DEFENSE BUSINESS BOARD

# Applying Best Business Practices from Corporate Performance Management to DoD

April 25, 2013

*These are the final briefing slides as approved by the Defense Business Board in the public meeting held April 25, 2013.*

# Agenda

# Overview

## Impetus for Study

While providing for the national defense, the Department currently faces significant budget reductions, mounting costs, and management challenges without the full benefit of modern management systems, processes, and information to make required decisions to balance national security and financial constraints

## Deliverables

Evaluate how successful executives of large and complex corporations plan, implement, and monitor strong performance, especially during periods of reduced resources and/or significant changes.  Recommend those world class business practices that are applicable to government which could be used by DoD leadership during this critical time of change

## Task Group

Joe Wright (Chair), Phil Odeen, Bobby Stein, Richard Spencer, Pat Gross, Fred Cook, Bill Phillips, Kelsey Keating (DBB Staff Analyst), and CDR Matthew Duffy, USN (DBB Military Assistant)

# Overview

- The Terms of Reference include the following:
  - What procedures, practices, and metrics are used by leading private sector companies to manage/oversee their performance during/after a period of change?
  - How does the private sector integrate performance monitoring processes with their ongoing budgeting process and their incentive structures? How could this be applied to DoD?
  - How would DoD use these successful private sector processes, practices, and techniques? What organizations would implement/monitor the processes?
- The Task Group views this as an opportune time to shift from "spending management" to "modernized, cost-based management" and to make necessary changes in the Department's organization and operations that would not normally be politically possible
- The Task Group therefore included recommendations for best practices on reducing costs without degrading warfighting capability

*"This effort will by necessity consider big choices that could lead to fundamental change…that involves not just tweaking…existing structures… [but] fashioning entirely new ones that are better suited to 21st-century challenges."* – Secretary Hagel, April 2013

# Process/Methodology

- Reviewed current/past DoD strategic and financial documents and reports/studies from think tanks and government agencies
- Evaluated past downsizing efforts in private/public sectors and 1990s DoD experience to identify practices that resulted in both success and failure
- Interviewed 50 individuals from the private sector and government, to include:
  - Current and former CEOs of Fortune 500 companies
  - Current and former Secretaries and Deputy Secretaries of Defense
  - Other Government entities including OMB, GAO, Simpson/Bowles, etc.
- Interviewees included Frank Carlucci, John Hamre, Gordon England, Alan Simpson, Erskine Bowles, Wilson Lowery (IBM), David Cote (Honeywell), and Jack Welch (GE)
  - See Appendices for a complete list of interviewees and reports/studies

# Assumptions

- Current political/economic pressures to reduce the U.S. deficit and debt are expected to continue, resulting in budget cuts to programs, Agencies, or "across the board" (i.e., sequester in 2013 and beyond)
- Budget Control Act (BCA) of 2011 reduced DoD's projected budget by 9% over the next 10 years; DoD is expected to continue to operate with reduced budgets for some time
- While downsizing efforts will be more difficult than past budget cuts (ongoing war on terror, far higher personnel costs, etc.), this is an opportunity to install modern management information practices and systems in order to reduce overhead, cut low priority programs, and increase the "efficiency" of the Department
- World class business practices can be applied to government/DoD for more "bang for the buck" resulting in increased capability for warfighting

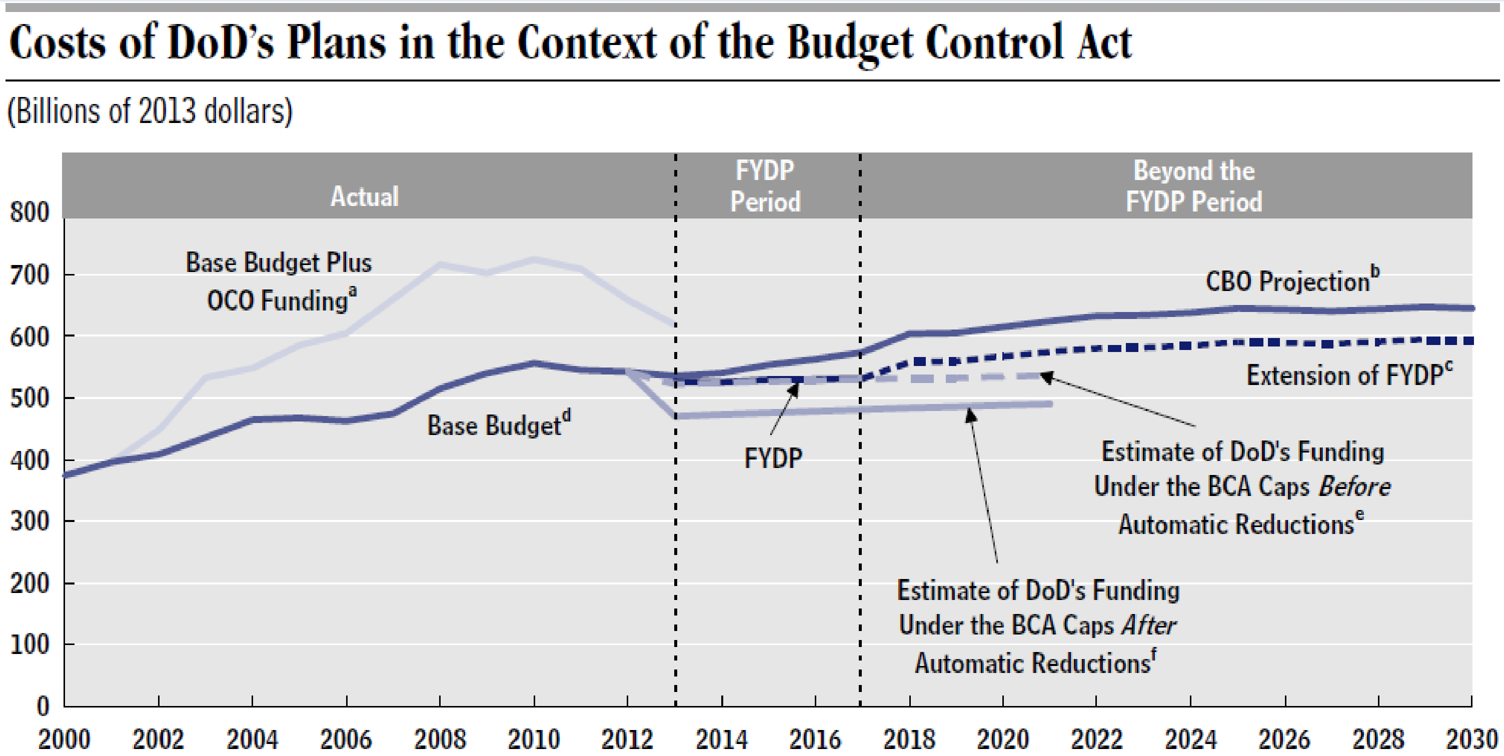
> *"Our national debt is our biggest national security threat."*
>
> \- ADM Michael Mullen, "Tribute to the Troops" breakfast, 2010

# Background
## Today's Budget Pressures

- DoD's topline budget increased 54% from $420B to $648B* from FY2001-2012 despite little change in active duty end-strength
  - DoD's base budget increased 26%, from $420B to $531B*
  - DoD overhead increased 20% from $221-$271B - total personnel costs increased from 50% of Total Obligation Authority (TOA) in FY85 to ~63% in FY12**
- But recently, DoD's projected topline has been reduced 13% over the next 5 years (Future Year's Defense Program (FYDP) FY13-17) resulting in a flat base budget***
  - BCA 2011 reduced DoD's out-year budget by $487 billion from FY12-21
  - DoD's funding of programs through the Overseas Contingency Operations (OCO) is being reduced with some costs being absorbed into base budget
- In addition, DoD has incurred another $41B (~8% base budget) in FY2013 sequester reductions

* FY13 Constant dollars
** Includes civilians, military, and contracts for services (FYDP data)
*** In FY13 Constant dollars; assumes elimination of OCO funds by 2017

# Background
## Today's Budget Pressures




- Unlike future sequester years (FY2014-2021), this year's [and perhaps next year's] reductions are proportionally across the board*
- FY2013 cuts will be spaced over a 7 month period ending September 31, 2013, because of the Continuing Resolution

*Excluding military personnel and OCO
CBO Chart: (b) CBO projections incorporate costs consistent with DoD's recent experience; (c) extension of the FYDP projects costs of DoD's plans using DoD's estimates where available; (e) budget estimates w/o sequestration; (f) budget estimates with sequestration

# Background
## How Did Private Sector Handle Last Crisis?

- In 2008, the U.S. private sector experienced its deepest recession since World War II
- Companies were forced to take rapid and extremely aggressive actions led by the CEO/senior management
  - Decisions made quickly based on market, competition, and profitability/cash flow
  - Overhead cut deeply, reporting layers reduced, and span of control increased
  - Headcount reduced and costs per person cut via pay freezes, bonus elimination, and reduced benefits (e.g. shift to defined contribution retirement plans)
  - Offices/operations consolidated, excess facilities/businesses closed or sold
  - Management information/reports were cost-based to ensure savings achieved – integrated into budget reporting system
- Companies that took quick action emerged stronger

*"Budget pressures can be an opportunity to reduce costs and improve efficiencies at DOD – this opportunity should not be wasted. We've come to a point in this country where we don't have a choice but to take action on costs."* - Former CEO of Fortune 50 company

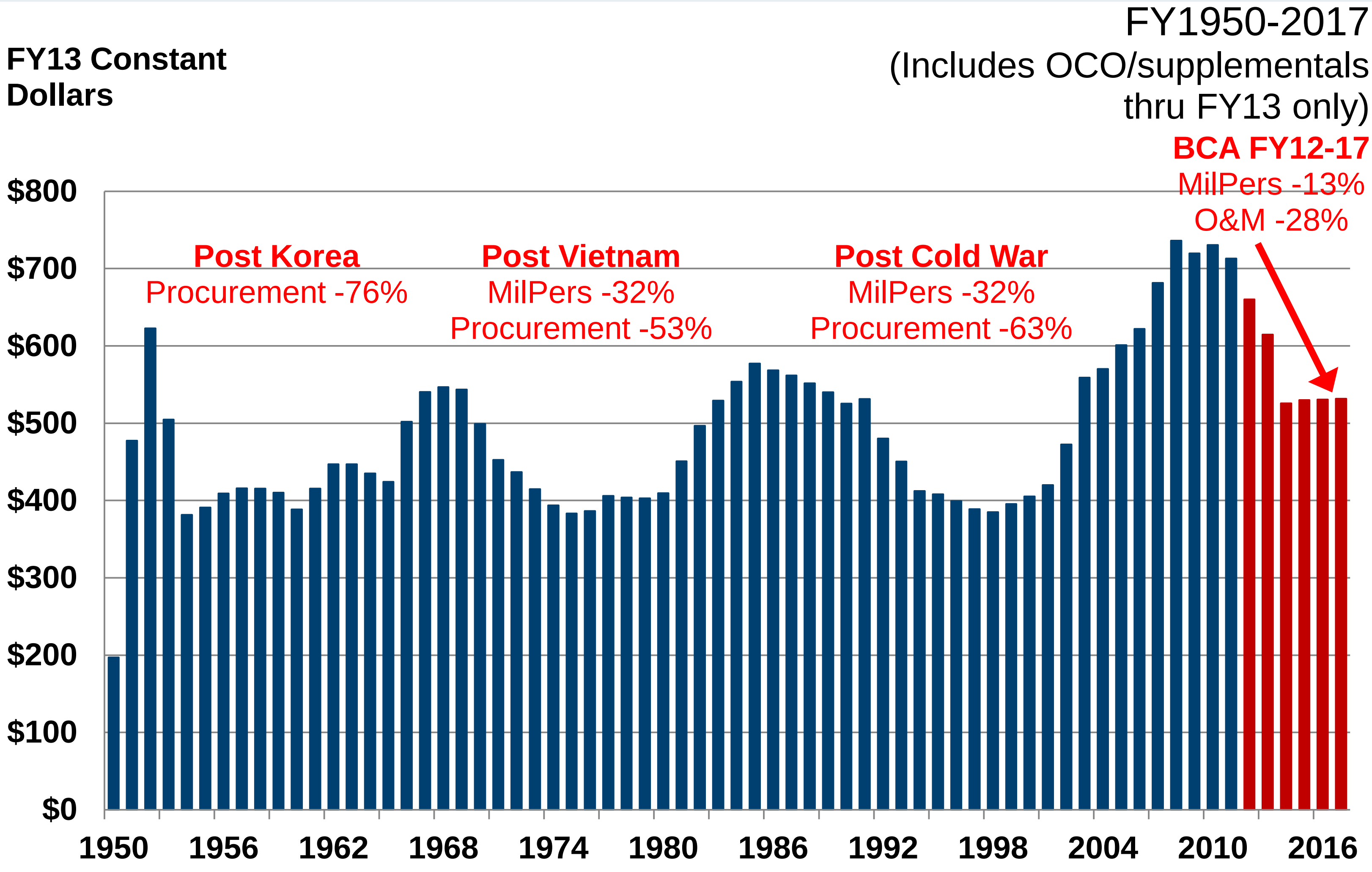
Note: A more detailed report on private sector downsizing best practices is included in DBB Report FY11-08

# Background
## Past DoD Downsizing Efforts

- After major war efforts, DoD's budgets declined (e.g. WWII, Korea, and Vietnam). Low point in all three cases was near $400B in today's dollars (see chart on pg 11)
- The Post Cold War drawdown budget declined 36% to $384B (FY13 constant dollars), from a peak in FY86 of $597B
- Substantial reductions in force structure, as shown in table below

| DoD Resource | 1986 | 1998 | Change |
|---|---|---|---|
| Active Duty Military Manpower | 2,100,000 | 1,500,000 | -29% |
| Civilian Personnel | 1,100,000 | 750,000 | -32% |
| Army Divisions | 18 | 10 | -44% |
| Air Force Fighter Wings | 24 | 12 | -50% |
| Strategic Bombers | 324 | 89 | -73% |
| Navy Combat Ships | 546 | 314 | -42% |
| Navy Carriers | 15 | 11 | -27% |
| Major Aircraft Procurement Programs | 8 | 4 | -50% |
| Major Bases (reductions from BRAC) | 495 | 455 | -8% |

# Background
## DoD Total Obligation Authority (TOA)




Source: FY 2013 Greenbook, table 6-1 "DoD TOA by Title"

# Background
## How Did DoD Manage Post-Cold War Drawdown?

- Opportunities achieved: Initiatives provided vision and shape to implementation driven from the top, with Service buy-in, and focused on sustaining key capabilities
  - Deputy Secretary Atwood's "Defense Reform Initiative": changed business operations, enabling significant support and personnel reductions
  - CJCS Powell's "Base Force": reduced the force structure consistent with SECDEF strategy
  - 1993 NDAA included authorities for financial separation incentives for civilian employees
  - Secretary Cohen's Defense Reform Initiative established offices to oversee downsizing
- Opportunities missed: Rapid and dramatic program curtailments with old legacy management systems maintained
  - "Procurement Holiday" (FY94-99): investment cut ~40%, equipment aged, creating significant future modernization bill. Acquisition workforce substantially reduced leading to gaps in experience and critical skill sets
  - Service budget choices led to unbalanced force/poor readiness – Departmental efficiencies did not result in sufficient savings to help fund modern combat needs
  - Dramatic consolidation of defense industrial base reduced competition and caused major industrial companies (e.g. GE, Texas Instruments, Ford, Chrysler, etc.) to exit DoD market. This reduced flexibility and range of capabilities of the industrial base
  - Civilian workers more closely tied to military capabilities were hardest hit (base operations, strategic/tactical support, and training) but those not directly tied to operating force (central support, headquarters, and communications) stayed flat/increased in size

# Observations on Management Systems

- Since the last downsizing, DoD has not installed the necessary management processes and Management Information Systems (MIS)/Enterprise Resource Planning (ERP) systems to provide performance and cost/metrics needed to make informed decisions on this downsizing process and to drive other efficiency/cost-reduction efforts in the Department
  - DoD has one organization focusing on budget/appropriations (Comptroller) and another (Deputy Chief Management Officer (DCMO)) as the "Performance Improvement Officer" without any systems to focus on costs or performance
  - The DCMO does not supervise and does not have direct authority over the Service CMOs or DCMOs. CMOs/DCMOs in turn do not have management experience and have limited authority over functional stovepipes. As a result, changes rarely occur, and outcomes rarely improve
  - There is no enterprise-wide process ownership of existing systems—each organization involved has its own needs and interests at heart and Department-wide planning and coordination is often absent
  - DoD remains on the GAO "High Risk List" in the areas of "Business Systems Modernization," "Financial Management," and "Business Transformation" (along with 10 other risk areas)

# Observations on Management Systems

- DoD has spent over $6B on its ERP-based transformation efforts to date, but less than 10% of the Department's TOA is actually being managed through these systems—and with mixed results (e.g., Expeditionary Combat Support System (ECCS), Defense Integrated Military Human Resources System (DIMHRS), etc.)
- As a result, data is not accessible, available, or easily shared and is often inconsistent
  - It is difficult to evaluate overall DoD performance in terms of its ability to support war fighters with efficient and effective business practices because the Department does not have sufficient, specific performance measures that would enable this evaluation
  - The limited data collection and cost accounting methodologies handicap officials who desire to promote more effective and efficient operations
  - Support functions grow relentlessly, are disconnected, and increasingly complex
  - Attempts to modernize and integrate business systems have been met with considerable resistance, resulting in a proliferation of stand-alone platforms
  - Inhibitors are not related to technology, but rather: functional governance, organization, fragmented ownership of processes, and a deep-seated cultural resistance to change

# Observations
## Best Management Practices- DoD vs. Private Sector

| Private Sector Best Practices | DoD Past & Current Practices |
|---|---|
| 20% overhead | 40% overhead |
| Focus expenditures on those activities based on future growth, profits, and return on investment | Prioritize activities/programs based on appropriated dollars – do not want to lose what they already have |
| Operate based on profits – a disciplining factor | Operate based on “use it or lose it” mentality |
| Pay attention to cost drivers – go after those not directly driving sales and revenue | Obligations tracked - costs are not normally measured/visible |
| Metrics consistently used, constantly measured | Metrics constantly changing, infrequently measured |
| Set realistic and specific goals/targets and timelines – stick to them | Set optimistic goals/targets and timelines in 5 year plans – restart plan every year |
| Eliminate or sell off non-profitable parts of the company in down markets | Reduce personnel and procurement/investment, and delay maintenance in down budgets |
| Leadership closely monitors priority metrics to ensure success | Limited leadership involvement or visibility on metrics – used for compliance purposes, not outcome |
| Transparency in data/metrics to ensure honesty in goal progress | Components reluctant to be transparent, leads to unrealistic reporting of goal progress |
| Data audited for consistency | Financial statements not auditable, data not consistent across all components |

# DoD is Entering a Period of Change Forced by Budget Reductions

*"This Department simply cannot risk continuing down the same path where our investment priorities, bureaucratic habits and lax attitudes toward costs are increasingly divorced from the real threats of today, the growing perils of tomorrow and the nation's grim financial outlook."*

*"My hope and expectation is that as a result of these changes over time, what had been a culture of endless money where cost is rarely a consideration will become a culture of savings and restraint."* - Robert Gates, 2010

*"Every dollar squandered on waste is one denied to the warfighter."*
- Secretary Donald Rumsfeld, September 10, 2001

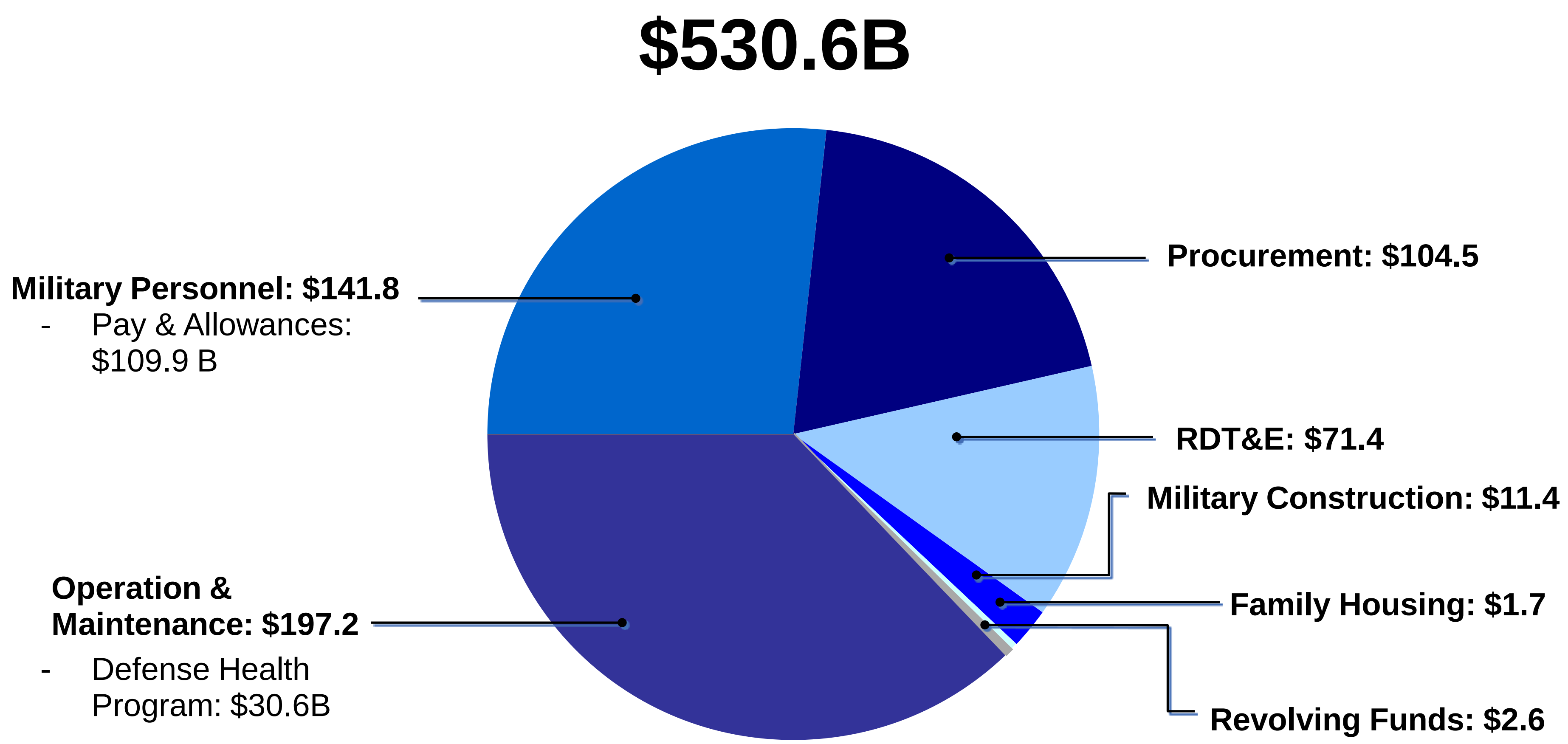
*"Since 1947, there have been four periods of significant increase in budget authority… followed by a period of significant decrease. Current Departmental processes are structured for programmatic growth with the even distribution of increases and decreases... Opportunities exist for redirecting funds, but culture, decision authority, and management's leadership challenges remain significant."* – DBB Transition Report, January 2009

# Observations

- Compared to private sector, DoD is complex and presents unique challenges
  - Greater scale – comparable to only a few very large companies
  - Far more interested parties, politics complicates change – numerous Congressionally imposed restrictions, requirements, and reports
  - DoD culture resists change; prefers improving existing processes at Service or sub-organization levels
  - Budget increased for over a decade and drives decisions – not performance, costs, efficiencies, etc.
- New SECDEF has opportunity to design and implement a new strategy for more efficient, agile DoD designed for the future with modern management practices
  - Continued budget pressure encourages DOD to take advantage of "Best Practices" to reshape Department
  - After decade of growth, there is "low hanging fruit" for the expected cost reductions/changes
  - Opportunity may be lost if "change" process is drawn out - resistance will increase with time
- This is also an opportunity to ask Congress to give DoD the flexibility needed to reduce costs and manage the Department to meet today's requirements
  - Making significant change will be difficult, perhaps impossible, unless the Congress is willing to reduce its myriad of requirements and limitations. This should be a high priority of the Secretary in 2013

*"It is not a great mystery what needs to change – what it takes is the political will… as Eisenhower possessed, to make hard choices – choices that will displease powerful people both inside the Pentagon and out."* - Secretary Robert Gates

# FY 2012 Base Budget (Enacted)




Source: http://comptroller.defense.gov/defbudget/fy2013/FY13_Green_Book.pdf

*These are the final briefing slides as approved by the Defense Business Board in the public meeting held April 25, 2013.*

# Recommendations
## Summary

- Private Sector downsizing approaches and tools can be used by the SECDEF to meet critical missions despite reduced funding – and improve management culture/systems
  - Process driven personally by the CEO and the Board
  - Reductions focused on overhead, supply chains, HQ staffs, layers and people costs
  - Reliable management information systems/data critical to successful implementation
  - Companies continued to invest in the future and emerged more agile and competitive
- Since downsizing process is already underway to reduce $41B to satisfy FY13 sequester, SECDEF should drive three primary processes in preparation for FY14:
  1. First develop a new strategic framework; determine likely funding levels, define essential military capabilities and a new, better focused, lower cost force structure
  2. Then identify specific areas for cost reductions and drive execution, but preserve critical investment funding, including R&D
  3. Use this opportunity to initiate a serious upgrade of DoD's management systems/process
- SECDEF leadership, firm execution, and persistent follow-up will be critical for success
  - Move quickly – resistance builds over time – communicate widely and often
  - Be bold – plan for reductions beyond the consensus targets
  - Develop better cost-based metrics and reporting systems – what is measured succeeds

*"There are too many programs under way. We cannot afford everything we might desire; therefore, in the future the Department must balance capacity portfolios to better align with budget constraints and operational needs, based on priorities assigned to the war fighter capabilities."* – Dr. Ashton Carter

# Recommendation 1
## First Develop a Strategic Framework

- On March 15, 2013, SECDEF directed a review to build upon the 2012 Defense Strategic Guidance and inform the 2014 QDR, to be completed by May 31 (see Appendix C). This is a good first step in moving quickly as it should let strategy drive the downsizing process and restructuring process
- DoD should conduct the 2014 QDR process as a planning exercise for the new strategy and downsizing

> *"The…QDR is not an attractive mechanism for a fresh examination of… rebalancing of the defense posture… process has become cumbersome and captured by the interests of the services, defense agencies, and the many joint program offices of the Pentagon… needs a fresh mechanism, such as the Bottom-Up Review, that closely links [the Secretary's] office to senior military commanders."* – 5 Former Deputies Memo, March 2013

- Based on the strategy, SECDEF should set a realistic multi-year funding profile – FYDP plus 5
  - This is needed to frame the reduction targets
  - Should avoid going back for further cuts by using "hoped for" outcomes
  - May need two projections: realistic and worse case

# Recommendation 1
## First Develop a Strategic Framework

- Based on the strategy & projected funding, SECDEF should develop priority forces/capabilities for the future
  - Output will be a set of high priority capabilities essential to our national security, together with high-level force structure to serve as the basis for the downsizing effort
- Based on the new funding profile and force structure, a matching investment program should also be developed
  - Adequately fund critical weapons development and production programs
  - Highlight significant capability shortfalls and look for alternative solutions
  - Recognize it will be necessary to take prudent risks
  - Review should be managed via regular Department structures – driven from the top by the DMAG/USD(AT&L)
- All other forces, programs, and functions are fair game for deep cost reductions

*"According to McKinsey studies, 89% of the current year's budgets can be explained by the previous year's budget. Fearful of losing what it already has won, the Pentagon attempts to adapt mature programs to new threats."* – McKinsey Study on DoD

# Recommendation 2
## Develop a Detailed Downsizing Plan

- Must be a top SECDEF priority – or it will not be successful
  - SECDEF must define end-state, goals, and instill a sense of urgency
  - He drives the process, assigns responsibilities and stays involved
- DEPSEFDEF serves as the key "program manager"
  - Stand-up a Downsizing Executive Team (DET), i.e., a "SWAT" or "Tiger Team," to develop a detailed Downsizing Plan to aggressively cut costs across DoD
    - DET is a group of experts brought into DoD for a short amount of time (e.g., <12 months) to develop Downsizing Plan and drive execution
    - DoD experience is critical and retired senior military would be useful members
- SECDEF should appoint a DET Leader with full support of DEPSECDEF
  - Senior civilian with proven private sector expertise in managing large budgets. Should also have experience in DoD
  - Retired senior flag officer to serve as Deputy to the DET Leader
  - DEPSECDEF will retain accountability for execution and results
- SECDEF should appoint a senior civilian executive with experience in ERP systems to install improved MIS process to track savings (which can later be expanded DoD-wide)

# Recommendation 2
## Develop a Detailed Downsizing Plan

- A senior level, top performer should be identified from each major component (OSD, JCS, MilDeps, Agencies, Field Activities) as liaison to DET
- DET should manage the downsizing process and report progress to SECDEF/ DEPSECDEF
  - Outside advisers should be used for special ad hoc analyses
  - A group of respected “grey beards” to “Red Team” results could also assist
- Initial Downsizing Plan should address three focus areas
  1. Overhead/DoD Headquarters Staff
  2. Personnel costs
  3. Logistics
- A Task Force should be established to concentrate on each of the three focus areas: goal to complete work in <1 year

> *“Further defense cuts appear inevitable…For the past several years, Pentagon efforts to meet reduced budget targets have targeted the wrong priorities…the primary drivers of DoD spending, including excess bureaucratic overhead, unused infrastructure, and unbridled personnel costs, have been left largely unaddressed and allowed to grow essentially unchecked as other resources tighten.”*
>
> – Mackenzie Eaglen, AEI, March 20, 2013

Note: See DBB Reports FY11-08, FY10-02, FY10-08, and July 2010 interim report for further recommendations on DoD management and overhead reductions

# Examples of Recommendations for Cost Savings from DBB and Other Studies

| Recommendation (source) | Recommendation (source) | Recommendation (source) |
|---|---|---|
| DoD adopt industry best practices in strategic sourcing to achieve 15-25% annual savings (DBB 11-02) (save $169-$218 Billion over 3 years) | Reduce overlap: OSD/JCS in Public Affairs, Legislative Affairs, Legal Affairs, Personnel Oversight, Cables, J-8/CAPE and JROC and AT&L (DBB June 2010 Brief) | Double the number of defense contractor positions scheduled for elimination from 10 percent of current staff augmentees to 20 percent (Simpson-Bowles) |
| Re-tailor the business model for the Commissaries (Sen. Coburn's 2012 report) (costs $1.4B annually) | Reexamine logistics support, force structure, procurement programs (DBB 11-08) | Reduce procurement by 15 percent, or $20 billion (Simpson-Bowles) |
| Send all military children based in the U.S. to local schools (Simpson-Bowles Commission) (save ~$753M annually) | Reexamine military and civilian pay benefits (DBB 11-08) | Eliminate the V-22 Osprey program (Simpson-Bowles) |
| Reduce civilian headcount levels to FY2003 or by 15%, whichever is greater (DBB June 2010 Brief) (~$8.5 Billion in civpay costs annually) | Purchase fuels through "hedging" ( DBB 11-06) | Cancel the Marine Corps' Expeditionary Fighting Vehicle program (Simpson-Bowles) |
| Index existing TRICARE client participation to industry deductibles, co-payments, and premiums (DBB 05-04) | Change military retirement system from defined benefit to transportable defined contribution plans (DBB 11-05) | Halve the number of F-35 Joint Strike Fighters in favor of F-16s and F/A-18Es (Simpson-Bowles) |
| Fewer Active Duty military (~10%) performing commercial activities (DBB June 2010 Brief) ($5.4B annually to be repurposed) | Freeze contracts-for-services spending until contractor headcount is known (DBB June 2010 Brief) | Cancel the Marine Corps F-35 program (Simpson-Bowles) |
| Integrate supply chains (DBB 11-07) (10-30% savings annually) | Streamline military mail system (DBB 11-04) | Cancel the Navy's Future Maritime Prepositioning Force (Simpson-Bowles) |
| Implement hiring freeze and head count control process – start w/ OSD, JCS and COCOMs (DBB June 2010 Brief) | Reduce indirect spending – frequency of duty station moves (DBB June 2010 Brief) | Cancel the new Joint Light Tactical Vehicle (JLTV), the Ground Combat Vehicle, and the Joint Tactical Radio (Simpson-Bowles) |
| Consolidate data centers under single governance authority (DBB 12-01) | Downsize COCOMs – real reductions (DBB June 2010 Brief) | Reduce military forces in Europe and Asia by one-third (Simpson-Bowles) |
| Divestiture of non-core activities (DBB 10-02) | | |

# Recommendation 2
## Focus Area 1: Overhead/Headquarters Staff

Overhead – General

- In a 2010 McKinsey & Co. report, the US/DoD consistently had some of the largest overhead and spending inefficiencies relative to the defense organizations of industrialized peers
- With over $270B of the topline budget spent on overhead and infrastructure, potential savings of ~$100B/yr should be an aggressive target; set goal to reduce overhead from 42% of base budget to 25% within 5 years; i.e. fund soldiers, not staff
- Overhead Task Force leadership: Experienced civilian leader (must understand DoD with private sector experience); Senior military officer as deputy (a key role so select with care)
- Key issues include:
  - Eliminate/reduce low value-added functions/offices based on new strategy and priorities
  - Reduce/consolidate management layers and support staff
    - Consolidate HQs and increase span of control
    - Taking a layer out saves cost, speeds decisions, reduces frustration
    - Reduce staff levels/deputies in most offices
  - Restructure central training ($57B) to focus on unit level training and computer-based training
  - Review of Defense Agencies/Field Activities – largely ignored despite significant cost growth (Defensewide overhead now $113B)
  - Infrastructure (e.g. bases, office space, and logistics facilities) must be reduced (a BRAC will be needed)
  - Challenge everything – unless overhead is cut dramatically, force structure/combat capabilities will degrade

> *"The real solution is to rationalize the work, not the workers, and to do so in a manner that prevents the problem from creeping back."* – Harvard Business Review

Note: See DBB Report FY11-01 for recommendations on establishing cost-conscience practices throughout DoD

# Recommendation 2
## Focus Area 1: Overhead/Headquarters Staff

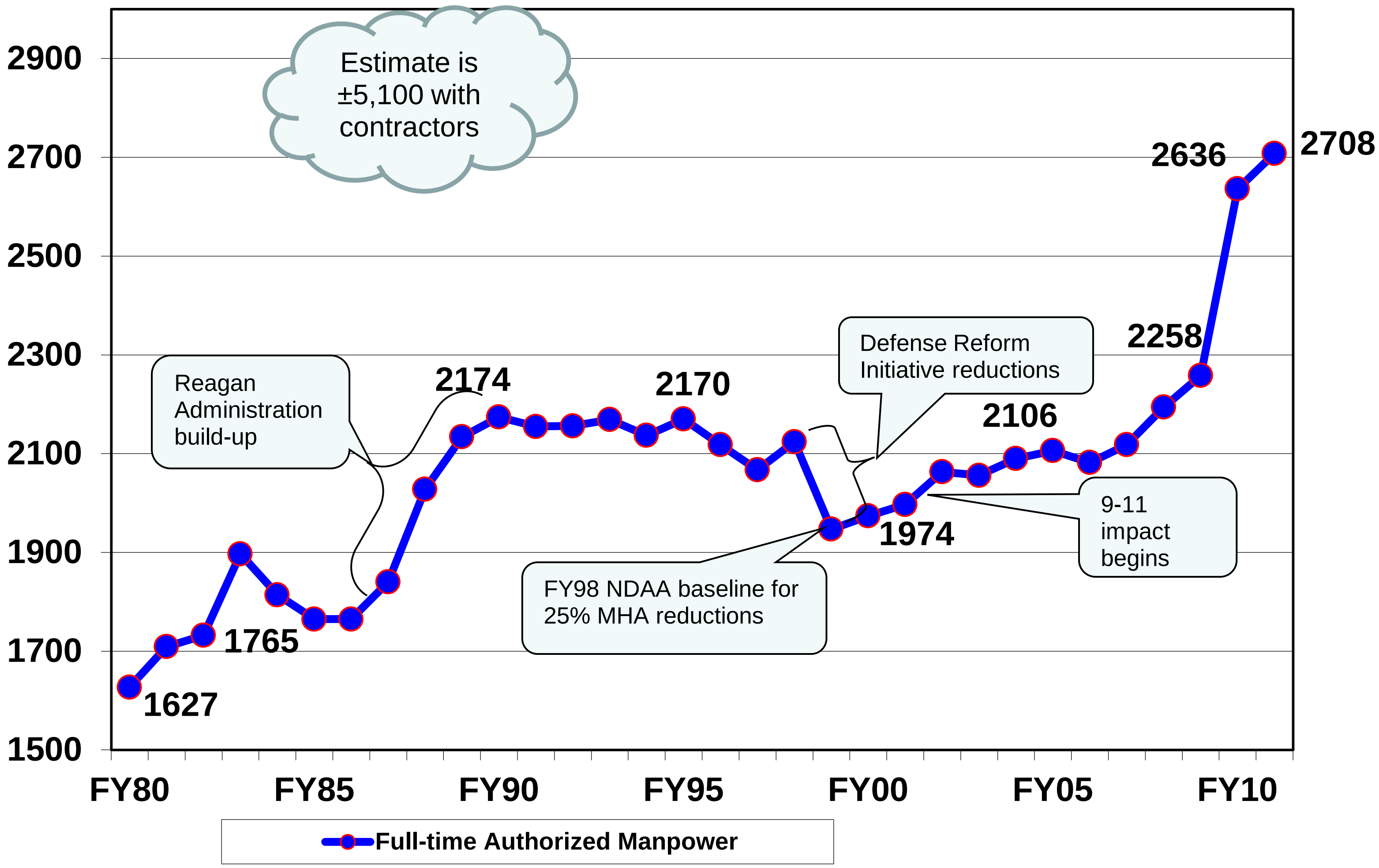
Overhead - DoD Headquarters Staff

- Structure and staffing of HQ staff at OSD/Joint Staff/Services
  - An estimated 61,750 HQ personnel across DoD – OSD staff has grown ~38%* (FY01-12)
  - Complex structure, overlapping responsibilities, excess support, costly personnel
  - Costs are significant – total Departmental management cost $43B in 2012
- HQ Staff Task Force leadership: Experienced DoD leader – civilian or retired military
  - Mind set – clean sheet of paper
  - Challenge all existing structures and processes - attack layers/span of control
- Key issues include:
  - Greatly increased complexity over time; multiple layers and unclear authority
  - Slow, diffused decision-making – who has true authority?
  - Overlapping responsibilities; thus most large issues go to SECDEF/DEPSECDEF for decision
- Substantial budget cuts (5-15%) can be achieved without affecting future mission readiness if there is an intense focus on reducing "overhead and infrastructure" spending
- Major reductions will be the "signal" that SECDEF is serious

> *"Headquarters at OSD and Services are migrating toward 'doing things' rather than 'overseeing.'"* – Military Service Senior Executive

Note: Secretary Rumsfeld conducted study in 2003 on streamlining OSD organization
*Source: FY2003 and FY2012 Defense Manpower Requirements Report, includes both military and civilian FTEs, does not include contractor numbers

# Trends in OSD Staff Size
## Projection a/o June 2010




Note: Chart does not include active duty reservists, detailees, contractor manpower, or temporary overstrengths
Source: ODAM June 2010

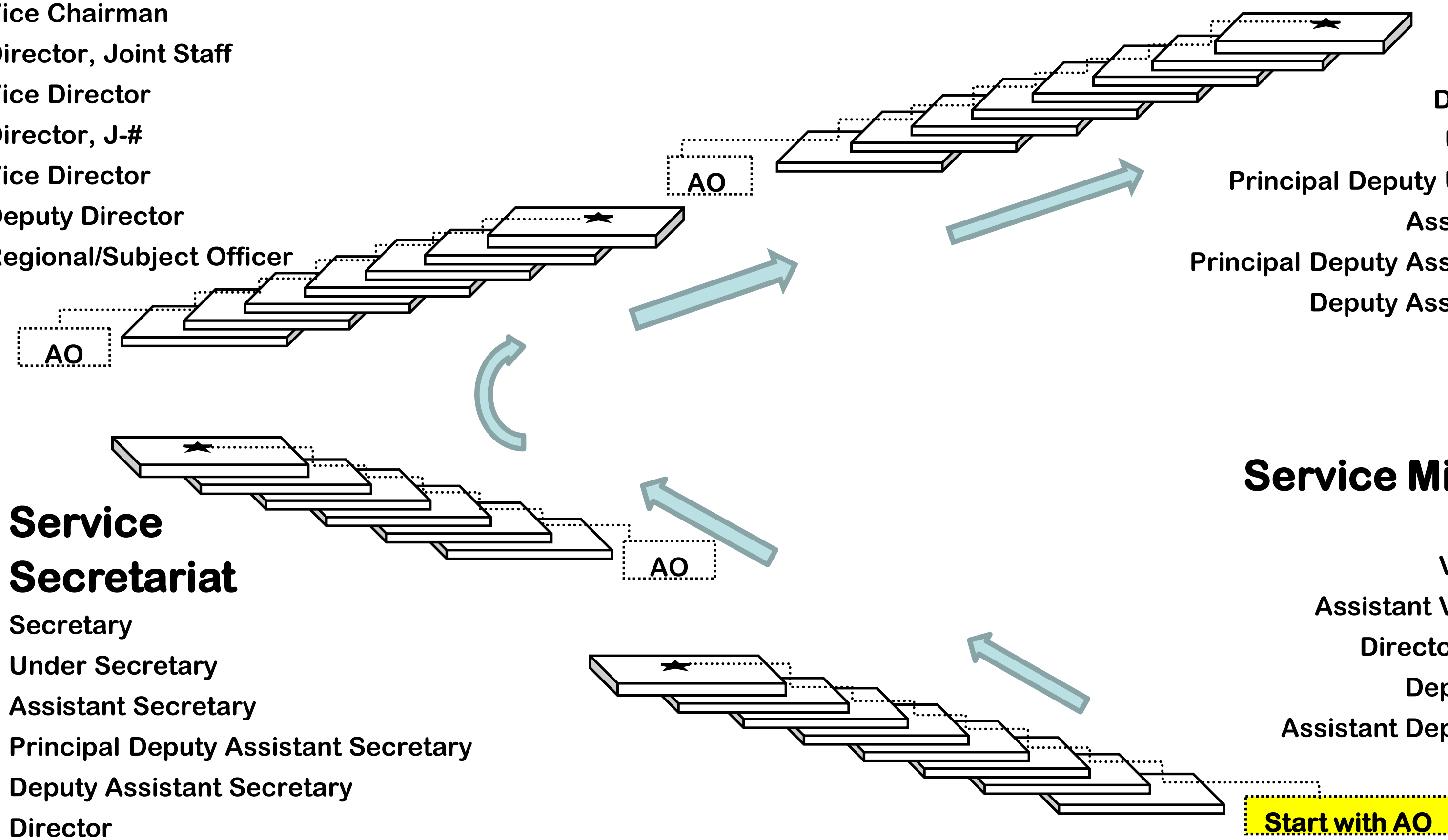
# DoD Layers

## Joint Staff

Chairman
Vice Chairman
Director, Joint Staff
Vice Director
Director, J-#
Vice Director
Deputy Director
Regional/Subject Officer

## OSD

Secretary
Deputy Secretary
Under Secretary
Principal Deputy Under Secretary
Assistant Secretary
Principal Deputy Assistant Secretary
Deputy Assistant Secretary
Office Director
Action Officer




## Service Secretariat

Secretary
Under Secretary
Assistant Secretary
Principal Deputy Assistant Secretary
Deputy Assistant Secretary
Director
Action Officer

## Service Military Staff

Chief of Staff
Vice Chief of Staff
Assistant Vice Chief of Staff
Director of Service Staff
Deputy Chief of Staff
Assistant Deputy Chief of Staff
Division Chief
Office Chief
Action Officer

*"Layers are evil…complexity drives costs."*- CEO comments on the downsizing approach

# Recommendation 2
## Focus Area 2: Personnel

- $263B (40% TOA)* spent on personnel (not including contractors), significant savings are achievable
  - Since FY01, civilian headcounts grew by 17.5% and active duty military headcounts increased modestly as Army and USMC expansions offset Navy and Air Force reductions – rising costs of civilian pay account for two-thirds of projected growth in O&M appropriations spending from FY13-21
  - Military personnel cost per person has grown due to regular pay increases/added benefits. Private sector and government civilian pay has been flat; military pay is very competitive
  - Senior military structure needs to be rationalized – in past 10 years, the number of general and flag officers increased ~9%, while uniformed personnel increased ~2%**
- The Department's low tooth-to-tail ratio (60:40) should be rationalized***

> *"Today the operational forces of the military…have shrunk dramatically…[y]et the three- and four-star command and support structures atop these smaller fighting forces have stayed intact"*
>
> – Secretary Hagel, April 2013

- Personnel Task Force leadership: Experienced civilian leader with retired military deputy. Recent Congressionally authorized "Blue Ribbon" panel on military compensation can help – but is unlikely to propose significant change

> *"…the escalating growth in personnel costs must be confronted… has grown by nearly 90% since 2001… If we fail to address it, then we won't be able to afford the training and equipment our troops need..."* – Secretary Panetta, 2011

*Sources: FY 2013 Greenbook for Civpay; FYDP for Milpers (includes DHP)
**Mackenzie Eaglen, AEI article, March 20, 2013
***Ratio of spending on forces to support; ratio of number of combat/combat-support forces to administrative and general forces is 25:75 (source: Mackenzie Eaglen, AEI article, March 20, 2013)

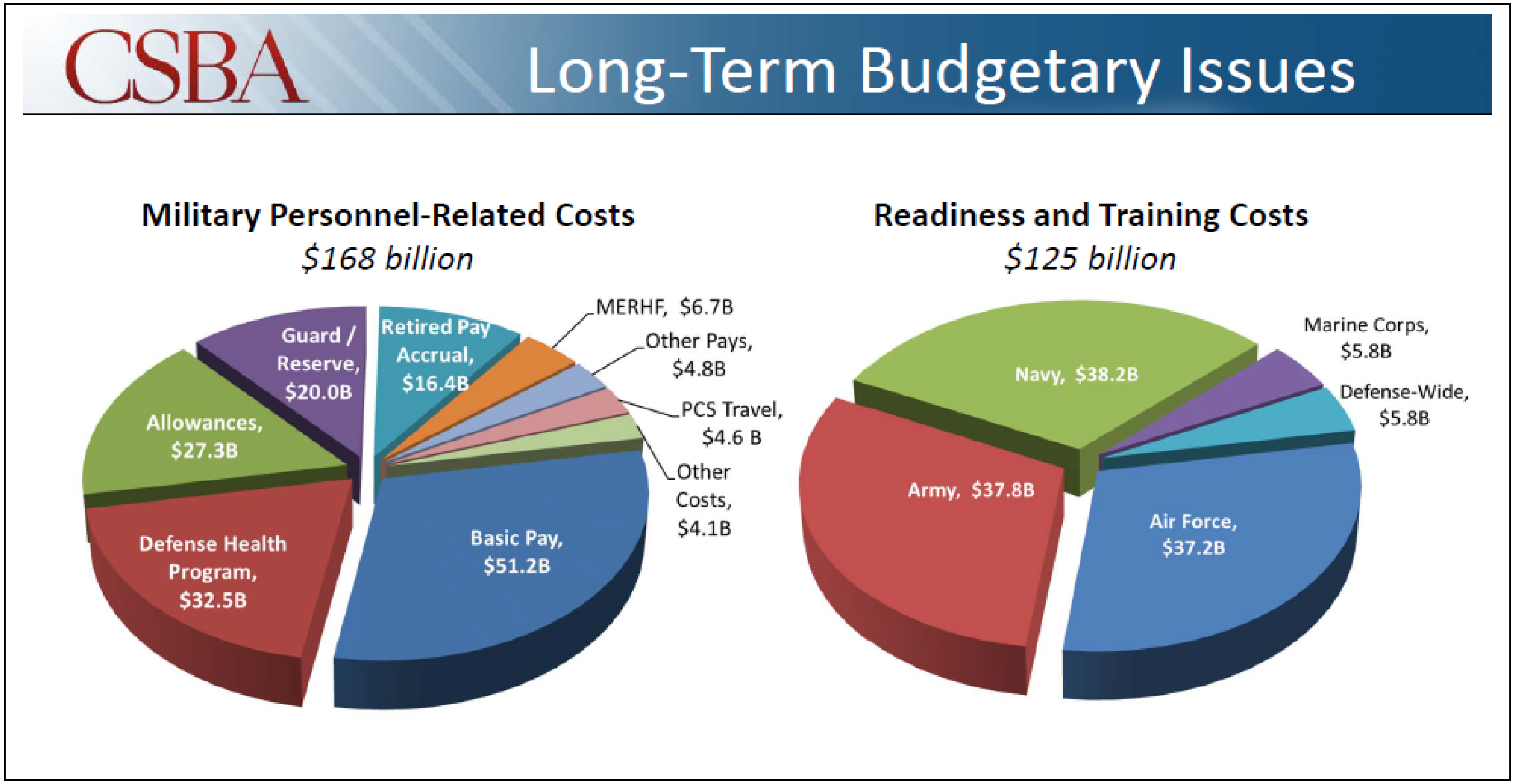
# Recommendation 2
## Focus Area 2: Personnel

- Key issues include:
  - Reduce civilian headcount as force structure, HQ, and overhead is cut
    - Severely limit released persons from returning as consultants or contractors – same for retired military returning as civilians
  - Costs per person (civilian and military) must be addressed
    - From FY01-12, active duty per capita cost increased 59%.* Officer/enlisted pay now at 80th percentile of college/high school graduates**
    - Slow the rate of annual increases - look hard at all benefits, especially retirement
  - Healthcare cost reductions are essential
    - TRICARE costs DoD $50B and will increase 50% to $77B by 2022***
    - TRICARE premiums are not indexed to inflation and have declined in constant dollars. They are significantly below comparable civilian costs****
    - Rationalize military medical structure – 3 separate HQ medical staffs and redundant facilities – very costly
  - Work with OPM to facilitate reductions in civilian personnel in DoD to match overhead reductions
    - Consider reducing civilian workforce by selective retirements (~53,000 eligible GS-12+)
    - Build a performance-based personnel management system to more efficiently manage civilian personnel

> *"The current TRICARE arrangement, one in which fees have not increased for 15 years, is simply not sustainable."* – Secretary Gates

* Source: FYDP (Milpers+DHP), per capita costs indexed to GDP
** Source: 11th Quadrennial Review of Military Compensation
*** Source: CBO
**** 2012 NDAA increased premiums from $230 to $260 per person and from $460 to $520 per family, see FY12 "Evaluation of the TRICARE Program"
Note: See DBB Report FY11-05 for recommendations on restructuring military entitlements

# Personnel-related Costs




- % DoD base budget devoted to military personnel-related costs
  - 2001 = 30%; 2012 = 34%; projected 2021= 46%
- % DoD base budget devoted to peacetime O&M costs
  - 2001 = 33%; 2012 = 31%; projected 2021 = 40%

Source: DoD Greenbooks; Center for Strategic and Budgetary Assessments, assumes historic growth rates of 2.6% (Milpers) and 2.5% (O&M); pie charts reflect FY13 budget request

# Recommendation 2
## Focus Area 3: Logistics

- Logistics (supply, maintenance, and transportation) costs $170B annually
  - Responsibilities are diffused across departments, agencies, and combatant commands
  - Need single point of command – OSD/Joint Staff oversee but do not direct (see DBB Report FY11-07) – “Best Practices” demonstrate 10-30% savings with fully integrated supply chain but need to create logistics management structure to provide clear authority and future direction
- Logistics Task Force leadership: Experienced civilian leader (must understand DoD with private sector logistics experience); Senior retired military officer as deputy
- Key issues include:
  - Supply functions spread across Services and DLA – duplicative facilities, overlapping functions
  - Maintenance – multiple underutilized facilities and potential to outsource
  - Transportation – TRANSCOM and Services both provide capability – reduce overlap
  - Consumables acquisition (fuels/electricity) – current practices raise costs/pose readiness risk
  - Facilities – For the 2005 BRAC, DoD reported there was almost 25% excess infrastructure, which was reduced by only 3.4%. Military personnel reductions have increased the gap between infrastructure needs and force size

Note: See DBB Report FY11-07 for further recommendations on optimizing DoD’s logistics structure

# Recommendation 2
## Focus Area 3: Logistics

- Examples of cost savings opportunities
  - Integrate TRANSCOM and DLA into central logistics agency
  - Combine purchasing by DeCA and DLA
  - Substantially reduce existing inventories in warehouses
  - Enter into longer-term contracts with suppliers
  - Reduce fuel specifications to commercial grade where it makes sense
  - Store fuel in existing facilities where it makes sense
  - Have DLA expand responsibility in purchasing spare/replacement parts for warfighting and other equipment
  - Convert more base located motor vehicles to natural gas fuel

*"This is a good time to take advantage of budget pressures – but reductions should be accompanied by a re-design of the "business model" under DoD activities."* – Former Senior OSD Executive

# Recommendation 3
## Performance Monitoring and Metrics Plan

- An improved SECDEF performance monitoring program needed to manage downsizing effort and then extended to improve overall Department oversight
- Accurate goal setting, monitoring, and reporting on downsizing projects are critical
  - Data needs to be materially correct, not precise
  - Current and past DoD leaders judged cost data was not adequate to plan programs and set goals
  - But given the time required to significantly modify reporting systems, it is necessary to use current systems, especially those that feed into and are utilized by Comptroller and CAPE
- Major challenges include:
  - Comptroller expanding beyond budget authority and obligations into performance tracking
  - Lack of cost reports on programs primarily funded via O&M
  - Results tracking of personnel reductions to include military, civilians, and contractors
- USD(C) needs to support senior executive on DET for performance tracking
  - DCMO currently reports in response to regulatory requirements, not for project management
  - Current metrics weak on tracking implementation (scorecards); not guided by business rules/best practices – need to track both inputs and outputs using consistent baselines/metrics

> *"Everything in DoD is how to spend 'new appropriations' – not how the old appropriations were spent"* - Former OSD Executive

# Recommendation 3
## Performance Monitoring and Metrics Plan

- Responsibility for integrating/simplifying multiple management processes to provide meaningful reporting information needs to be established
  - Diffused responsibility should be eliminated between USD(C), CAPE, DCMO, CIO, Services and fragmented OSD staff – Comptroller should be responsible for tracking downsizing results and implementing improved performance monitoring systems Department-wide
  - Combining budget and performance monitoring responsibilities under Comptroller will put “teeth” into management reporting and “performance/cost” controls into financial decisions
- DEPSECDEF, VCJCS, and Downsizing Executive Team should meet weekly to assess progress, make decisions on remedial actions, and approve plan revisions
  - Face to face meetings, principals only, limit numbers of “horse holders”
  - Process must be open, timely, and action oriented
  - Slippages and shortfalls must be identified, remedial actions developed, and revised schedule and priority spelled out
  - SECDEF and CJCS attend frequently to reinforce their role and emphasize importance

> *“Unless costs are tracked, savings goals will be missed.”*
> - CEO of Fortune 100 Company

# Recommendation 4
## Follow-up and Communicate

- Regularly update other key stakeholders – Office of Management and Budget, Government Accountability Office, and key Congressional Committees
  - Celebrate Successes
  - Identify issues and shortfalls – take remedial action quickly
- Develop an active and frequent communication plan
  - Key DoD stakeholders – e.g., Combatant Commanders (role for VCJCS)
  - Key Congressional Committees – early buy-in critical to success
  - Public communications – across DoD and beyond
  - Defense Industrial Base – do not ignore, they will be heavily impacted
- SECDEF must continuously communicate progress updates to stakeholders to maintain focus, momentum, and support

*"But the effort, if done right, will produce a smarter, right-sized force that has fewer layers of overhead and infrastructure. If budget trends reverse, new money can then be reinvested into deferred modernization and efforts to restore readiness."*

– Mackenzie Eaglen, AEI, March 20, 2013

# Concluding Remarks

All those interviewed, inside and out of DoD, felt that now is the time to make significant changes to a Department which has become much too cumbersome to efficiently effect its mission. A Department with overhead that is too large, too duplicative; that honors traditional organization and outdated infrastructure; and is unable to react to today’s transformative markets and environments must be restructured in order to support our National Defense Strategy.

# Outbriefs

- Timing is critical as the Department is already planning for the FY15 budget cycle, carrying out the Strategic Choices and Management Review (with subsequent implementation), preparing for the 2014 QDR, and continuing the efficiencies initiatives under the More Disciplined Use of Resources exercise
- The Task Group will plan to brief the study's recommendations to the following senior leaders in DoD:
  - SECDEF
  - DEPSECDEF
  - CJCS
  - VCJCS
  - USD(AT&L)
  - USD(C)
  - D,CAPE
  - DCMO
  - Service CMOs

DEFENSE BUSINESS BOARD

# Questions?

DEFENSE BUSINESS BOARD

*Business Excellence In Defense of the Nation*

*These are the final briefing slides as approved by the Defense Business Board in the public meeting held April 25, 2013.*

# Appendices

A. List of Interviews
B. Study Process
C. March 15 Strategy Memo by Secretary Hagel
D. Selected Quotes

# Interviews

Conducted interviews with current and former executives in industry and government:

## Private Sector

- Tony Alvarez, CEO, Alvarez & Marsal
- Bill Anders, former CEO of General Dynamics
- Norm Augustine, former President and CEO of Lockheed Martin
- Denis Bovin, CEO, Stonekey Partners, LLC
- David Cote, President and CEO, Honeywell
- Robin S. Lineberger, CEO Federal Government Services, Deloitte LP
- Wilson Lowery, Founder and Senior Executive, WLLP Capital (formerly VP of Quality and Reengineering, IBM)
- Sean O'Keefe, Chairman and CEO, EADS North America (former USD(C))
- Arnold Punaro, CEO, The Punaro Group LLC
- Bill Roberti, Managing Director (Public Sector), Alvarez & Marsal
- Mark Ronald, Senior Advisor to Veritas Capital and to the Center for Strategic and International Studies (former CEO of BAE Systems)
- Sandy Weill, former CEO, Citibank
- Jack Welch, former CEO, General Electric
- Frank Zarb, former Chairman, NASDAQ and CEO, Travelers

# Interviews

## Current DoD

- Ashton B. Carter, Deputy Secretary of Defense
- Office of the Under Secretary of Defense (Comptroller)
  - Robert F. Hale, Under Secretary of Defense(Comptroller)/CFO
  - Andrew Morgan, Director of Business Integration
- Elizabeth “Beth” McGrath, Deputy Chief Management Officer
- Office of the Director, Cost Assessment and Program Evaluation
  - Christine Fox, Director
  - Richard Burke, Deputy Director, Cost Assessment and Program Evaluation
  - Steve Miller, Director, Advanced Systems Cost Analysis Division
  - John Orem, Acting Director, Force and Infrastructure Analysis Division
- Service CMOs
  - Joseph Westphal, Under Secretary of the Army
  - Eric Fanning, Under Secretary of the Air Force, then-Deputy Under Secretary of the Navy

# Interviews

## Former DOD

- Frank Carlucci, former SECDEF (1987-89)
- Gen James Cartwright, former VCJCS (2007-2011)
- Gordon England, former DEPSECDEF (2006-2009)
- John Hamre, President and CEO of CSIS and former DEPSECDEF (1997-00) and USD(C) (1993-94)
- Tina Jonas, former USD(C) (2004-2008)
- Kenneth Krieg, former USD(AT&L) (2005-2007) and former Director, CAPE (2003-2005)
- William Lynn, former DEPSECDEF (2009-11) and former USD(C) (1997-01)
- ADM William Owens, founding Partner/Chairman, Prometheus Partners and former VCJCS (1994-96)
- Dov Zakheim, former USD(C) (2001-04) and former SVP, Booz Allen Hamilton

# Interviews

## Other Federal Government

- Alan Simpson, former United States Senator (WY)
- Edward A. Powell, Jr., former Deputy Secretary (Acting) of Veterans Affairs
- Erskine Bowles, former White House Chief of Staff and Administrator, Small Business Administration
- Government Accountability Office
  - Gene Dodaro, Comptroller General of the United States
  - Janet St Laurent, Managing Director, Defense Capabilities and Management
  - David Fisher, Chief Financial Officer and Chief Administrative Officer
  - Asif Kahn, Director, Financial Management and Assurance
  - Paul Francis, Managing Director, Acquisition and Sourcing Management
  - Christopher Mihm, Managing Director for Strategic Issues
- Office of Management and Budget
  - Daniel Werfel, Controller, Office of Federal Financial Management
  - Shelley Metzenbaum, Associate Director, Performance and Personnel Management
  - Mathew Blum, Associate Administrator, Office of Federal Procurement Policy
  - Steven VanRoekel, United States Chief Information Officer
  - Kathy Peroff, Deputy Associate Director for National Security
  - Mark Cancian, Chief, Force Structure and Investment Branch
  - Bill Campbell, National Security Division
  - John McClelland, National Security Division

# Study Process

- Literature Review
  - Reports from Government and Think Tanks
    - American Enterprise Institute
    - Center for Strategic and Budgetary Assessments
    - Center for Strategic and International Studies
    - Congressional Budget Office
    - Congressional Research Service
    - Defense Business Board
    - Government Accountability Office
    - Institute for Defense Analysis
    - McKinsey & Company
    - RAND Corporation
  - DoD strategic and financial documents
    - 2010 Quadrennial Defense Review
    - 2013 Strategic Management Plan.
    - DoD Comptroller Greenbooks (primarily FY2012 and FY2013)
    - FY2013 More Disciplined Use of Resources
    - FY 2013 Defense Budget Request Overview Book
- Evaluated past downsizing efforts in private/public sectors and 1990s DoD/USG efforts to identify practices that resulted in both success and failure

SECRETARY OF DEFENSE
1000 DEFENSE PENTAGON
WASHINGTON, DC 20301-1000

MAR 1 5 2013

MEMORANDUM FOR DEPUTY SECRETARY OF DEFENSE
SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
CHIEFS OF THE MILITARY SERVICES
COMMANDERS OF THE COMBATANT COMMANDS
DIRECTOR, COST ASSESSMENT AND PROGRAM EVALUATION
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE

SUBJECT: Strategic Choices and Management Review

The Department of Defense must constantly examine the choices that underlie our defense strategy, posture, and investments, including all past assumptions and systems. This will be especially important in the period ahead, as both budgetary and strategic uncertainty affect our planning. We must think and act ahead of this uncertainty, and not in reaction to it.

Accordingly, I am directing the Deputy Secretary of Defense, working with the Chairman of the Joint Chiefs of Staff, to conduct a Strategic Choices and Management Review. This review will:

- Define, for my consideration, the major strategic choices and institutional challenges affecting the defense posture in the decade ahead that must be made to preserve and adapt defense strategy and management under a range of future circumstances.
- Consider the 2012 Defense Strategic Guidance as the point of departure and be informed by the Chairman's Risk Assessment. The results will frame my Fiscal Guidance for the FY 2015 budget and ultimately be the foundation for the statutorily required Quadrennial Defense Review due in February 2014.
- Be inclusive but confidential to allow for the free exchange of ideas. Service Secretaries and Chiefs, Office of Secretary of Defense Principals, and Combatant Commanders will serve as essential participants.

This will be an iterative process, reporting to me at regular intervals with the aim to conclude the process by May 31, 2013. I appreciate your efforts and support in this process. Thank you.

Chuck Hagel

OSD003024-13

# Selected Quotes

- *"…without reform, America's defense establishment will continue to spend ever more for ever less capability… further painful defense cuts are unavoidable and must be prepared for… push back against damaging automatic, across-the-board cuts in favor of authority to make strategic reductions…"* – Editorial in DefenseNews.com, Feb 2, 2013
- *"DoD still spends too much for Cold War capabilities and is adding new capabilities on top of the old base. They should cut overhead immediately, look to overseas bases for closing, reduce civilian/uniform ratio, allow no contract/replacement for staff augmentation and look at programs that are in trouble. Need to move quickly and complete in two years. Should establish a progress review focused on downsizing."* – Former USD(Comptroller)
- *"To most observers…the most dangerous of ticking time bombs at the Pentagon is budgetary. The impact of any financial contraction will be magnified by the swelling retirement and medical accounts that gobble up huge portions of the budget."* - Harlan Ullman, "Three Ticking Time Bombs at the Pentagon," December 19, 2012
- *"Overall, nearly half of the growth in defense spending over the past decade is unrelated to the wars in Afghanistan and Iraq – personnel costs grew while end strength remained relatively flat, the costs of peacetime operation grew while the pace of peacetime operations declined, and the acquisition costs increased while the inventory of equipment grew smaller and older. The base budget now supports a force with essentially the same size, force structure, and capabilities as in FY2001 but at 35 percent higher cost. The Department is spending more but not getting more."* - Todd Harrison, The Center for Strategic and Budgetary Assessment, July 15, 2011
- *"The armed services continue to operate predominantly Reagan-era aircraft, ships and ground vehicles that gradually are becoming technologically obsolete and increasingly costly to maintain. After a decade of lavish spending, the Pentagon is now left with an aging fleet of weapon systems, and overstrained force, out-of-control personnel and health care costs…"* - National Defense, July 2011