

*Accurate
Credible
Defensible*



Should Cost Management

February 2012

Mr. Nidak Sumrean
Director, Cost Engineering
and Industrial Analysis



Report Documentation Page

Form Approved
OMB No. 0704-0188

Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.

1. REPORT DATE FEB 2012	2. REPORT TYPE	3. DATES COVERED 00-00-2012 to 00-00-2012			
4. TITLE AND SUBTITLE Should Cost Management		5a. CONTRACT NUMBER			
		5b. GRANT NUMBER			
		5c. PROGRAM ELEMENT NUMBER			
6. AUTHOR(S)		5d. PROJECT NUMBER			
		5e. TASK NUMBER			
		5f. WORK UNIT NUMBER			
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Sea Systems Command, Washington Navy Yard, DC, 20376		8. PERFORMING ORGANIZATION REPORT NUMBER			
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)		10. SPONSOR/MONITOR'S ACRONYM(S)			
		11. SPONSOR/MONITOR'S REPORT NUMBER(S)			
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES Presented during ASNE Day 2012 "Naval Warfare - Critical Engineering Challenges" February 9-10, 2012, Arlington, VA					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 13	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

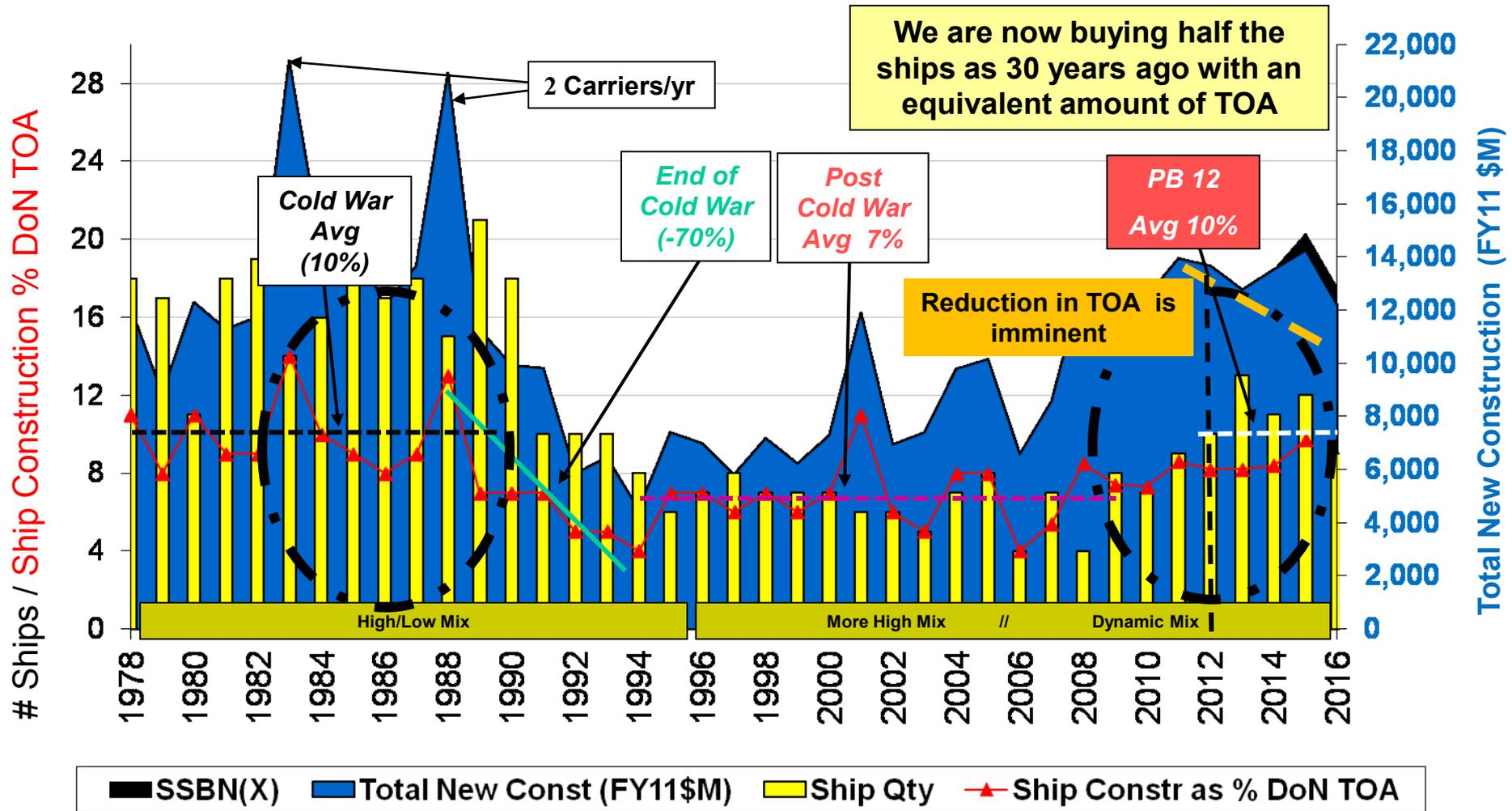
Driving Change in Navy Acquisition

“...In this fiscal environment, every program, every contract, every facility will be scrutinized for savings - savings that won't reduce readiness or our ability to perform essential missions...”

*- Defense Secretary Leon Panetta
Remarks made to Congress-
October 11, 2011*



Shipbuilding Procurement History



Better Buying Strategies are key to addressing the issues of affordability

2011 NDAA Language

(H.R. 6523, Subtitle B, Sec. 811)

- Recognizes the difference between “estimates for program baselines and analysis” and “targets for contract negotiation purposes” and amends *Section 2334 of Title 10, United States Code* as follows:
 - “(A) cost estimates developed for baseline descriptions and other program purposes conducted pursuant to the subsections (a)(6) (i.e., independent cost estimates and cost analyses) **are not to be used for the purpose of contract negotiations or the obligation of funds**; and
 - (B) cost analyses and targets developed for the purpose of contract negotiations and the obligation of funds are **based on the Government’s reasonable expectation of successful contract performance...**”

WILL COST / SHOULD COST

ASHTON B. CARTER, SECDEF, MEMO (14 SEP 2010)

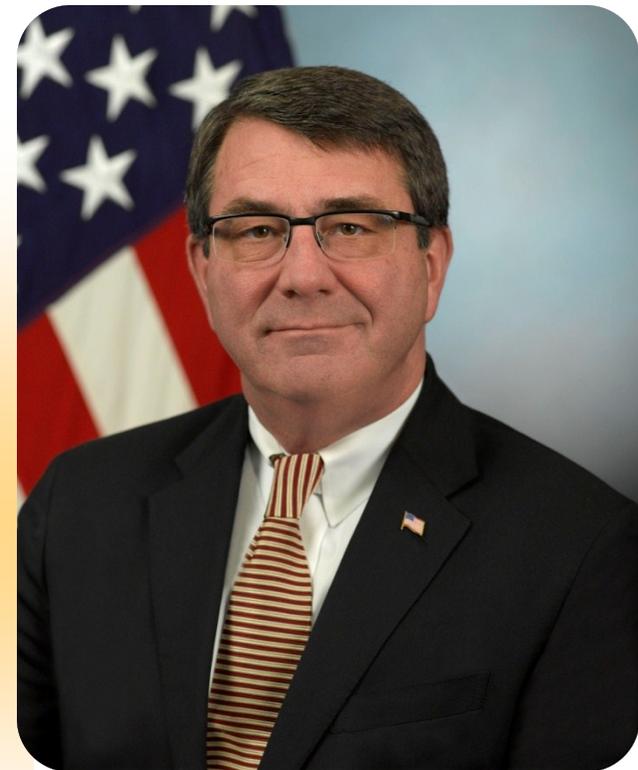
MEMORANDUM FOR ACQUISITION PROFESSIONALS

SUBJECT: Better Buying Power; Guidance for Obtaining Greater Efficiency and Productivity in Defense Spending

“TARGET AFFORDABILITY AND CONTROL COST GROWTH”

Drive productivity growth through Will Cost/Should Cost Management. During contract negotiations and program execution, our managers should be **driving productivity improvement in their programs.** “They should be scrutinizing every element of program cost, assessing whether each element can be reduced relative to the year before, challenging learning curves, dissecting overheads and indirect costs, and targeting cost reduction with profit incentive – in short, executing to what the program **should cost.**”

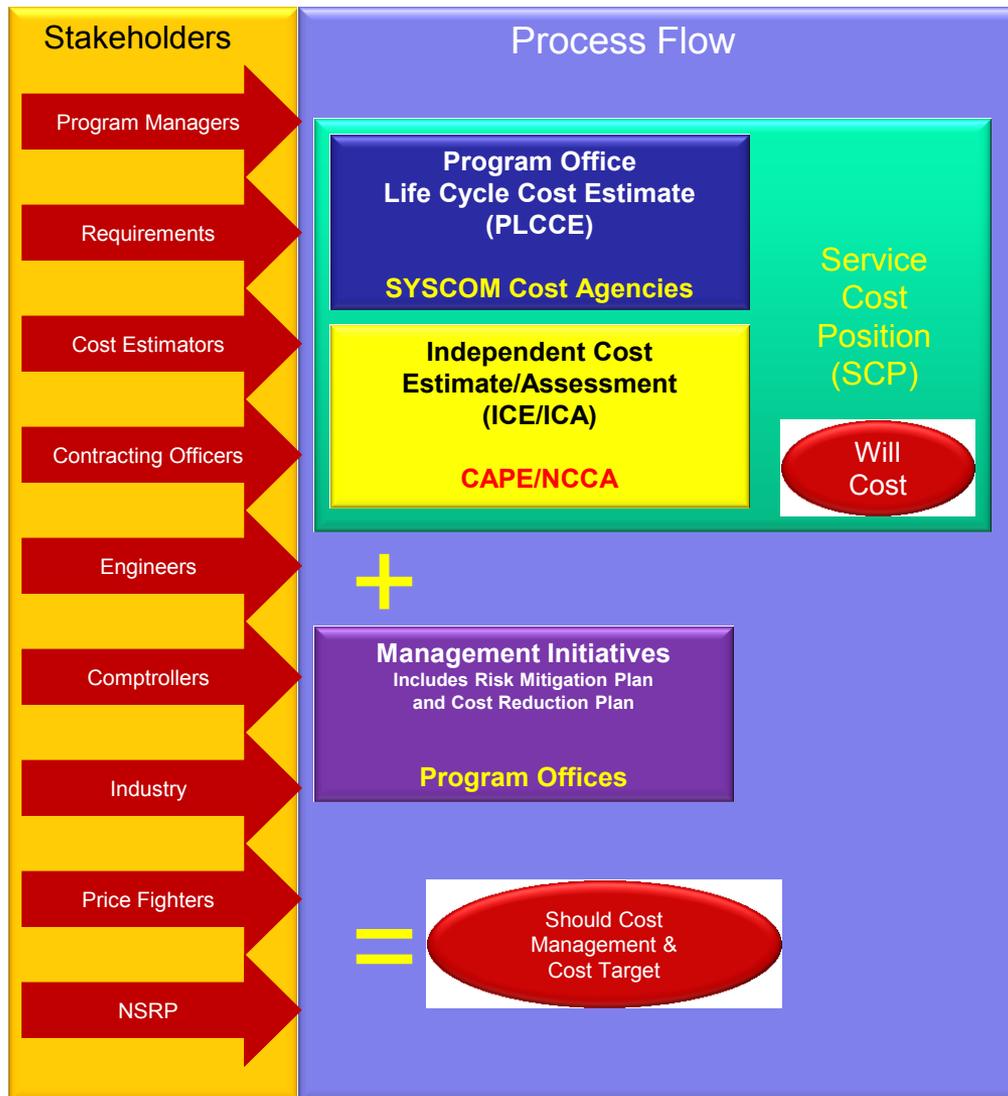
“... I will require the manager of each major program to conduct a Should Cost analysis justifying each element of program cost and showing how it is improving year by year or meeting other relevant benchmarks for value.”



DoN Guidance

- *“Program managers, through continuous Should-Cost Management, will identify discrete, and measurable actions or initiatives that achieve savings against the Will-Cost estimate.”*
- *“The program office is responsible for developing Should-Cost management targets and initiatives along with all tracking and reporting requirements.”*
- *“For ACAT I programs, the Will-Cost estimate is the CAPE Independent Cost Estimate or the Service Cost Position.”*
- *“Will-Cost estimates for ACAT II and III programs will be presented at milestone decisions and approved by SYSCOM cost estimating organizations...”*
- *“USD (AT&L) and ASN (RD&A) will approve Should Cost Management targets at milestones and at annual Gate reviews/ Configuration Steering Boards.”*
- *“Program offices, SYSCOM cost staffs, and NCCA will ensure full incorporation of the achieved savings into updated Will-Cost Estimates.”*

Should Cost Management (program execution targets) Development



- **Service Cost Position**
 - A reconciliation of the PLCCE and the ICE or ICA
 - Represents the “Will” cost position for the program
 - Identifies key cost drivers and areas of risk
- **Management Initiatives**
 - Leverages information from the PLCCE or SCP on key cost drivers and risk
 - Relies on cross-functional collaboration
 - Program Managers
 - Cost Estimators
 - Comptrollers
 - Engineers
 - Contracting Officers
 - Includes a detailed Risk Mitigation Plan and a Cost Reduction Plan
 - Identifies savings that can be reasonably achieved by changes in processes, materials, or investment in new technology
- **Program “Should” Cost Management**
 - Determined by decreasing the SCP by the value of savings identified through management initiatives
 - Tracked by PEOs as programs progress over time

Should Cost Management in a Nutshell

Critical Elements



Requirements Management



Acquisition Strategy that
Maximizes Competition and
Shares Risk



Aggressive Schedule
Management



Detailed Understanding and
Management of All Costs



Active Risk and Opportunity
Management Approach

- Should cost management requires us to work as a team, not just in our functional “swim lanes”
- Identifying opportunities
 - Major cost drivers from “will-cost” estimate
 - Major areas of risk from “will cost” estimate
 - Industry benchmarks and best practices
- Meeting challenges
 - Scrutinizing every element of cost
 - Providing proper incentives
 - Financial/contractual challenges
- Measure progress
- Industry can succeed in this environment

IF WE DON'T CONTROL OUR COSTS, SOMEONE ELSE WILL

Diving Deep Enables Better Insight and Understanding

CORPORATE ANALYSIS PUBLICLY AVAILABLE

“DEEP DIVE” COMPETITION SENSITIVE

CORPORATE OVERVIEW

EXECUTIVE COMPENSATION

CORP/SECTOR FINANCIAL ANALYSIS

ECONOMICS

SUPPLIER BASE

PAST PERFORMANCE C/S

COST STRUCTURE

- ORGANIZATION
 - SECTORS
- EXECUTIVES
- BOARD OF DIRECTORS
 - HIGHLIGHT RETIRED MILITARY/DoD
- NAVY PORTFOLIO

- PERFORMANCE PAY vs. SALARY
 - TOP 5
- CRITERIA

- REVENUE GROWTH
- OPERATING MARGINS
- CAPITAL INVESTMENT
- CASH FLOW
- RATIO ANALYSIS
- DEFENSE AVERAGE COMPARABLE

- INFLATION
- LOCAL UNEMPLOYMENT
- LOCAL MARKET LABOR RATES
- UNION REPRESENTATION
- LOCAL INCENTIVES
- INDUSTRY PRODUCTIVITY

- MAKE vs. BUY
- SUPPLIER NETWORK
- WORKLOAD
- CAPACITY
- TECH LEADER or FOLLOWER
- WHO HAS THE INTELLECTUAL PROPERTY – PRIME OR SUPPLIER

- EARNED VALUE
- CPARs
- RECORD OF PAST EFFORTS AT DESIGN AND PROCESS COST REDUCTION INITIATIVES

- ELEMENTS
 - MAT'L, LABOR, O/H
 - SOURCING STRATEGIES
 - RAW MAT'L & COMPONENTS
 - LABOR SKILLS AND UNIONS
 - FIXED V. VARIABLE O/H AND DRIVERS

- COST TRENDS & COMPARISONS
 - DIRECT
 - INDIRECT

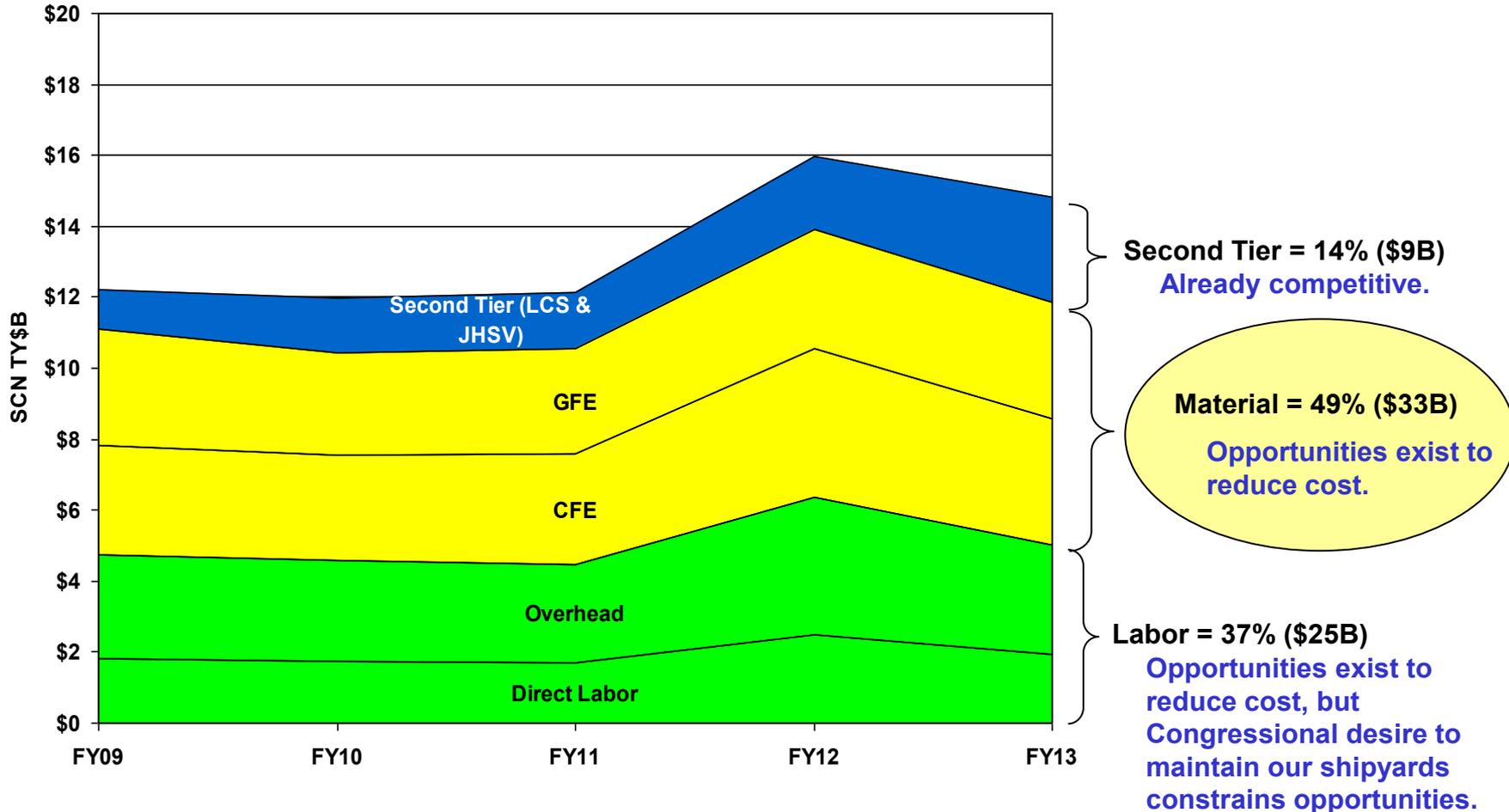
BIG PICTURE

- EDUCATED BUYER
- INDUSTRY MOTIVATION AND INSIGHT
- IDENTIFICATION OF RISKS AND OPPORTUNITES

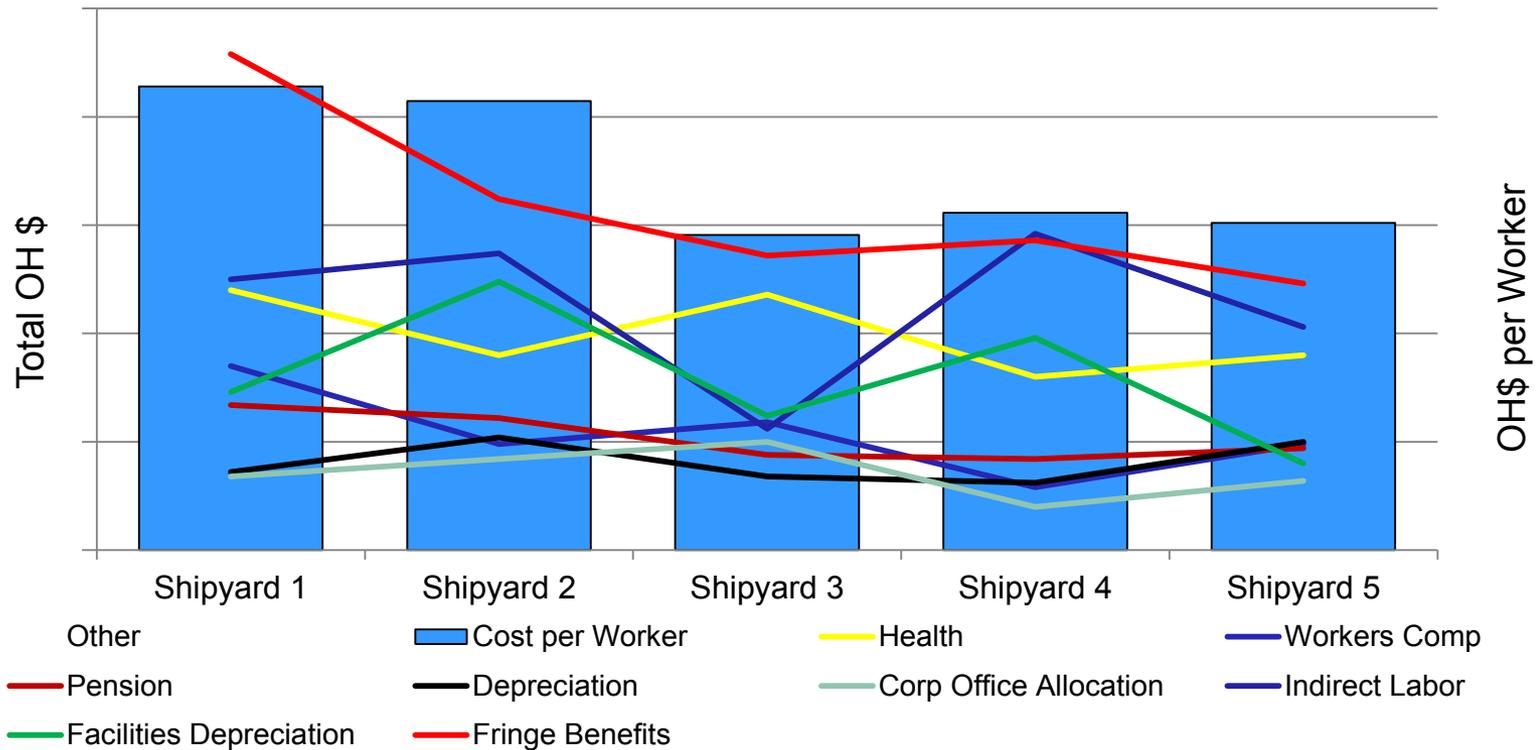
TACTICAL

- ACQUISITION STRATEGY DEVELOPMENT
- PREPARATION FOR CONTRACT NEGOTIATION
- ENABLER FOR “WILL/ SHOULD” COST

Where are the Opportunities?



Benchmarking Provides Should-Cost Opportunities



Benchmarking and finding best practices in shipyards and in supplier facilities helps identify opportunities for improved efficiency.

Should Cost Management Summary

- Should Cost Management Opportunities

- Commonality program savings
- Learning curve improvements
- Process Improvements
- Changes in Contracting
- Gov't Furnished Equipment



- What Not to Include in a Should Cost Target

- Straight percentage reductions
- Large investments with no near-term cost recovery