

291

L. H. ...

THE INDUSTRIAL COLLEGE OF THE ARMED FORCES  
Washington, D. C.

Industrial Mobilization Course

LECTURE

Policies and Procedures in Procurement

Lecture IV - "Factors in Contract Placement"

0840-0930, 8 February 1946

Instructor: Captain Thomas B. Worsley, A.C.

I. Introduction.

A. Gentlemen, there are two major aspects of purchase policy and procedure which occur early in the contracting process. One is the placement of contracts or selection of contractors, and the other is contract pricing.

B. In the last lecture on purchase policies and procedures, my fellow Pentagon corporal, Captain Lovenstein, covered the objectives of contract pricing and the wartime market conditions which create a pricing problem. In this period we shall attempt to cover the second major aspect of purchase policy and procedure; that is, factors, considerations, or criteria involved in placement of contracts.

C. As we have seen in earlier lectures, in peacetime price is often the major factor in contract placement. Of course, other factors such as the technical and financial competence of contractors also play an important part in selection of contractors. Nevertheless, under the generally more competitive market conditions of peacetime and the reliance on formal advertising, competitive bidding, and award of contracts to low bidders, price does play a major role, and often the major role in selection of

contractors where contracts must be awarded to the lowest bidder. It is obvious that no great amount of choice is left to contracting officers. Of course, the need for secret development or procurement of some items makes formal advertising and competition bidding impracticable even in peacetime.

D. As has been pointed out earlier, the usual peacetime practice of relying upon price as a major factor in contract placement is possible and desirable because:

1. Government buying is relatively small in volume and value.
2. The factors of production (facilities, finance, manpower, know-how and materials) are relatively plentiful.
3. Speed of procurement is secondary.
4. For the reasons just mentioned primary emphasis may be placed upon equitable distribution of government business among sellers as well as maximum return for taxpayers' money. This emphasis upon equitable distribution of Government business and economy in the use of public funds is a necessity during peacetime, but, as we shall soon see, becomes a luxury which cannot be afforded in all cases in wartime.

E. We have also seen that in wartime the large volume of procurement brings about a relative scarcity of time and of the means of production and distribution ("know-how", manufacturing facilities, manpower, materials, and transportation facilities). This word scarcity is perhaps the key word in war economics and explains most of our war economic problems and the controls necessary to meet these problems. Back in the days when

2-4

I was a student of peacetime economics, that is, in the days of relative plenty, I often wondered why so much emphasis was placed upon scarcity in determining values. After some five years of observing war economics I don't think any of us needs to be told of the wartime importance of scarcity. The necessity for protection of facilities and personnel against both internal sabotage and enemy action, in other words, the need for security, also looms as an important consideration, and as we shall see, various economic, political and social factors come to bear upon placement of contracts in wartime.

F. These scarcities of the elements of production as well as scarcity of time outweigh price in importance during wartime, but price still plays a large part in placement of contracts. In wartime, governments appropriate plentiful supplies of funds. Alas, saving taxpayers' money is no longer one of the leading considerations! The factors which are given greatest value, therefore, are what economists call "real", rather than monetary, factors. However, price, as we shall see, still plays a part in contract placement.

G. In order that a choice of contractors might be made on the basis of these factors which are more important in wartime than price or technical and financial competence, negotiation of contracts was, as we have seen, given precedence over competitive bidding early in World War II. This policy of mandatory negotiation and reliance on factors other than price was set forth in WPB Directive Number 2 in March of 1942. As we shall see, it has been amended to reflect changing needs of the war economy at various significant periods.

H. When we say, however, that other factors become more important than pricing in selection of contractors during wartime, we must keep one fact firmly in mind: that is that the very fact that other factors involved in wartime placement of contracts are given primary consideration (emphasis on speed and quality in performance and efficient use of manpower, materials and facilities), makes it especially necessary to have sound methods of negotiation and price supervision to insure that the contract prices agreed upon with such contractors will be close enough to their cost to encourage efficient operation, to prevent excessive profits and to restrain inflationary influences. In other words, pricing becomes very important after contracts have been placed, if not before, during wartime.

## II. Wartime Evolution of Factors Involved in Contract Placement.

A. It is impossible to treat factors in contract placement during wartime as static or absolute in their applicability and relative values. These factors change in both number and relative emphasis as the economy undergoes transition:

1. From peacetime to expansion for war: during this phase speed of delivery comes first and few other factors need be considered in placement of contracts.

2. As the procurement and production effort expands in volume toward a peak, speed still remains first, but scarcity of factors such as machine tools requires conservation of such material means of production and contract placement policies must take this into account.

24

3. As the war economy reaches peak production and starts toward contraction all the means of production become scarce and while primary emphasis is still placed upon speed and the ability to meet quality and quantity requirements, conservation of scarce manpower, conservation of facilities and materials and the favoring of smaller plants which might otherwise be overlooked in the scramble for speed and in the distribution of materials, play a predominant part in contract placement.

4. As the economy proceeds from the contraction phase toward peacetime production it is natural that emphasis is placed upon avoiding commitments for too long periods or too large quantities in order that termination claims and the volume of surplus property may be minimized. Emphasis is, for similar reasons, placed on scheduling close to requirements. Contracts and letters of commitment with flexible provisions are used to make possible a rapid pulling in of sales where necessary. Eventually there is a return to formal advertising and reliance upon competitive bidding, that is, upon pricing as a leading factor, and often the leading factor in placement of contracts.

B. Illustrations from History of World War II. It seems advisable to illustrate points just made with reference to the actual economic history of World War II. Only in that way can we show the relationship between world events, production needs, and contract placement policy and procedure. We shall, therefore, embark upon a brief history lesson.

1. 1 January 1940-7 December 1941 (Pearl Harbor).

As the war clouds gathered early in 1940, after Hitler's victories in Poland, the American defense effort got underway. From that time until Pearl Harbor and far beyond, the emphasis was upon speed and this emphasis increased.

a. We, therefore find: a gradual relaxation of reliance upon formal advertising and competitive bidding.

b. Spreading work among subcontractors both large and small, that is, without reference to their size, was emphasized. During these early days large firms which could meet the requirements for speed in producing large quantities of high quality material were, with least administrative assistance from contracting officers, naturally favored. Political pressure, as well as economic causes, however, forced the spreading of contracts geographically.

c. Every effort was made to expedite procurement and production, including decentralization of procurement operations.

d. As war industries and communities became threatened, because of cessation of civilian production, premium prices, that is, prices higher than those which might have been offered<sup>competitors</sup>, were allowed by the OPM to save such communities or industries.

2. 7 December 1941 (Pearl Harbor)-October 1942.

Then came Pearl Harbor!! As those of us who were in Washington at the time remember, everything was electrified and the attitude became "Damn the Price - Full Speed Ahead", (or no more "too late and too little").

2/14/42

Primary emphasis was, therefore, placed on speed all the more. Any contacting officer of 1942 will tell you that! Ability to deliver on time and sub-contracting, became even more important than formerly. The scarcity of "know-how", including engineering and managerial resources as well as productive capacity, meant that second emphasis should be placed upon conserving the larger and more capable concerns which had been overloaded previously for the more difficult jobs. The growing scarcity of machine tools needed as a basis for intricate production caused third emphasis to be placed on avoiding contractors who would need new equipment in order to meet contract requirements.

To set forth the policy covering the relative emphasis or values of these factors WPB put out its Directive No. 2 on 3 March 1942. It is interesting to trace the evolution of this directive in War II. It mirrors the development of the war economy. It is noteworthy that the factor of price is not mentioned in the Directive in connection with selection of contractors although the Directive does require negotiation of contract prices.

3. 10 October 1942-18 September 1943.

By the fall of 1942 production was proceeding from the expansion to the peak production phase. New shortages became apparent and old ones more intensified. Primary emphasis was still upon speed of delivery, but the growing shortage of machine tools, labor, facilities with extraordinary competence in handling complex operations, and the need for protecting smaller plants against complete liquidation in the

face of material and manpower controls brought about reshuffling of emphasis. We, therefore, find avoiding creation or purchase of new machinery in second place, avoiding scarce labor areas and favoring surplus labor areas in third place and avoiding placement of simple jobs with firms capable of complex ones and the spreading of production among smaller plants as such, receiving emphasis in that order. Price became the final consideration, subject to the above factors. It was during this period that Congress passed the Small War Plants Act to protect small business. Congress, like Americans in general, of course, has always loved the small business man, ostensibly in the interest of preserving a sound middle class and an atomistic or competitive economy, an economy of many sellers, but perhaps also for sentimental reasons and because the small business man is a very numerous individual who in the aggregate, accounts for quite a few votes (more than so-called "big business"). It was during this period (December 1942) that the War Manpower Commission designated labor areas on the basis of the degree of scarcity of labor. To encourage pricing contracts outside of scarce labor areas and with smaller war plants, the WPB and the procuring Services encouraged payment of price premiums.

4. 18 September 1943-12 May 1945.

In the Fall of 1943 over-all production for World War II reached its peak. The scarcities previously mentioned became intensified and shifted in relative importance. To reflect this change of emphasis

WPB Directive No. 2 was reamended. The chart here behind me pertains to the period of peak production after the Fall of 1943 and shows the scale of relative values or importance of the factors involved in contract placement in the eyes of WPB. Speed still came first and the need for it was stressed in regulations regarding the timing of placement of prime and subcontracts, as well as scheduling of deliveries as far in advance of requirements as possible. Loss of manpower to the Armed Forces and the inevitable concentration of contracts in certain industrial centers of the country had by now caused manpower considerations to take a place second only to that of speed and ability to meet quantity and quality requirements. This same growing scarcity of manpower and of critical materials caused next or third degree emphasis to be placed on cost and efficiency in manufacturing and on the price incentives for such efficiency. By this time consideration for small war plants had moved up the ladder, conservation of special abilities was still high, but the growing supply of facilities such as machinery and plants had brought about a lower position for conservation of facilities. Transportation scarcities had brought addition of a factor involving the avoiding of overloading of transportation facilities and avoiding crosshauls, and an additional factor of assuring more than one source of supply for reasons of security, was added. Price still was considered subordinate to these other factors and premium prices to encourage use of smaller plants and surplus labor areas were continued.

5. Then we come to May 1945 and VE Day, a most happy occasion! As we shifted from production for a two-front to production for a one-front

war, Directive Number 2, WPB, was again amended. This time it allowed wider discretion for placement in scarce labor areas, since it was expected that labor shortages would soon ease up. As some plants would be terminated after VE Day, first consideration would be given to private rather than Government plants in being released from war production. The outline points out that there were also several other less significant changes.

6. 31 January 1946.

By the end of last month we were well on the way to reconversion to peace despite strikes and other obstacles. Again we find the Government becoming a comparatively small buyer, and again there is the possibility of competition within some industries still selling to the Government.

We, therefore, find that War Department Procurement Regulation Number 2 was republished on 31 January of this year to set forth the policy changes made advisable by the new market situation. The new regulation emphasizes procurement at least expense through formal advertising and competitive bidding where:

a. Ample supplies of items and ingredients of these items are available to meet all civilian and military requirements and,

b. There are sufficient producers to assure competition.

The War Department now places primary emphasis on technical and financial ability to perform. This is not a radical departure as it was always taken for granted. Now it <sup>is</sup> explicit, not merely implicit. Next emphasis

is on price, whether the price is arrived at by formal advertising and competitive bidding or by negotiation. When negotiation rather than formal advertising is used, procurement regulations call for considering the following factors:

- (1) Release of privately-owned plants.
- (2) Avoiding creation of new facilities.
- (3) Avoiding overloading of transportation.
- (4) Favoring small business concerns.
- (5) Assuring more than one source of supply.
- (6) Granting most developmental contracts to the firms which carried out development.

As in the past, contracts are not to be placed with disqualified or debarred bidders. With these recent changes in regulations and in emphasis or evaluation we complete the cycle which we began during the economy of peace and traced through the war years.

### III. Further Consideration of Two Major Factors Involved In Contract Placement During World War II.

There are two interesting developments in the field of contract placement factors that appear to deserve special consideration. These are the policy and procedure used in favoring smaller war plants, and the policy and procedure involved in avoiding scarce and favoring surplus labor areas.

A. It has been seen that in the early days of war procurement, large war plants were favored by contracting officers because of their

ability to deliver on time large quantities of high quality materiel. We have also seen that the policy of encouraging subcontracting without reference to the size of plants involved, developed rather early. As shortages of critical materials and other factors of production grew, smaller plants not having war contracts or the priorities growing out of such contracts, were faced with the threat of extinction.

For these reasons and others previously mentioned, Congress in June 1942 therefore passed the Smaller War Plants Act, under which the Navy and War Departments, among others, have worked to place the largest practicable volume of prime contracts and to encourage subcontracts with small business concerns. The SWPC was given power to make prime contracts with the procurement agencies and to subcontract to smaller plants. It was also given power to certify smaller plants, for placement of contracts to the heads of the military department. In practice, however, the Navy and War Departments have taken it upon themselves to effectuate policies favoring smaller plants without the necessity of plant certification or the taking of prime contracts by the SWPC. In carrying out this policy, the two military departments have established procedures which are similar in general, but vary in accordance with their organizational differences. In the War Department, a Smaller War Plants Branch was set up at Army Service Forces Headquarters for staff supervision, but the responsibility for operating procedures involving SWPC policy was placed upon the chief of each technical services. In each War Department technical service headquarters, the SWPC placed its so-called "procurement specialists", who worked with

"smaller war plants offices" and in the technical service headquarters to screen the Army Supply Program and procurement directives for items within the productive capabilities of smaller plants. In the contracting offices or field offices of the technical services, similar "procurement specialists" of the SWPC first worked with smaller war plants officers of the contracting services to determine which particular procurements were suitable for manufacture for smaller concerns, the minimum portion found suitable, how many smaller plants SWPC would designate, and the date by which such designation would be submitted to the contract office. Only secret, confidential and emergency procurements might be excluded by the chief of the technical service under the SWPC program.

As the program developed, it became obvious that it was not necessary to have screening of procurement directives at both headquarters and field offices of the technical services. By April 1944, therefore, the field office was performing the only full screening operation.

To encourage placement of contracts with smaller war plants, contractors might be paid premium prices up to 15 percent higher than the average price at which the purchase could be made from suitable large concerns, that is, concerns having over 500 wage earners. This premium could be paid only where justified by higher cost. In practice, payment of such a premium was usually not necessary since many small plants were sufficiently efficient to submit relatively low bids.

While there was a considerable fluctuation in the total amount of War Department business (value) going to smaller plants, the percentage

of the total number of contracts varies but slightly from 60 percent. The percentage of delivery value rose from 12.6 in 1943 to 25.7 in February 1945. The increase was partly due to pressure by representatives of the SWPC in each procurement office, but was also due to the fact that large firms came into the war program relatively early, and after that date additional requirements had to be met by smaller ones.

Since Navy procurement is centralized to a greater degree than Army procurement, that is, since Navy contracting officers are more often located in Washington Bureau Headquarters than in field offices, Navy procedure for favoring smaller plants varied in detail. Nevertheless, we find that the Office of Procurement and Materiel, the Navy coordinating office which corresponded in general to the Army Service Forces Director of Materiel, had its Smaller War Plants Section, corresponding to the Smaller War Plants Branch in the Purchases Division of the Army Service Forces Headquarters. Each Navy bureau had its "procurement coordinator", who worked with Smaller War Plants "representatives" to carry out such screening and other operations as have been described in connection with Army procedure.

B. It has been shown that as the war progressed, manpower shortages increased because of losses to the Armed Forces and the growing size of war production. The major industrial centers of the country soon became over-crowded with work and manpower shortages developed.

To meet the need for controls over manpower supply, the War Manpower Commission had been created in 1942, and by December of that

year, a procedure had been worked out whereby the War Manpower Commission designated labor "areas" on the basis of the degree of scarcity of labor in such areas. At first, there were only three areas, but before the end of December 1942, there were four. Group I were areas in which acute labor shortages existed or were anticipated. Group II were areas in which labor shortages existed which might endanger essential production or areas which were approaching the balance of demand for and supply of labor. Group III were areas in which labor supply substantially balanced demand. Group IV were areas in which substantial labor surplus existed or is expected to develop. The WMC divided the country into twelve regions and classified localities in accordance with their labor supply situation. Production Urgency Committees were established in labor shortage areas. They had authority to approve placement of contracts in Group I areas.

Placement of contracts in such Group I areas was however to be avoided as far as possible, though certain contracts could be placed therein with or without clearance of the Production Urgency Committees, under prescribed circumstances. There were similar restrictions, though less stringent, in Group II areas. There were no restrictions on placement in Group III or IV or in unclassified areas. In fact, it was the positive policy to encourage placement in such surplus or near-surplus areas. This policy applied to subcontracts as well as prime, and prime contractors were urged by contracting officers to effectuate it in placing subcontracts.

To effectuate the policy in regard to labor areas, the services were authorized and directed to pay a premium price up to 15 percent higher than the lowest of the prices bid by bidders located in Group I areas. Such premium prices might also be paid to effectuate policies involving the other factors in contract placement - the history of which has been already traced. Power to pay a premium of more than 15 percent in connection with either the smaller war plants or the labor area programs was vested in the director of the Purchase Division of the Army Service Forces, in the case of the War Department.

In other lectures it has been pointed out that scarcity of labor led to the development of the so-called West Coast Manpower Program as early as September 1943. This program was expanded by December 1943 to include six other areas - Detroit, Akron, Hartford, Buffalo, Chicago and Cleveland. Baltimore, Norfolk, Indianapolis and Salt Lake City were other scarce labor areas.

#### IV. Application of Major Policies Involved in Contract Placement During World War II.

It will be the responsibility of the Purchase Policy Committee from this group to study and evaluate the application of the major policies involved in contract placement during World War II. This will be studied during Phase V of this course. Of course, there have already been certain histories of contract placement policies written by the various headquarters and operating offices involved in contracting in the War and Navy Departments. These histories have the disadvantage of

242

being written by people closely connected with carrying out the policy. Such people have the advantage of close familiarity, but the difficulty of arriving at any objective evaluation. They sometimes suffer from the provincialism which comes from being on the inside of a single organization. This provincialism no doubt was shared by most of us present before we had the privilege of attending the Army Industrial College and entering the realm of objective, cosmopolitan and stratospheric thought!

It is well known that the types of commodities purchased by the various Navy Bureaus and Army Services, as well as the industrial centers from which these items were purchased, had a strong bearing upon the success of any given service in carrying out certain of its policies involved in contract placement. For example, it was easier for the Navy Bureau of Supplies and Accounts or the Army Quartermaster Corps which purchased many standard commercial items produced normally by smaller firms dispersed throughout the United States to make a good show in connection with the smaller war plants and labor area policies, than it was for the Navy Bureau of Aeronautics or the Army Air Forces, the Navy Bureau of Ordnance or the Army Ordnance Department, The Navy Bureau of Ships or the Army Signal Corps. These latter purchasing agencies bought large and complicated items which often could be produced only by large plants and whose production was concentrated in areas having labor shortages. It was easy for the Quartermaster to place contracts in such a surplus labor area as New York City because every fire trap and loft in Manhattan or Brooklyn plays some part in manufacture of clothing - a Quartermaster item, before the joint purchasing office was set up in New York. It would have been

harder for the Air Forces or the Navy Bureau of Aeronautics to get bombers produced in such spots. In addition, a large amount of judgment, weighing, and balancing was required in carrying out contract placement policy. Contracting officers were like jugglers keeping eyes on 8 or 10 balls at once. Too much attention to any one ball could mean dropping some others. Such considerations as these and others must be kept in mind by the Committee on Purchase Policy in evaluating the relative success in application of contract placement policy by the various services in World War II.

V. Some Future Considerations As To Contract Placement.

We might shift from looking backward in the manner of Monday morning quarterbacks or the well-known fillilu bird to the more difficult function of crystal-gazing as to future developments.

A. If some of our prophets of the new Buck Rogers era are to be believed, placement of Government contracts for defense purposes in the future may be affected strongly by the need for pre-emergency dispersion, concealment and secrecy of vital war plants.

B. The policy developed during World War II of relying on more than one source of supply will become more important than ever.

C. It will be necessary to place contracts for such things as aircraft bombs, guided missiles, etc. before an emergency arises. The technical nature of new weapons will make it necessary to rely on highly-skilled contractors capable of advanced research and development, as well as production.

D. Besides these considerations involving placement of contracts before an emergency, it is obvious that in the type of emergency contemplated by some thinkers, speed of procurement would become more important than ever before.

E. Placement of contracts in such a way as to avoid undue reliance on transportation facilities in one area and to minimize transportation costs may be more important in view of new weapons and impending railroad rate increases.

F. Placement of contracts in smaller plants and in smaller towns might be of growing importance in the interest of security. Such considerations as scarcity of facilities, manpower and materials, however, might never have time to develop in any future emergency.