DEFENSE BUSINESS BOARD

Report to the Secretary of Defense

Applying Best Business Practices from Corporate Performance Management to DoD

Report FY13-03

- **Recommendations on managing for peak performance with reduced resources**

Preface

This report is a product of the Defense Business Board (DBB). Recommendations by the DBB are offered as advice to the Department of Defense (DoD) and do not represent DoD policy.

The DBB was established by the Secretary of Defense in 2002 to provide the Secretary and the Deputy Secretary of Defense with independent advice and recommendations on how “best business practices” from the private sector’s corporate management perspective might be applied to the overall management of DoD. The Board’s members, appointed by the Secretary of Defense, are corporate leaders and managers with demonstrated executive-level management and governance expertise. They possess a proven record of sound judgment in leading or governing large, complex corporations and are experienced in creating reliable solutions to complex management issues guided by best business practices.

Authorized by the Federal Advisory Committee Act of 1972, the Government in Sunshine Act of 1976, and other appropriate federal regulations, the Board members are a federal advisory committee and volunteer their time to work in small groups (subcommittees) to develop recommendations and effective solutions aimed at improving DoD.

Applying Best Business Practices from Corporate Performance Management to DoD

TASK

The Deputy Secretary of Defense (DEPSECDEF), Dr. Ashton B. Carter, asked the Defense Business Board (hereinafter referred to as “the Board”) to form a Task Group to evaluate how successful executives of large and complex corporations plan, implement, and maintain strong performance, especially during periods of reduced resources and/or significant changes in the marketplace. The Task Group was also asked to identify strategies and practices, together with performance metrics, that could be used by DoD leadership to address its current challenges. See **Tab A** for a copy of the Terms of Reference (TOR) outlining the scope and deliverables for the Task Group.

The DoD currently faces an extraordinary confluence of management challenges, mounting costs, and budget reductions, all while continuing to provide for the national defense. The Task Group viewed this as an opportune time for DoD leadership to shift from a culture of “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’s recommendations include best practices on reducing costs without degrading core DoD missions.

Mr. Joseph Wright served as the Task Group Chair. The other Task Group members were Mr. Patrick Gross, Mr. Philip Odeen, Mr. Richard Spencer, Mr. Robert Stein, Mr. Frederic Cook, and Mr. William Phillips. Ms. Kelsey Keating served as the Staff Analyst and CDR Matthew Duffy, USN, served as the Military Representative.

PROCESS

The Task Group’s draft findings and recommendations were presented to the Board for deliberation at the April 25, 2013 quarterly Board meeting where the Board voted to approve the recommendations. See **Tab B** for a copy of the brief approved by the Board.

The Task Group interviewed over 50 individuals from government and the private sector, including senior executives who successfully led their companies through periods of dramatic change; former DoD senior leaders, many who were present for the 1990's downsizing; and current senior leadership from DoD, the Office of Management and Budget (OMB), and the Government Accountability Office (GAO) (see **TAB C**).

The Task Group also reviewed DoD strategic and financial documents and reports and studies from think tanks, businesses, and government agencies (see **TAB D**). They evaluated past downsizing efforts in the public and private sectors, as well as the 1990s DoD experience, to identify practices that resulted in both success and failure.

Four basic assumptions served as a basis for the study:

1. Current political and economic pressures to reduce the U.S. deficit and debt continue, resulting in further budget cuts or even "across the board" reductions (i.e., a sequester in 2013 and beyond).

2. DoD continues to see reduced budgets, such as the Budget Control Act (BCA) of 2011 which reduced DoD's projected budget by approximately nine percent over ten years.

3. Downsizing efforts will be more difficult than in the past (ongoing war on terror, higher personnel costs, etc.). However, budget reductions present an opportunity to install modern management practices and systems in order to reduce overhead, cut low priority programs, and increase "efficiency" of the Department.

4. World class business practices can be applied to DoD to get more "bang for the buck" for increased capability for warfighting.

While the Department will be considering strategic reductions in selected weapon systems, the Task Group focused on a process to reduce administrative/infrastructure costs without impacting combat effectiveness.

BACKGROUND

Today's Budget Pressures

The Department faced rapid budgetary growth from Fiscal Years (FY) 2001 through 2012 despite little change in active-duty end-strength. Much of this growth was due to the addition of Overseas Contingency Operations (OCO) funding for Operation Iraqi Freedom, Operation New Dawn, and Operation Enduring Freedom. These expenses, and a base budget increase of 26%, contributed to an overall budget increase of 54% over that period of time.

The BCA of 2011 reduced the Department's out-year budget by 9%, or $487 billion through FY 2021; if OCO funding is absorbed into the base budget as operations in Afghanistan continue to wind down, the combined topline reduction will be approximately 13% by FY 2017. DoD also incurred an additional $41 billion in sequestration-related reductions for FY 2013 and may see additional reductions in FY 2014. Unlike future sequester years, this year's reductions are proportionally across the board and must be spaced over a seven month period of time, making decisions for these cuts even more challenging.

How Does the Private Sector Handle Crises?

In 2008, the U.S. private sector experienced its deepest recession since 1945. In response to the new market environment, successful companies, led by their CEOs and senior management, took rapid and extremely aggressive actions. Decisions were made quickly and based on market indicators, competition, and profitability/cash flow. Overhead was cut deeply, reporting layers reduced, and the span of control for managers increased. Headcounts were reduced and costs per person were cut through pay freezes, bonus eliminations, and benefit reductions or alterations. Offices and operations were consolidated and excess facilities and businesses were sold or closed. Management information and reports were cost-based to ensure that savings were realized, and these specific cost management reports were integrated into the budget reporting systems. Companies that took quick action emerged stronger.

Past DoD Downsizing Efforts

The Department has been through three major downsizing efforts since 1947 as budgets declined after Korea, Vietnam, and the Post-Cold War collapse of the Soviet Union. In all three cases, the base budget was reduced to approximately $400 billion in FY 2013 constant dollars. While each drawdown was unique in length and severity of its reductions, the procurement accounts were affected most acutely. The Post-Cold War drawdown budget declined 36% from FY 1986 to FY 1998 and was accompanied by substantial reductions in force structure (-32% in Milpers and -63% in Procurement accounts) (See **TAB B**, chart 11).

The Post-Cold War drawdown comprised of several initiatives during three presidencies with varying degrees of success. Those initiatives that were successful provided vision, were driven from the top with Service buy-in, and focused on sustaining key capabilities. DEPSECDEF Donald Atwood's reforms changed business operations to enable significant support and personnel reductions. Chairman of the Joint Chiefs of Staff (CJCS) Colin Powell's "Base Force" initiative reduced the force structure consistent with the Secretary of Defense's (SECDEF) strategy. Secretary William Cohen's "Defense Reform Initiative" established offices to oversee downsizing and efficiencies with consistent tracking/follow-up.

However, these reductions also resulted in missed opportunities as programs were dramatically and rapidly curtailed while legacy management systems and organizational structures were kept in place. The "Procurement Holiday" from 1994-1997 cut investments by nearly 40%. As a result, equipment aged and created a significant modernization bill. The acquisition workforce was substantially reduced which led to gaps in experience and critical skill sets. The Military Services made budget choices that led to unbalanced forces and poor readiness. Departmental efficiencies did not result in sufficient savings to help fund modern combat needs. During this time, the defense industrial base dramatically consolidated which reduced competition and caused major industrial companies to exit the DoD market (e.g., GE, Texas Instruments, Ford, Chrysler, etc.). This industry consolidation reduced the flexibility and range of capabilities of the industrial base. Civilian workers more closely tied to military capabilities (base operations, strategic/tactical support, and training) were hardest hit; those not directly tied to the operating force (central support, headquarters, communications) stayed flat or increased in size.

OBSERVATIONS

Compared to private sector organizations, DoD is highly complex and presents unique challenges. The Department is greater in scale, has far more interested parties, and as a large bureaucracy, generally has a cultural resistance to change. In addition, its budget, which has increased for over a decade, often drives decisions rather than strategy or performance. The chart below highlights some of these key differences.

Private Sector Best Practices	DoD Past & Current Practices
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
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 have
Pay attention to cost drivers – go after those not directly driving sales and revenue	Obligations tracked - costs are not normally measured/visible
Leadership closely monitors priority metrics to ensure success	Limited leadership involvement or visibility on metrics – used for compliance, 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

Declining budgets offer the SECDEF an opportunity to design and implement a new strategy for a more efficient and agile DoD, designed for the future and supported by modern management practices. Continued budget pressures encourage DoD to take advantage of best practices to reshape the Department. And after a decade of growth, there is “low-hanging fruit” for the expected cost reductions and changes. DoD has already achieved several isolated, small-scale successes in cost reductions linked to performance management, which are outlined in **TAB E**.

This is also a very important opportunity for the SECDEF 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 Congress is willing to reduce its myriad of requirements and limitations that prevent DoD management from making necessary, cost-saving decisions.

The Task Group noted that many of the senior leaders in the Department today, both military and civilian, have never had to manage under significantly reduced budgets. The Task Group also found that DoD has not installed the necessary management processes, Management Information Systems (MIS), and Enterprise Resource Planning (ERP) systems to provide the necessary data on performance needed by senior leadership to make informed decisions and oversee implementation – not only for the current downsizing process but also to drive other efficiency and cost reduction efforts in the Department. This is despite the fact that DoD has spent over $6 billion on its ERP-based transformation efforts to date.

The Task Group also found that the Department is not structured to efficiently manage performance and track costs. DoD has one organization focusing on budget/appropriations (Comptroller) and another (Deputy Chief Management Officer (DCMO)) acting as the "Performance Improvement Officer," both without any systems to focus on costs or performance and no enterprise-wide process ownership of existing systems. Further, the DCMO does not have direct authority over all of the Service CMOs or DCMOs, who in turn have limited authority over functional stovepipes.

As a result, critical data for management is not accessible, available, or easily shared and is often inconsistent or not comprehensive. Limited data collection and cost accounting methodologies handicap officials who desire to promote more effective and efficient operations. Support functions have grown relentlessly, are disconnected, and increasingly complex. Attempts to modernize and integrate business systems have been met with considerable resistance which has resulted in a proliferation of stand-alone platforms. It is difficult to evaluate DoD in terms of its overall performance because the Department does not have specific performance measures that would enable this evaluation.

RECOMMENDATIONS

Private sector downsizing approaches and tools can be used by the Department to more efficiently meet critical missions despite reduced funding. Since the downsizing process is already underway to reduce obligations by $41 billion to satisfy FY 2013 sequestration requirements, these recommendations should be considered for the FY 2014 budget as well as improving the Department's management decision and information processes.

Based on the Task Group's findings and observations, the Board recommends that the Department consider the following guidelines as a roadmap for successful performance management during this time of reduced resources.

<u>Step 1: Develop a Strategic Framework</u>

1. Based on the outcome of Secretary Hagel's Strategic Choices in Management Review, DoD should conduct the 2014 Quadrennial Defense Review process as a planning exercise for the new strategy and downsizing.

2. Based on the strategy, SECDEF should set a realistic multi-year funding profile to frame the reduction targets (10 year targets, i.e. FYDP plus 5 years).

3. Based on the strategy and projected funding, SECDEF should develop priorities and capabilities for the future force structure. These priorities and capabilities will establish the parameters for the downsizing effort.

4. Based on the new funding profile and force structure, DoD should develop a matching investment program to adequately fund critical weapons development and productions programs, highlight shortfalls and look for alternative solutions, and take prudent risks. This process should be managed through regular Department structures and driven from the top by the Deputy's Management Advisory Group (DMAG) and the Undersecretary of Defense for Acquisition, Technology, and Logistics (USD(AT&L)).

Step 2: Develop a Detailed Downsizing Plan

1. The SECDEF should drive the downsizing process and instill a sense of urgency in developing a detailed downsizing plan to accompany the new strategic framework. It must be a SECDEF priority or it will not be successful.

2. The DEPSECDEF, in his role as the Department's Chief Management Officer, should serve as the key "program manager" for the downsizing process.

3. The DEPSECDEF should 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. The DET should be a group of experts brought into DoD for a short period of time to develop the plan and quickly drive execution. DET members should have DoD experience (critical) and retired senior military members would be useful.

4. The SECDEF should appoint a DET Leader with full support from the DEPSECDEF. This should be a senior civilian with proven private sector expertise in managing large budgets. A retired senior flag officer should serve as deputy to the DET Leader. The DEPSECDEF should retain accountability for execution and results.

5. The SECDEF should appoint a senior civilian executive with experience in ERP systems to install an improved MIS process to track realized savings (the process can later be expanded DoD-wide).

6. A senior level, top performer should be identified from each major DoD component as a liaison to the DET.

7. Outside advisers should be used for special ad hoc analyses. A group of respected "grey beards" could be used to "red team" results.

8. The initial Downsizing Plan should address three areas which are the primary drivers of DoD cost growth:

- Overhead and DoD Headquarters Staff: Over $270 billion of the topline budget is spent on overhead and infrastructure; the DET should set a goal to reduce overhead from 42% of base budget to 25% within 5 years. There are an estimated 61,750 Headquarters personnel across DOD and OSD staff has grown ~38% (FY01-12) resulting in greatly increased complexity, multiple layers, unclear authority, and slow, diffused decision-making. Major reductions to overhead and Headquarters staff will be the "signal" that SECDEF is serious.

- Personnel Costs: DoD spends $263 billion annually on military and civilian personnel. Since FY 2001, civilian headcounts have grown 17.5% while active duty headcounts have been flat; however, active duty per capita costs have increased 59%.

- Logistics: DoD spends $170 billion annually on supply, maintenance, and transportation. Responsibilities for logistics are diffused across military departments, agencies, and combatant commands. DoD will need to assess its logistics management structure for opportunities to reduce overlap and realize savings demonstrated by "best practices."

9. A Task Force should be established to concentrate on each of the three focus areas with a goal to complete all work in less than one year. Detailed recommendations on the structure of each Task Force can be found in the presentation slides (**TAB B**).

Step 3: Develop a Performance Monitoring and Metrics Plan

1. An improved SECDEF performance monitoring program is needed to manage the downsizing effort which can then be extended to improve overall Department performance management.

2. An improved management information process is needed for this downsizing oversight. Current and past DoD officials have said that cost data was not adequate to plan programs and set goals. Given the time constraints, it is necessary to make use of current systems that are employed by Under Secretary of Defense (Comptroller)

(USD(C)) and Cost Assessment and Program Evaluation (CAPE). Data needs to be materially correct, not precise.

3. The USD(C) should be the senior SECDEF executive responsible for tracking downsizing results and implementing improved performance monitoring systems Department-wide (i.e., no more diffused responsibility). Combining budget and performance monitoring responsibilities under USD(C) will also put “teeth” into management reporting and performance/cost controls into financial decisions.

4. The DEPSECDEF, Vice Chairman of the Joint Chiefs of Staff, and DET should meet weekly to assess progress, make decisions on remedial actions, and approve plan revisions. These meetings should be face-to-face, principals only, open process, timely, and action-oriented. The SECDEF and CJCS should attend frequently to reinforce their roles and emphasize the importance of the effort.

Step 4: Follow-up and Communicate

1. Communication is critical to implementing successful turnarounds, both internally and externally. The Department should develop an active and frequent communication plan to regularly update key stakeholders in individual DoD components, other federal government offices and agencies, the Defense Industrial Base, and the general public.

2. The SECDEF must continuously communicate progress updates to all stakeholders to maintain focus, momentum, and support.

3. Successes should be celebrated.

4. Issues and shortfalls should be identified and remedial actions taken quickly.

CONCLUSION

All those interviewed, inside and outside of DoD, felt that now is the time to make significant changes to a Department which has become 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. As Secretary Rumsfeld said, "every dollar squandered on waste is one denied to the warfighter" and as one senior Service official stated, "we know what to do, we just need to be told to do it." This opportunity should not be wasted.

Respectfully submitted,

Joseph Wright
Task Group Chair

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TAB A

TERMS OF REFERENCE

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DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

DEC 2 2 2012

MEMORANDUM FOR CHAIRMAN, DEFENSE BUSINESS BOARD

SUBJECT: Terms of Reference, "Applying Best Business Practices for Corporate Performance Management to DoD"

In today's environment, the Department of Defense (DoD) faces an extraordinary combination of management challenges, budget reductions, and mounting costs, all while continuing to provide for the national defense. To ensure our success, every organizational leader within DoD should diligently seek opportunities to optimize organizational performance using innovative and cost effective management tools.

As DoD's advisory board for providing independent advice on DoD's management and governance, with members who possess a proven track record in the private sector, the Defense Business Board (DBB) is uniquely qualified to provide advice on private sector best practices of relevance to DoD. Therefore, request you establish a Task Group to evaluate how successful, large and complex corporations plan, implement, and manage for peak performance on an ongoing basis and especially during periods of substantial change due to reduced budgets and resources. Your study should identify effective procedures, practices, and associated metrics and recommend which of these might assist DoD organizational leaders. The study should also review examples of federal performance management tools and practices that might enhance DoD's organizational management, such as the Government Performance and Results Act. At a minimum, recommendations should address the following:

- What key procedures, practices, and metrics are used by leading private sector companies to continually oversee the performance of their major projects, line operations, and organizations on a continual basis and particularly during and after a period of substantial change?
- Which of these practices would best apply to DoD?
- How would DoD implement successful private sector processes, practices, and techniques? How would they be approved, and what would be the appropriate monitoring organization and process?
- 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?

The Offices of the Deputy Chief Management Officer and Director of Cost Assessment and Program Evaluation will serve as DoD liaisons for this study and provide technical assistance, as needed. The DBB's recommendations will be submitted to me no later than January 24, 2013.

OSD015547-12

As a subcommittee of the Board, and pursuant to the Federal Advisory Committee Act of 1972, the Government in the Sunshine Act of 1976, Federal regulations, and DoD policies and procedures, this Task Group will not work independently of the Board's charter and will report its recommendations to the DBB for full deliberation and discussion in open session. The Task Group does not have the authority to make decisions on behalf of the Board, nor can it report directly to any Federal officer who is not also a Board member. The Task Group will avoid discussing "particular matters" within the meaning of section 208 of title 18, U.S.C.

Ashton B. Carter

cc:
Deputy Chief Management Officer
Director, Cost Assessment and Program Evaluation

Defense Business Board

TAB B

FINDINGS AND RECOMMENDATIONS

PROVIDED TO THE BOARD ON APRIL 25, 2013

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DEFENSE BUSINESS BOARD

Applying Best Business Practices from Corporate Performance Management to DoD

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

Mr. Joseph Wright (Chair), Mr. Philip Odeen, Mr. Robert Stein, Mr. Richard Spencer, Mr. Patrick Gross, Mr. Frederic Cook, Mr. William 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."

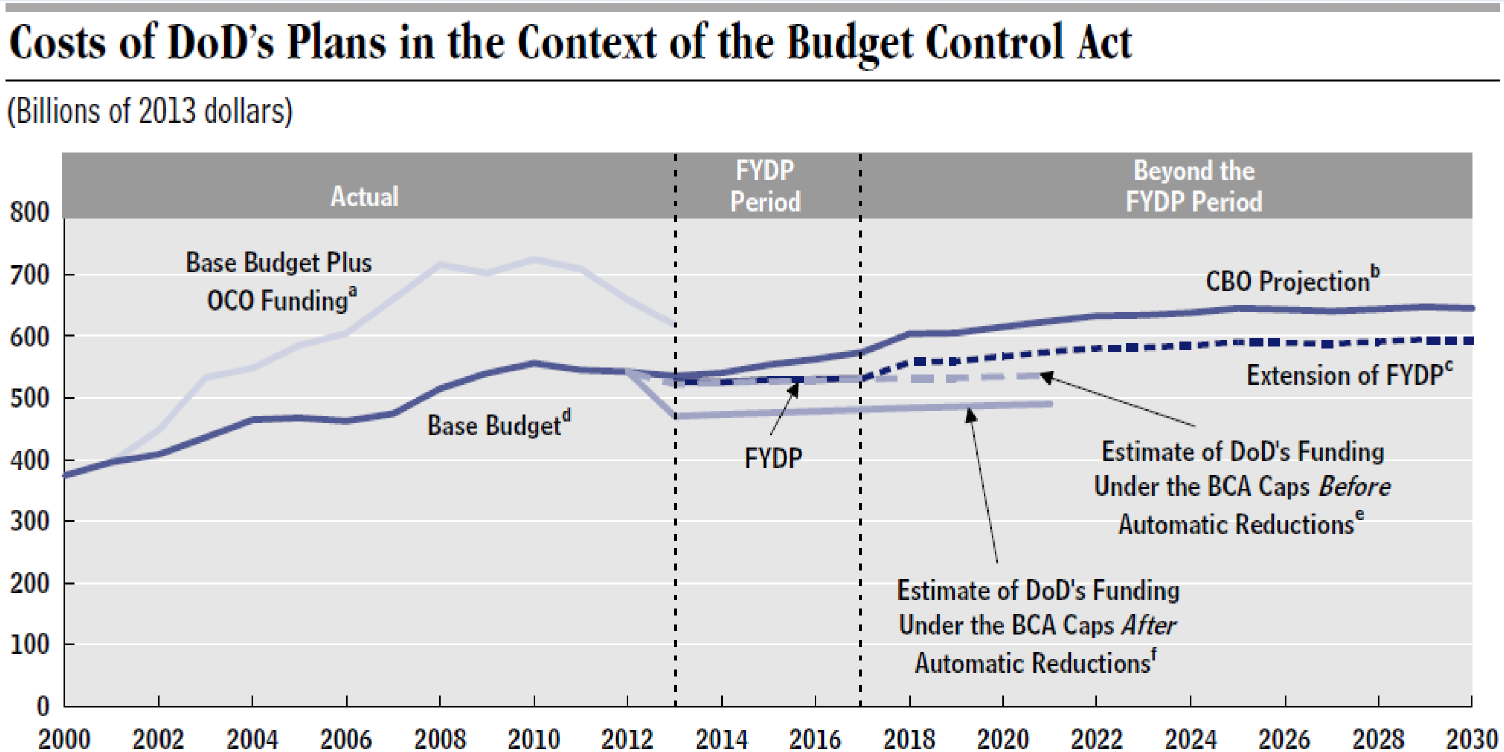
- ADM Michael Mullen, "Tribute to the Troops" breakfast, 2010

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 30, 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

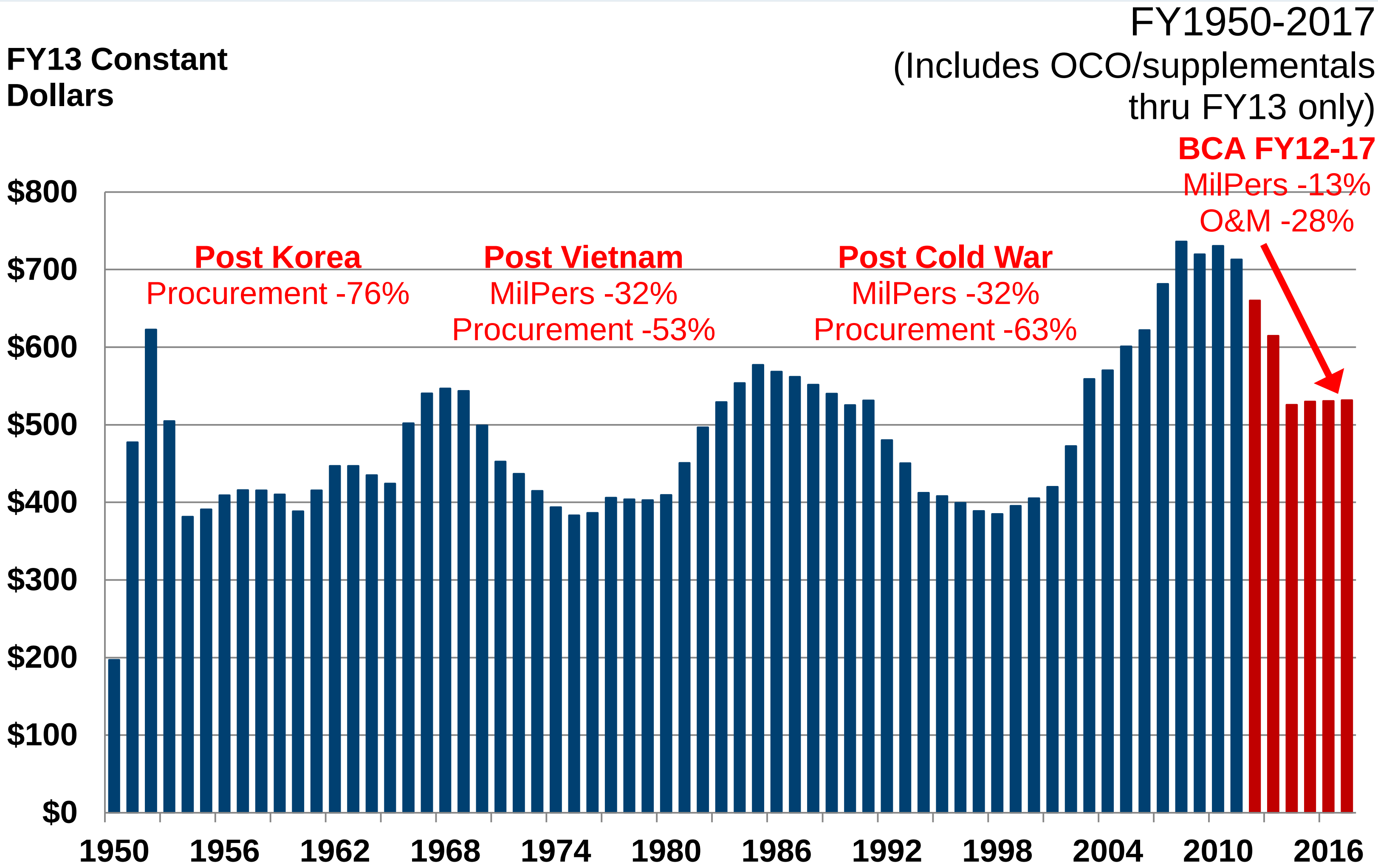
Note: A more detailed report on private sector downsizing best practices is included in DBB Report FY11-08

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 reforms: 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

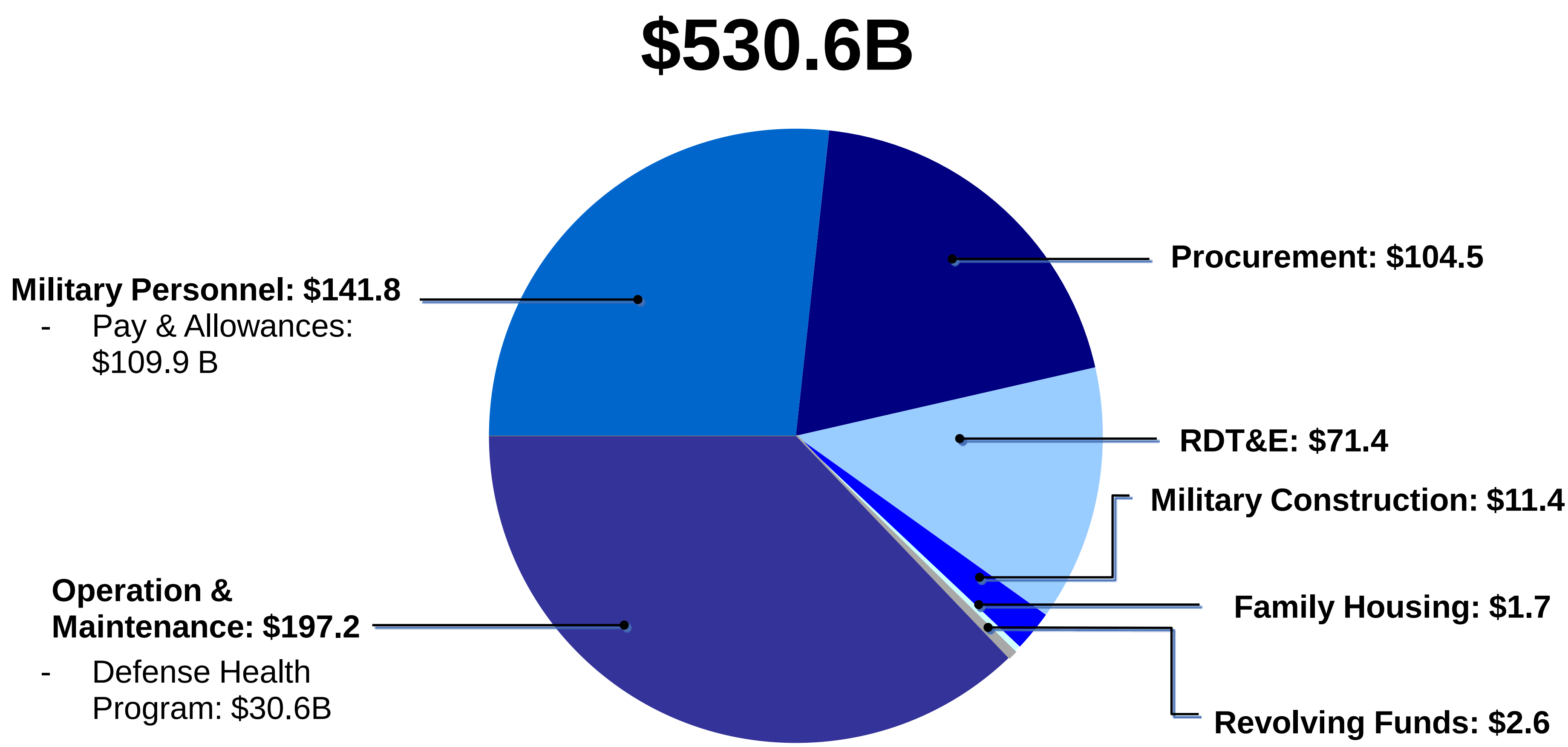
"Since 1947, there have been four periods of significant increase in budget authority… followed by a period of significant decrease. Current Departmental processes are structured for programmatic growth with the even distribution of increases and decreases... Opportunities exist for redirecting funds, 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 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

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
- DEPSECDEF 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 (Defense-wide 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

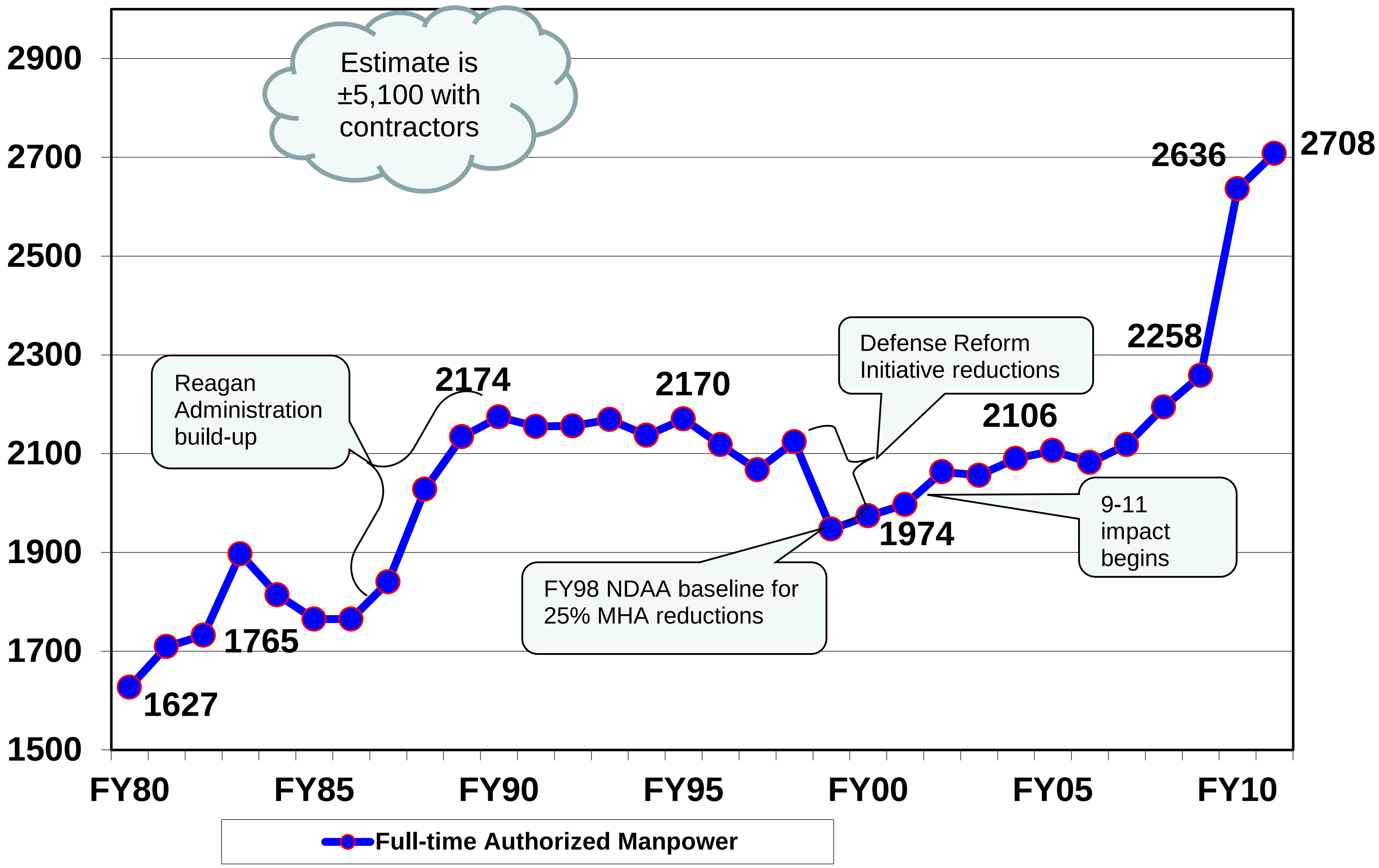
Overhead - DoD Headquarters Staff

- 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

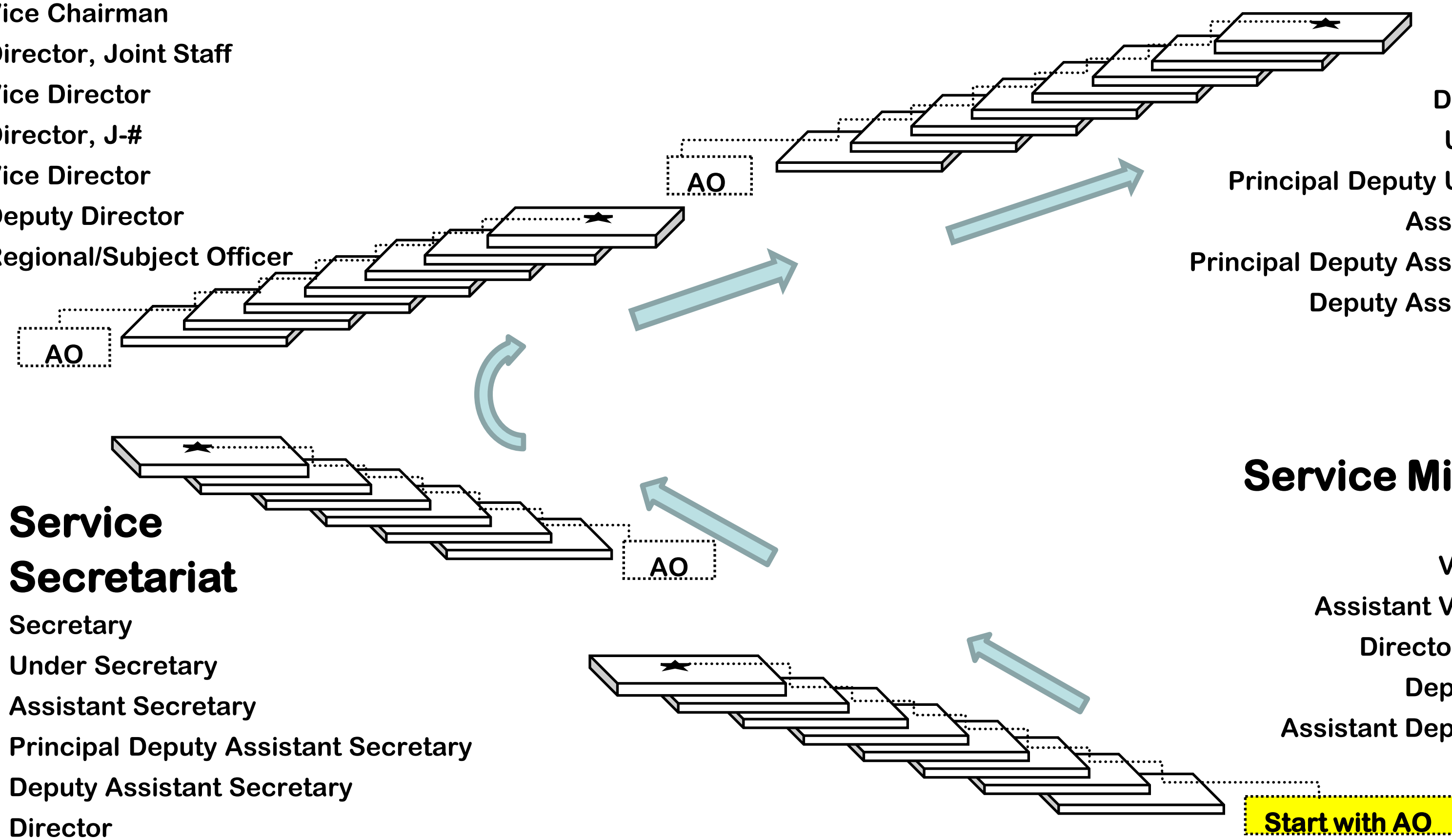
DoD Layers

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)

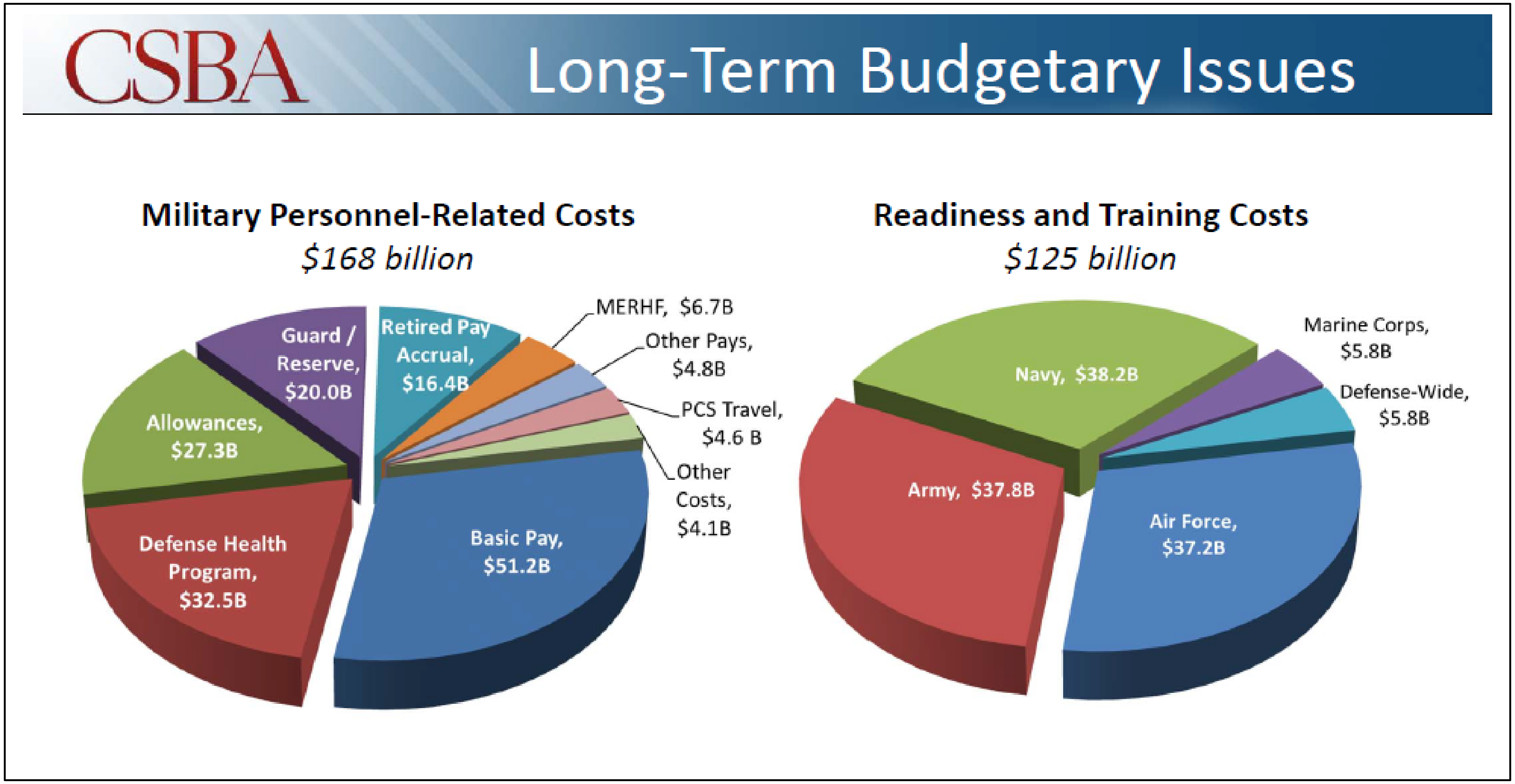
Recommendation 2
Focus Area 2: Personnel

- 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
  - 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

Appendices

A. List of Interviews

B. Study Process

C. March 15 Strategy Memo by Secretary Hagel

D. Selected Quotes

Appendix A: List of 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

Appendix A: List of 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

Appendix A: List of Interviews

Former DOD

- Frank Carlucci, former SECDEF (1987-1989)
- Gen James Cartwright, former VCJCS (2007-2011)
- Gordon England, former DEPSECDEF (2006-2009)
- John Hamre, President and CEO of CSIS and former DEPSECDEF (1997-2000) and USD(C) (1993-1994)
- 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 (2009-2011) and former USD(C) (1997-2001)
- ADM William Owens, founding Partner/Chairman, Prometheus Partners and former VCJCS (1994-1996)
- Dov Zakheim, former USD(C) (2001-2004) and former SVP, Booz Allen Hamilton

Appendix A: List of 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
  - Kathleen 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

Appendix B: 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
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MAR 15 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

Appendix D: 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

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TAB C

LIST OF TASK GROUP INTERVIEWS

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List of Interviews

Private Sector

Tony Alvarez, CEO, Alvarez & Marsal

William 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

Current DoD

Ashton B. Carter, DEPSECDEF

Robert F. Hale, USD(C)/CFO

Andrew Morgan, Director of Business Integration, OUSD(C)/CFO

Elizabeth “Beth” McGrath, Deputy Chief Management Officer

Christine Fox, Director, Cost Assessment and Program Evaluation (CAPE)

Richard Burke, Deputy Director, CAPE

Steve Miller, Director, Advanced Systems Cost Analysis Division, CAPE

John Orem, Acting Director, Force and Infrastructure Analysis Division, CAPE

Joseph Westphal, Under Secretary of the Army

Eric Fanning, Under Secretary of the Air Force, then-Deputy Under Secretary of the Navy

Former DOD

Frank Carlucci, former SECDEF (1987-1989)

Gen James Cartwright, former VCJCS (2007-2011)

Gordon England, former DEPSECDEF (2006-2009)

John Hamre, President and CEO of CSIS and former DEPSECDEF (1997-2000) and USD(C) (1993-1994)

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 (2009-2011) and former USD(C) (1997-2001)

ADM William Owens, founding Partner/Chairman, Prometheus Partners and former VCJCS (1994-1996)

Dov Zakheim, former USD(C) (2001-2004) and former SVP, Booz Allen Hamilton

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

Gene Dodaro, Comptroller General of the United States, GAO

Janet St Laurent, Managing Director, Defense Capabilities and Management, GAO

David Fisher, Chief Financial Officer and Chief Administrative Officer, GAO

Asif Kahn, Director, Financial Management and Assurance, GAO

Paul Francis, Managing Director, Acquisition and Sourcing Management, GAO

Christopher Mihm, Managing Director for Strategic Issues, GAO

Daniel Werfel, Controller, Office of Federal Financial Management, OMB

Shelley Metzenbaum, Associate Director, Performance and Personnel Management, OMB

Mathew Blum, Associate Administrator, Office of Federal Procurement Policy, OMB

Steven VanRoekel, United States Chief Information Officer, OMB

Kathleen Peroff, Deputy Associate Director for National Security, OMB

Mark Cancian, Chief, Force Structure and Investment Branch, OMB

Bill Campbell, National Security Division, OMB

John McClelland, National Security Division, OMB

TAB D

LIST OF WORKS REVIEWED BY THE TASK GROUP

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Bibliographical Review

Reports from Government and Think Tanks

American Enterprise Institute. *Shrinking Bureaucracy, Overhead, and Infrastructure: Why This Defense Drawdown Must Be Different for the Pentagon*. Mar 2013.

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---. *What the Fiscal Cliff Deal Means for Defense*. Mar 2013.

---. *Analysis of the FY2013 Defense Budget and Sequestration*. Aug 2012.

Center for Strategic and International Studies. *Planning for a Deep Defense Drawdown – Part I*. May 2012.

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---. *Long-Term Implications of the 2013 Future Years Defense Program*. Jul 2012.

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Defense Business Board. *Management Information Task Group Report: Recommendations on the implementation of balanced scorecard metrics for the Department of Defense*. Dec 2002.

---. *Creating a Chief Management Officer in the Department of Defense Task Group Report*. May 2006.

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Government Accountability Office. *Defense Infrastructure: Budget Estimates for 1996-2001 Offer Little Savings for Modernization*, Apr 1996.

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---. *Defense Business Transformation*. Jan 2011.

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---. *Maximizing DOD's Potential to Achieve Greater Efficiencies and Improve Business Operations*. Jun 2011.

---. *DoD Civilian Workforce: Observations on DOD's Efforts to Plan for Civilian Workforce Requirements*. Jul 2012.

Institute for Defense Analysis. *Implications of Defense Budget History for Acquisition Budget 2010-2020*. Dec 2009.

McKinsey & Company. *Lessons from Around the World: Benchmarking Performance in Defense*. 2010.

RAND. *Defense Planning in a Decade of Change: Lessons from the Base Force, the Bottom-Up Review, and the Quadrennial Defense Review*. Oct 2001.

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Senator Tom A. Coburn, M.D. *The Department of Everything*. Nov 2012.

<u>DoD Strategic and Financial Documents and Reports</u>

2010 Quadrennial Defense Review.

2013 Strategic Management Plan.

Defense Manpower Requirements Report for FY2012.

FY 2013 Defense Budget Request Overview Book.

FY2013 More Disciplined Use of Resources.

Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items—Their Purposes and Legislative Backgrounds, 7^{th} Ed. Nov 2011.

National Defense Budget Estimates for FY2012.

National Defense Budget Estimates for FY2013.

Report on the Bottom-Up Review. Oct 1993.

The Eleventh Quadrennial Review of Military Compensation. Jun 2012.

Defense Business Board

TAB E

EXAMPLES OF SUCCESS IN CORPORATE PERFORMANCE MANAGEMENT

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Examples of performance management improvements/changes in DoD and other government agencies - state, local, and foreign

Department of Defense
Defense Readiness Reporting System (DRRS) – System implemented to improve readiness reporting across DoD by using consistently measurements and metrics across the Services and COCOMs. System used for assessing units' readiness for individual missions, automation of resource and training calculations, and the enhanced ability of associated units to report their combined or separate readiness. DRRS is an upgrade to the older Status of Resources and Training System (SORTS).
CAPE's full cost of manpower (FCoM) tool: FCoM is designed to generate cost estimates associated with Department of Defense (DoD) manpower—military, civilian, and contractor personnel. It shows estimated costs borne by the DoD Component, the DoD as a whole, and Federal Government as a whole. FCoM was created to provide a consistent approach for DoD to estimate the fully-burdened costs of manpower.
DCMO's Defense Business Council (DBC): DBC works to align DoD's business strategies and outcomes with its IT investments. Additionally, DCMO established an Integrated Business Framework that allows DoD leaders to share success stories, eliminate redundant systems, rationalize DoD's business system investments, and certify systems deemed necessary.
Navy's Visibility and Management of Operating and Support Costs (VAMOSC): VAMOSC is a management information system that collects and reports US Navy and Marine Corps historical operating and support (O&S) costs. VAMOSC provides the direct O&S costs of weapon systems, some linked indirect costs (e.g., ship depot overhead), and related non-cost information such as flying hour metrics, steaming hours, age of aircraft, etc.
Navy's "Contractor Court": In October 2011 the Navy established a Services Requirements Review Board where senior officials of the command assumed personal responsibility for reviewing all significant services contracts in the command to identify opportunities for service acquisition efficiencies, process improvements, and cost savings. The new process has enabled NAVSEA to achieve savings of as much as 20 percent on its service contracts in the first year alone. The Assistant Secretary of the Navy for Research, Development, and Acquisition has directed that the process be institutionalized across the Navy.
Foreign
United Kingdom's Ministry of Defence (MOD): Faced with budget cuts, the UK MOD is piloting a program to convert its procurement and sustainment operation into a government-owned, contractor-operated (GOCO) entity.
State and Local Government
City of Indianapolis: In June 2010 the city of Indianapolis launched a $16m ERP project to consolidate its 30-year-old financial systems (both city and county) into one system, with an emphasis on business process improvements, rather than technological improvements. The old legacy systems gave rise to over 1,100 "shadow systems" and made costs difficult to track. The intent of the ERP implementation is to provide a "single, consolidated source for financial and human resource information to be stored, reported, and shared across the enterprise."