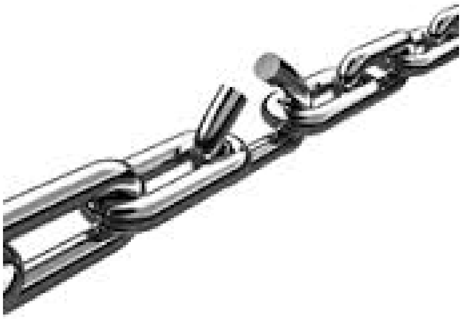

The *relationship* between a prime contractor and a subcontractor (or between a higher-tier subcontractor and its own subcontractors) is the key to effective program management. Most people know this and many preach it – but in our experience very few practice it.

We discuss program management a lot on this blog. For all the CAS and FAR and DFARS stuff we post, and for all the DCMA/DCAA audit stuff we post, we keep coming back to program management. Why? Because if the programs aren't effectively managed then everything else is reduced in importance. Program schedule slips and cost overruns put the squeeze on company cash flow and profits. Program problems divert management's attention from other matters. Program problems today often mean fewer programs tomorrow (thanks to CPARS reports). Therefore, effective program management is the bedrock of the company, both today and tomorrow.

And the bedrock of effective program management is effective subcontractor management.

This is especially true at the larger contractors, those that bill themselves as "system integrators" where 70% or more of program costs are incurred outside the contractor's premises, by various subcontractors located in disparate geographical areas. These large companies have come to realize – too slowly, in the case of a few – that traditional subcontractor quality assurance and surveillance techniques are insufficient to manage the program risks in today's environment. What worked in the 60's and 70's will not work in the second decade of the 21st century. New techniques are required to effectively manage a global supply chain; which is why Boeing had to significantly revamp how it was managing its 787 program suppliers.

So it's funny, then, that Boeing has recently been in the news for screwing-over its suppliers. It's funny (or ironic, if you will) that the company that had to figure out how to better manage its supply chain in order to get the 787 program back on track is the same company that is now (reportedly) working hard to piss-off those same suppliers. Yeah, a pissed-off supplier is not going to be your best supplier. Relationships matter.

We once heard the story about a helicopter manufacturer in Connecticut who had a very successful defense program. After 9/11 that program was deemed critical to kinetic operations in Southwest Asia. The customer wanted more product; it needed more flight capacity. The contractor, who was already working three shifts per day, seven days per week, couldn't make any more product, and it would take 2 to 3 years to bring another factory online in order to increase capacity. What could they do?

Well, after consultations with the customer, the contractor decided to enter into a co-production deal with a smaller contractor up the street (metaphorically speaking). That smaller contractor had a factory and staff and engineers, and could be up and running in a matter of months. It was a win/win! The Presidents of two contractors met to hammer out an agreement-in-principle, shook hands, and then turned it over to the contracts folks to work up a contract that both parties would execute.

What happened after that is the moral of this little vignette. The Contracts folks from the big contractor decided to earn their salaries by screwing-over the little contractor. They negotiated hard and they negotiated from a position of strength, and they got concessions. After all was said and done, the FFP subcontract between the two contractors was priced so that the smaller contractor made very little profit. Obviously, all the new work reduced indirect cost rates and kept people employed and that was a tangible benefit, but the price was so low that any unexpected bump in the ramp-up of the new factory was going to cause cost problems (not to mention schedule slips).

So what did the smaller contractor do in response to the cost pressures imposed by the subcontract? It assigned its most junior personnel (i.e., the lowest-cost) to the project. It abided by the letter of the contract: no more. It took no risks and added no value and simply performed as directed.

What do you think happened?

Yep. The ramp-up of the new factory didn't go well. There were delays. There were quality problems. And the smaller contractor didn't worry too much about those problems, because it had contractual coverage. If the bigger contractor wanted something different --- well, that was a change order, wasn't it? And change orders require proposals to identify cost and price impacts. And those proposals require fact-finding and negotiation. And those tasks took time and they took resources away from what actually mattered, which was getting the new factory up and running so that products could be shipped to the warfighters who desperately needed them.

Remember, the products being built were for *flight*. They carried people from Place A to Place B. They needed to work and work well and be safe. Quality escapes were *not good*. The government customer made its displeasure with the situation known via Corrective Action Requests (CARs). Including at least one Level 3 CAR.

Level 3 CARs are *not good*. At least one of them was leaked and was reported widely. That didn't reflect well on management at either of the contractors.

So the moral of this little vignette is that prime contractors (and higher tier) subcontractors need to establish effective working relationships that supersede the contractual language under which they are working. If you damage those working relationships, if you screw-over your subcontractor, you are running the very real risk that your subcontractor is going to find a way to screw you right back. In this case, the smaller contractor screwed-over its bigger prime by following the letter of the subcontract instead of the spirit, by assigning qualified (but very junior) personnel to the program in order to live within tight price ceilings, and by sitting back and watching the trainwreck happen.

By the way, it was the *new* President of the bigger contractor that told us this story. The old President and several of his management team had "moved on" as part of the company's corrective action plan implemented in response to that Level 3 CAR.

Relationships matter.

In contrast, Dr. Robert Carman told us about his supplier relationships. He told us about holding a competition to award a 5-year requirements contract. Several bids were received but not all approved suppliers bothered to submit bids. Several of the bids seemed lackadaisical but one stood out. And that one bidder received a subcontract award. Dr. Carman's company agreed to award that one subcontractor its total requirements for that product for a period of five years.

And then Dr. Carman's company won a major defense acquisition program. Huge. Lots of business for everybody, including suppliers.

And all that work went to the one successful bidder.

The other approved suppliers complained because they were losing significant amounts of business, but their complaints were baseless and they got nothing. Meanwhile that one supplier got record-setting levels of work.

Dr. Carman met with the senior leadership of that company every month for five years. They met and they reviewed status and they discussed issues of mutual concern. And they bonded. Relationships were forged.

Dr. Carman told us how those relationships overcame program challenges. His company needed a new product that involved new production techniques? No problem. The supplier initiated its own IRAD program to develop those new techniques. Those new techniques led to new orders – not only from Dr. Carman's company, but from other A&D companies as well – because the supplier now had a competitive advantage in the marketplace. Dr. Carman's company identified quality problems? No problem. The supplier deployed additional high-level resources; it hired consultants (on its own dime). It bent over backwards to help Dr. Carman out, because that's what friends did for each other.

Contrast those two stories.

Now let's look at Boeing and how it's (reportedly) screwing-over some of its suppliers. Here is **one link** to many reports on the topic.

Apparently the problem started at Rockwell Collins, a publicly traded company. (In which we own a small number of shares of stock.) In its most recent quarterly financials, COL reported good numbers but degraded cash flow. According to Bloomberg: “While Rockwell Collins’s third-quarter profit of $1.63 a share beat estimates, analysts on a conference call focused on its disappointing cash receipts. The $138 million generated in the quarter was short of estimates, and the supplier’s earnings release predicted free cash flow would total about $750 million for 2016, the low end of its previous guided range.” That news didn’t help COL’s stock price (dammit!).

COL’s CEO told analysts “’In general, this is catching the supply chain off guard and it’s inconsistent with our contract.’ … While Boeing notified Rockwell Collins it was slowing supplier payments, ‘they’re delinquent for payments they had for the quarter.’” Bloomberg reports that Boeing is between $30 and $40 million behind in its contractually required payments.

And it’s not just Rockwell Collins. Boeing is also in the process of screwing-over GKN, another supplier. According to the Bloomberg article, “[Boeing] is negotiating a prolonged payment schedule with … GKN for parts including winglets, cabin windows and ice protection systems supplied across Boeing’s commercial fleet. Those changes have ‘already had an impact’ on working capital, GKN Chief Financial Officer Adam Walker said Tuesday ….”

For its part, Boeing admitted that it is in the process of changing its payment terms for large suppliers “to support [its] competitive position.” The Bloomberg article stated “Reuters reported earlier this month that Boeing was shifting supplier payments from 30 days to as many as 120 days.”

It’s a good thing this change of payment terms and alleged violations of subcontract agreements seems to be limited to Boeing’s commercial aircraft business. As we all know, if Boeing tried to do the same thing to its defense suppliers it would run afoul of certain FAR and DFARS requirements, and DCAA might find that it had a significant deficiency in its accounting system – which would lead to mandatory payment withholds. There are no such consequences on the commercial side of the house.

Unless, of course, you think about the two vignettes we related in this blog article. If you do think about them, you may realize that not all consequences are obvious. Some are stealthy and do long-term damage to the prime contractor (or higher-tier subcontractor) that maximizes its own results on the backs of its suppliers. Relationships matter, and decisions can damage relationships.

Maybe Boeing needs to relearn this lesson?