



## Earmarked for Change

**Recent efforts at earmark reform raise a number of strategic questions for federal contractors and challenge them to create a more balanced portfolio of external and internal funding streams. What hard questions should firms that have benefited from earmarks be asking as they prepare for coming change?**

Tim Stanos, Jay Korman & Jim Tinsley

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### Executive Summary

The House Appropriations Committee recently announced that it will not accept earmark requests directed at for-profit organizations via the annual spending bills for FY2011. If this ban were to be fully enforced, it would have major implications for defense contractors given that the vast majority of earmarks are within the Department of Defense’s budget.

Questions remain, however, as to the impact these restrictions will have given their opposition within various congressional circles as well as the multiple earmark reform loopholes already being exploited by beneficiaries of directed congressional spending. While it is difficult to discern whether this announcement will have any real effect on the majority of funding targeted at for-profit organizations, companies are scrambling to get in front of the issue and reassess their strategies in light of these emerging restrictions.

Avascent believes that the recent efforts at earmark reform raise a number of strategic questions for federal contractors and challenge them to create a more balanced portfolio of external and internal funding streams.

### House Action

Many Capitol Hill insiders as well as outside observers note that earmark reform became more plausible in 2010 after the passing of Congressman John Murtha (D-PA) in February. Murtha had long been an unabashed proponent of congressional earmarks, and as chairman of the defense spending panel, ushered millions of dollars to his district annually. While many insiders anticipated that changes were coming, few expected that changes would come so quickly.

House Appropriations Committee Chairman David Obey (D-WI) announced earlier this month that his panel would not be accepting

earmark requests that would benefit for-profit organizations. New chairman of the House Appropriations Defense Subcommittee Norm Dicks (D-WA) has joined forces with Obey to push the new restrictions, which have been applauded by Speaker Nancy Pelosi (D-CA).

Obey’s announcement came shortly after Minority Leader John Boehner (R-OH) said that the Republican Conference would consider putting a halt to all earmark requests by House Republicans for the remainder of the year. One week later, Boehner and his colleagues made it official through an intra-party vote.

While Obey’s proposal specifically targets for-profit organizations, the Republican agreement bans all earmark requests, including those directed to non-profit organizations. In addition, whereas Obey’s initiative would pertain only to appropriations bills, Republicans broadened their scope to include authorization bills as well.

### Senate Response

While House Republicans and Democrats battle over the extent of earmark restrictions to impose, Senate leaders from both parties are more averse to change. Senate Appropriations Committee chair Daniel Inouye (D-HI) and ranking member Thad Cochran (D-MS) have each spoken out against restricting earmark requests, arguing instead that Congress must exercise its control over “the power of the purse.”

Inouye and Cochran trumped efforts by Senator Jim DeMint (R-SC) to institute a year-long ban on earmarks, when the Senate voted last Tuesday to reject DeMint’s proposal. Along those lines, Senate Majority Leader Harry Reid (D-NV) was reported to have rejected restrictions similar to those being implemented by Obey in the House.

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### The Road Ahead

The extent to which the recent House and Senate maneuvers actually impact for-profit organizations’ ability to benefit from earmarks remains to be seen. As a means to circumvent similar regulations in years past, corporations have established non-profit entities that act as “middle men” to pass through earmarked dollars to the companies that set them up.

Moreover, while there are strict rules regarding earmarks and a formal process in which they must be requested, vetted, and allocated, Congress can add significant funding for projects outside of that process with tools such as committee adds. Thus, unless the definition of an earmark is made more expansive, the new restrictions still leave major loopholes for government affairs offices and lawmakers that know the system well.

Knowing these loopholes exist, Obey and Dicks have promised new reforms that would require investigations by agency inspectors general to ensure that the expenditure of earmarked dollars is above-board. Proponents of the latest reforms also point out that lawmakers will be much more reticent to make waves in light of recent ethics probes concerning a number of congressmen, including Murtha, as well as the conviction and imprisonment of former Rep. Randy Cunningham (R-CA). Each of these individuals was either alleged or proved to have been involved in wrongdoing associated with earmarks, among other questionable activities.

### Implications for Federal Contractors

It is clear that congressionally-directed spending on Department of Defense programs and initiatives will continue. How far the pendulum will swing in favor of limiting

earmarks, however, cannot be determined at this point. As such, firms that now benefit from earmarks should prepare for coming change by asking hard questions on the following:

- *Policy Boundaries:* Legislative tracking over the next several months is crucial as both parties – and factions within each party – parry competing concepts for earmark legislation.
  - What is likely to result from these efforts at reform?
  - Which activities will be restricted when new rules are in place, and what are the work-arounds that will enable high-priority programs and initiatives to get congressional funding?
  - What will the competitive environment be for earmarks if they are limited to Senate appropriations?
- *Partnership Analyses:* More restrictive earmarking legislation will likely require another layer of partnership / teaming due diligence when determining the probability for success of a given initiative.
  - In this new environment, who are the right partners for a given program, and what is the appropriate share of work and investment for each partner?
  - Will non-profits and universities become more prominent players in the acquisition process, beyond more niche traditional research and technical roles?
  - Will companies who have been primarily funded through earmarks continue investing in their partners’ programs?

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- *Customer Mapping:* Understanding customer acquisition channels, from requirements to the end-user, becomes absolutely critical if the forcing function of congressional appropriations is restricted or eliminated.
  - How can companies ensure their offering has the support of key decision makers and influencers?
  - What alternative funding and acquisition channels are available?
  - How can companies create pull for their programs by addressing decision makers’ most important requirements?
- *Pipeline / Portfolio Analysis:* The current debate over earmarks has served as a wake-up call especially for firms with a heavy dependence on congressionally-directed funding.
  - How dependent are revenues or growth targets on earmarks?
  - How can companies reduce dependency on earmarks to ensure a more balanced risk profile, while still ensuring that nearer-term revenue targets are met?
  - What arguments will be persuasive to upper management to justify substituting IRAD for expected earmark funds? What will the ROI be for IRAD-funded programs?
  - Are their positive IP implications for pursuing IRAD options instead of earmarks that would improve margins or time to market?
  - Can technology development timelines be accelerated through IRAD to improve time to market?

## Conclusion

As business executives evaluate their program funding options in this new legislative landscape, it is important to keep in mind that while the latest earmark reforms may impact expected funding streams, they only add a complicating factor to an already complex operating environment for corporate government affairs offices. And while these new reform efforts have proceeded at a more rapid pace than expected, few in Washington doubted that earmarks would face increasing scrutiny as fiscal responsibility becomes a political watchword.

Avascent believes that the recent congressional action serves as more of a wake-up call to for-profit organizations to reassess their funding portfolios than an end to all earmarks. The decision of a for-profit organization to pursue government funding through any channel – whether Congressional adds, DoD discretionary budgets, CRADAs, or program budgets – has always brought with it certain risks, rewards, and uncertainties. The benefits of pursuing those funding options should be continually weighed against the business case for funding projects internally or through structured partnerships with other firms.

With balanced funding strategies in place, changes in policy that may result from this earmark tug-of-war are more of an inconvenience than a threat to federal contractors.





## About the Authors

**Tim Stanos** is a Senior Associate with the Avascent Group where he manages engagements with defense and aerospace clients and tracks legislative affairs. You may contact him via email at [tstanos@avascent.com](mailto:tstanos@avascent.com)

**Jay Korman** is a partner with the Avascent Group and directs work with large defense and aerospace prime contractors. You may contact him via email at [jkorman@avascent.com](mailto:jkorman@avascent.com)

**Jim Tinsley** is a partner with the Avascent Group and directs work for commercial companies pursuing federal contracts. You may contact him via email at [jtinsley@avascent.com](mailto:jtinsley@avascent.com)

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## Contact

The Avascent Group  
1225 Eye St. NW  
Washington, DC 20008  
(202) 452-6990  
[www.avascent.com](http://www.avascent.com)



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