

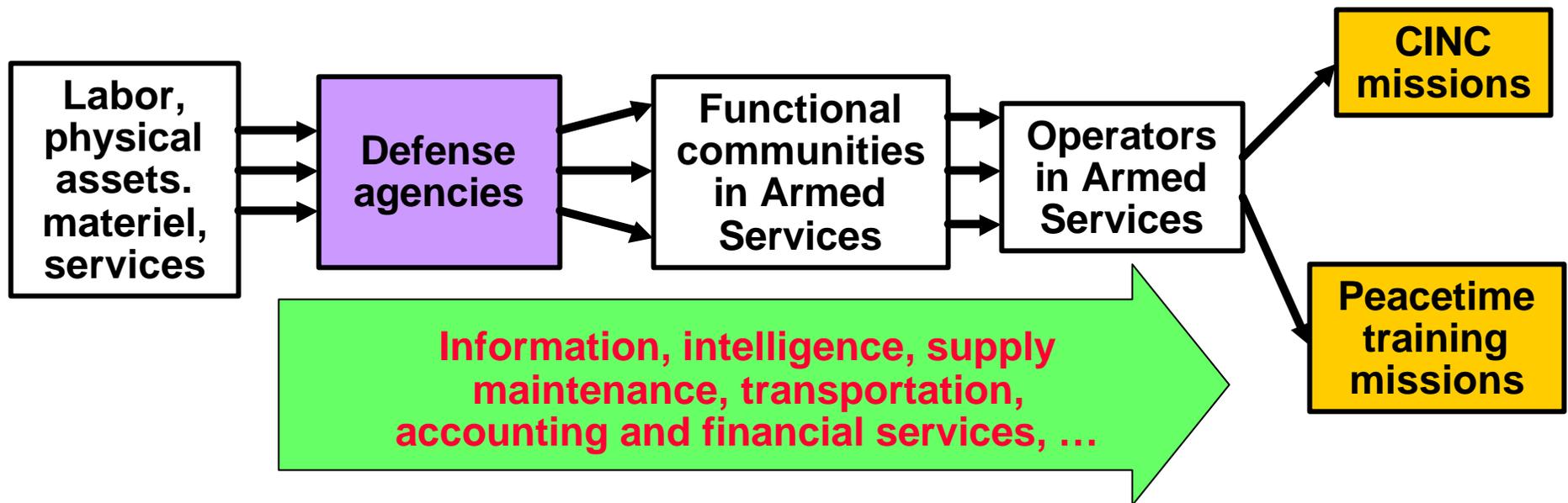
Governance of Defense Agencies: Insights from the Economics of Supply Chains

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How Do Agencies Affect The Ultimate Users of Their Activities?



Agencies buy inputs to produce **activities** that they deliver to **ultimate users** through DoD supply chains

Strategic Sourcing Seeks to Align Users and Sources

- View any agency in terms of specific activities it produces (use performance-based budgeting (PBB) or activity-based management (ABM) focus)
- View each activity an agency provides as a link in one or more supply chains
- Manage each supply chain to align it with the priorities of its ultimate user
 - in a contingency, a CINC
 - in peacetime, a Component responsible for training
 - a military family
- Align the activities an agency produces with the priorities of the ultimate users that they support

Two Basic Governance Issues Are Critical for Any Agency

- **Who should provide the activities that the agency currently provides?**
 - immediate users in DoD (Components)
 - some other government activity (agency, executive agent, ...)
 - private firms
 - public-private partnerships
- **What should be the terms of relationship between ultimate users and providers, whoever they are?**
 - reporting relationships and processes
 - formal performance contracts or MOUs
 - effective programming and budgeting processes
 - shared models, data flows, and planning processes
 - performance (“motivational”) metrics
 - internal transfer prices
 - other incentives

Two Broader Governance Issues Derive from the First Two

- **What high-level governance structure should provide the answers to the questions above?**
 - **Defense Support Executive, Senior Executive Council, Primary Secretarial Assistants, agency Boards of Advisors, users, agencies, others?**
- **How should DoD manage diversity in the nature of these issues across defense agencies?**
 - **No one approach is likely to fit all agencies**

Choose the broad approach to governing defense agencies most likely to yield the right answers to the basic governance issues raised earlier

What Agency Metrics Are Relevant to Ultimate Users?

- Start with system metrics
 - Military capability (current and future)
 - Work force/quality of life (current and future)
 - Total ownership cost (current and future)
- Choose performance metrics for activities in agencies derived (“cascaded down”) from such system metrics.

A feature of a derived demand, the value generated by agency activities derives from the value ultimate users place on these activities

What Aspects of Activities Provided in Agencies Raise Values of System Metrics?

- **Examples:**
 - **More collocated physical assets with stochastic availability (scale economies) can reduce costs, increase performance of an activity**
 - **Single center of excellence (exclusive authority to produce an activity) can reduce duplication of public goods; encourage monopolistic waste, rent seeking**
 - **Enforceable, incentivized performance agreements (more effective coordination) can increase alignment of activity providers and users, reduce monopolistic waste**
- **Other factors: scope, network, organizational/management economies; strategic focus, criticality, local flexibility, ...**

DoD policy has systematically emphasized scale economy and duplication issues over monopoly and alignment issues

On-Going Changes in the World Suggest a Better Way to Think about Governing Defense Agencies

- **Commercial firms give increasing emphasis to alignment and monopoly issues, at the expense of scale economy and duplication issues**
- **Commercial firms break up the supply chain (“outsource”) only when they develop relationships that can maintain an effective level of integration**
- **DoD can benefit from a move in the same direction where appropriate**
 - **Increasing recognition of supply chain in performance management**
 - **Increasing emphasis on closely coupled supply chains**
 - **Increasing importance of infrastructure to the immediate fight**

An Updated Economic Perspective Should Help Improve Governance of Defense Agencies

- **Lots of trade offs to consider.**
 - **Factors: Scale economies, duplication, monopoly, alignment, ...**
 - **Elements of alignment: Reporting relationships, agreements, system integration, incentives...**
- **Different governance arrangements are likely to work best for different activities now provided by agencies**
- **Choose governance arrangements to optimize supply chains, not agencies or even activities in agencies**
- **Recognize the growing importance of alignment relative to scale economies when placing activities in an agency or elsewhere**