, including hiring processes and pay scales, that can leave contractors as the only source of capabilities available to agency management.
- Underinvestment in training and developing people to ensure that they have the skills to perform their jobs.
- “Competitive sourcing” program that has led to outsourcing of some positions based on a complex “make vs. buy” analysis (A-76 studies)

The Obama administration has made it clear that the federal government needs to reevaluate when it is appropriate to outsource and use contractors. President Obama’s memo on contracting reform, issued on March 4, 2009, specifically directs the White House Office of Management and Budget (OMB) to issue guidance on the appropriateness of outsourcing. Additionally, OMB is to draft further guidance on the definition of “inherently governmental” positions, per the National Defense Authorization Act (NDAA).

FAIR supports efforts to “insource” but advises a deliberate and systematic approach based on facts and analysis

The Federal Acquisition Innovation and Reform Institute (FAIR) supports efforts to “insource” critical positions and personnel so that the government possesses adequate organic capability to address the challenging and daunting tasks ahead of us. However, we recommend that the administration, Congress, and agencies proceed with caution, through a deliberate and systematic approach to insourcing based on facts and analysis. Agencies should also adopt realistic timelines for recruiting and integrating new personnel as well as developing new business processes, if required.. Rushing to undo what has been in the making for years, perhaps decades, will be counterproductive. We must also take into account the retirement “tsunami” that makes merely maintaining the current size of the workforce a challenge.

To bring talented people into government in large numbers, federal employment must once again become attractive. President Obama’s call to service certainly has heightened interest in public positions. But that by itself won’t be enough. Federal recruiting,

compensation, and professional development policies and processes must change and become competitive with the private sector. While it may be feasible to hire thousands of people during the current economic downturn, it will be difficult to retain this talent unless systemic human capital issues are addressed.

While we look to rebuild government capacity, we cannot lose sight of the fact that industry plays a critical role in supporting and partnering with government. The current rhetoric that categorizes all contractors as dishonest, as opposed to those few that are guilty of fraud and abuse will only deter the best suppliers that we so badly need from competing for government business. President Obama has laid out an ambitious agenda to address a broad array of national security, economic and social issues such as health care reform, energy independence, and social innovation. The technical expertise, innovation, and scale that industry can bring to bear will be an essential component of addressing these issues.

Guidance for insourcing should address the critical question of ‘inherently governmental’ and core competencies

As the Obama administration, Congress, and agency leadership lay out guidance and legislation regarding positions that should be insourced, the most important questions that we should be asking are:

- What are ‘inherently governmental’ positions? Are there any currently being performed by contractors and if so, how can they be insourced immediately?
- What core competencies are critical to achieving agency and program missions? Which positions are tied to core competencies? What is the right balance between government versus contractor positions (in the short-term and longer term)? Beyond number of positions, does the government have the ability to create efficient business models to deliver capability and expertise being provided by contractors? Where should government still continue to leverage government expertise and technical capabilities?
- How and when should positions be insourced? What are critical processes and policies, such as the hiring process and the pay system, that need to be improved to attract the required number of staff?

This paper addresses the first two questions in detail while touching on key issues related to the last question.

Identifying Candidates for Insourcing

FAIR recommends considering three types of positions for possible insourcing:

1. “Inherently governmental” positions
2. “Core Competency” positions
3. Long-term contracted positions

1. “Inherently Governmental” positions

As the term implies, inherently governmental positions belong under government control; there is little debate on this point. Last year's National Defense Authorization Act gives the Office of Federal Procurement Policy (OFPP) another opportunity to address the issue of inherently governmental. While we generally agree with the definition, FAIR is recommending some additional guidance to policy already in place.

First, it is instructive to look at policy already in place. More than 15 years ago, Policy Letter 92-1¹ gave the first government-wide guidance to help the executive branch avoid making "an unacceptable transfer of official responsibility to government contractors." The letter characterized inherently governmental activities as those requiring "governmental decision making because they are so intimately related to the public interest that no question of ulterior motivation can be allowed to arise concerning those choices and those activities."

The policy distinguishes between inherently governmental and supporting activities that contractors may undertake. As stated in the policy letter, "Inherently governmental actions do not normally include gathering information for or providing advice, opinions, recommendations, or ideas to government officials." That distinction allows the government to take advantage of private sector analysis and expertise while remaining fully in charge and in command of the decision-making.

The guidance in 92-1 is adequate in that it considers three key factors:

- Retention of governmental decision making
- Conflict of interest
- Use of contractors for support activities to provide data, information, etc. as long as previous two conditions are addressed

FAIR recommends, in addition to the above, the government also incorporate guidance that ensures agencies adequately define roles and responsibilities for inherently governmental positions, and benchmark compensation and skills in order to attract qualified personnel. Too often, programs are plagued with "fraud, abuse and waste" because the government cannot afford to hire highly skilled, qualified people to manage programs and provide adequate oversight to contractors. Additionally, programs are typically understaffed, further exacerbating issues related to poor program and contractor management.

FAIR also recommends that guidance related to "core competency" positions be incorporated as part of any guidance/policy for 'inherently governmental' positions (as described in next section).

2. "Core Competency" Positions

Considerably more difficult than the question of inherently governmental positions is that of positions related to core competencies. Often, this much more ambiguous area has led

¹Policy Letter 92-1, Subject: Inherently Governmental Functions, issued September 23, 1992 by the OMB's Office of Federal Procurement Policy (OFPP).

to subjective decisions and become part of the public debate. For example, how do we decide whether security contractors in Iraq really should be government positions? How should the Department of Defense determine the proportion of systems engineers that should be government versus contractors?

Rather than making pure subjective decisions, policy makers and agency management should consider the following questions

- What core competencies are critical to achieving agency and program missions?
- Which positions are tied to or support a required core competency?
- What is the right balance of workforce between government and contracted core competency positions? The answer to this question partly lies in answering:
 - What are those specific positions that, at a minimum, are required to provide oversight to contractors, interpret their work, and ensure avoidance of conflict of interest?
- Beyond minimum requirements for core competencies, does a robust “make vs. buy” analysis support a justification for creating new government positions? Or should the positions continue to be contracted, assuming minimum capacity for oversight.

Toolkit: Value stream analysis

Value stream analysis, a common tool used in Lean Six Sigma and continuous improvement programs, can help identify activities that should be staffed with federal employees. Through value stream analysis, an agency can break down functions (such as finance, IT or acquisition) into major activities, which can be profiled relative to key decisions made, supporting analysis, information and expertise required, and expected level of activity throughout the fiscal year (among other categories). By adding the other criteria (i.e. mission related technical expertise, scale and efficiency, etc.), agencies can systematically determine core competency positions.

To answer these questions, we must begin by asking “What is a core competency?” Very simply stated, a core competency is critical to achieving an organization’s mission and goals. According to Wikipedia, a core competency is central to meeting customer needs (or meeting a mission), cannot be imitated by competitors and can be leveraged across multiple products or parts of the organization.

In addition to the above, some other considerations in determining government core competencies include:

- Mission related technical and management expertise – Government should retain adequate technical and management expertise to make key decisions related to program strategy and planning, provide contractor oversight, and interpret data and information provided by contractors, and ultimately make independent

decisions.² For example, it may be okay for an agency to use a contractor for recruiting coordination (e.g interviews) but government should retain ultimate responsibility making the hiring decision.

- Scale and efficiency - Using fully burdened costs (including all benefits, facilities, retirement, etc.) and objective cost/benefit analysis, agencies should also evaluate whether they have the scale to maintain expertise and capabilities in specific areas. Not every area of expertise can possibly be maintained by an agency in an efficient manner. Naturally, there will be suppliers that have developed unique business models that allow them to serve their customers, including government, in delivering their capabilities and expertise in the most efficient and effective manner. In cases where conflict of interest cannot be avoided, government may not have any choice but to perform the function itself.

One example of a core competency is systems engineering in the DoD. Systems engineering is a core capability required to design a weapon system. While industry can carry out systems engineering for a weapon system (for example), the Department of Defense should have at least minimum capability to interpret contractor work and drive independent decisions. Given the many weapon systems in various phases across the DoD at any one time, the capability can also easily be leveraged across the department. The primary question left to answer is the ability of the DoD to attract and retain high caliber systems engineers through competitive compensation and an attractive career path.

The answer may not be as simple in other cases. There may be many more supporting jobs than full-fledged government core competency related positions. There may also not be sufficient scale for the government to efficiently build the required expertise. In such situations, acquisition strategies can separate contractors providing decision support from those executing the decision, in order to avoid conflicts of interest.

Long-term contracted positions

The third category of insourcing candidates includes “staff aug” positions that have been contracted for long periods of time, often 5 to 10 years or more. They range from clerical positions to ongoing program management. The reasons are often tied to inability of government to hire through the cumbersome hiring process, uncompetitive pay, and hiring freezes.

In evaluating such positions and related contracts, policy should require:

² Policy Letter 92-1 addresses the issue of government oversight as follows: "Official responsibility to approve the work of contractors is a power reserved to government officials. It should be exercised with a thorough knowledge and understanding of the contents submitted by contractors and a recognition of the need to apply independent judgment in the use of these work products."

- Confidence that positions will be required for at least another 5 years (if not longer)
- Cost/benefit analysis, with fully burdened costs, demonstrating that government can perform roles more efficiently and at a lower cost than contractors. We recommend a much more streamlined and classic “make versus buy” analysis as opposed to the A-76 process.
- Ability to attract, pay, and retain talent for similar skills at market wages. The skill levels being compared must be “apples to apples.” Wage comparisons, once fully burdened, should be based on true market wages rather than government pay scales, which may not be competitive with the market.

We caution against categorizing large number of positions into broad categories such as “program management” as that may not demonstrate the expertise and capability being acquired. Instead, requirements should be assessed on a case by case basis to determine capabilities that truly can benefit from being “insourced” and positions that can continue to be contracted.

Prioritizing Candidates for Insourcing

While the preceding analysis may indicate hundreds or even thousands of positions for insourcing, actual implementation should be approached cautiously, with a realistic timeline that allows for recruiting, integration, and ongoing development of any new personnel. Additionally, focusing on just numbers rather than quality can also lead to loss of critical capability that currently may be provided by contractors.

How should agency management prioritize insourcing of positions? Three common-sense screens will help with the decisions:

- **Mission criticality of the function/activities:** Going automatically to the top of the list are inherently governmental positions. Positions related to agency core competencies, on the other hand, may be more or less mission-critical. The higher priority goes to spots that tie directly to the agency mission or whose key skills should be in-house and harnessed for continuous improvement.
- **Skill gap:** Another criterion is the level of skill gap for any critical position. The larger the existing skill gap relative to requirements, the longer it will take to ultimately build required capability. When insourcing such positions, agencies must build a realistic timeline for transitioning capability over time and managing the knowledge transfer from contractors so that essential know-how is not lost in transition. Skill sets must also remain equivalent to those being acquired from contractors in order to retain similar capabilities.
- **HR preparedness:** As mentioned throughout, human capital processes will be key not just to insourcing, but to long-term sustainability. It is encouraging that the administration and OPM recognize the need to redesign HR processes and have begun to build a reform agenda.

Conclusion

With President Obama's call for public service and the current economic downturn, there has never been a better time to attract people to government. However, a rush to insource thousands of positions, while trying to take on ever more government programs, can end in disaster.

Agencies should approach insourcing with a clear plan of action, focusing in the short-term on inherently governmental positions and key mission critical roles. Simultaneously, they should develop long-term plans that address other roles as well as systemic HR issues, working in collaboration with OPM and their HR functions to address hiring processes, compensation, and professional development. Through a collaborative effort and deliberate thinking, we can surely have a government capable of addressing the myriad of challenges we face today.

References and Definitions

Policy Letter 92-1 issued by the U.S. Office of Management and Budget (OMB) Office of Federal Procurement Policy (OFPP)

http://www.whitehouse.gov/omb/procurement/policy_letters/92-1_092392.html