

2002 Defense Economics Conference
Defense Agencies: Public Provision of Commercial
Goods and Services

Defense Agencies Formation Panel

Thursday, February 14, 2002

Chaired by Mr. James Locher

Background Presentation by Dr. David Graham

Panel:

Mr. Donald Shycoff

Mr. Paul Strassmann

RADM James Davidson

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Jim Locher: To talk about the formation of Defense Agencies, we need to talk a little bit about the history of the Department of Defense. The Department of Defense's implementation of the concept of unification was troubled for nearly four decades. The National Security Act of 1947, designed to unify the military, produced instead a loose, unworkable confederation of powerful independent Services.

The OSD's Historical Office said the 1947 Act, and I quote, "confirmed the principle of unification by cooperation and mutual consent." The weak Secretary of Defense had only the power of persuasion to gain the cooperation from the services. The Joint Chiefs of Staff were crippled by the de-facto veto each Service could exercise on every issue.

The Services used their vast power to emasculate the unified commands, despite the necessity for them demonstrated during World War II. Presidents Truman and Eisenhower repeatedly sought to overcome the deficiencies of the 1947 Act. They did succeed in strengthening the authority of the Secretary of Defense. However, many other important areas remain unreformed.

It was into this hostile environment, with continuing strong resistance to unification, central direction, and consolidation, that the Defense Agencies were born. Given the larger institutional battles being waged, the new-born Defense Agencies had to fend for themselves.

The Defense Secretary's authority to create Defense Agencies was not requested by the Pentagon, but prescribed by Congress in the

1958 Reorganization Act. Not surprisingly, the Department of Defense was initially disinclined to use the new authority fully. Following his 1961 appointment, however, Secretary of Defense McNamara employed the new authority to activate the Defense Communications Agency, and to create the Defense Intelligence and Defense Supply Agencies.

Initially, many agencies reported to the Secretary through the Joint Chiefs of Staff. Eventually, management oversight became the sole responsibility of OSD, where it received low priority. The military departments, sensing a loss of authority and control, normally objected to the establishment of each agency. As they did to all Joint organizations that limited their autonomy or assumed their responsibilities, the Services often treated the Defense Agencies as adversaries.

As friction mounted, detractors perpetuated myths about the performance of Defense Agencies. And as President Kennedy said, and I quote, "The greatest enemy of the truth is very often not the lie - deliberate, contrived and dishonest, but the myth - persistent, persuasive, and unrealistic." Over the past 40 years, unsubstantiated accusations have outnumbered genuine assessments of Defense Agency performance.

The 1986 Goldwater-Nichols Act succeeded in finding the elusive balance between Joint and Service interests. Despite the Act's intent of leaving no Joint enemy behind, the Defense Agencies never fully escaped their grim beginnings.

This morning's panel will examine the history of the Defense Agencies' formation, assess the impact of environmental factors in the agencies' development, and attempt to separate fact from fiction. Issues will include: When, how, and why were various Defense Agencies created? What were the institutional and cultural barriers? What were the expected benefits of establishment or expansion of these agencies? What need for management oversight was foreseen? And what lessons can be learned?

The four panelists bring a wealth of experience, and a variety of perspectives on the Defense Agencies. David Graham is an Assistant Director of the Strategy Forces and Resources Division of the Institute for Defense Analyses. Prior to joining IDA in 1984, he worked at the Department of Labor, the Civil Aeronautics Board, the Center for Naval Analyses, and the Board of Governors of the Federal Reserve System. Dave co-authored the recent IDA report, "Next Steps For Managing Defense Agencies, Field Activities, and Support Processes."

Don Shycoff's career in the Department of Defense spans 37 years. He served as a Budget Analyst and Branch Head in the Bureau of Ships, Budget Analyst and Office Director in the DOD Comptroller's Office, Deputy Comptroller of the Defense Logistics Agency, Principal Deputy DOD Comptroller, and finally, acting DOD

Comptroller. From 1989 to 1992, Don led the Defense Management Review, which resulted in major changes in a number of Defense Agencies. Since leaving government service in 1993, he has served as a consultant and has written two books, including the "Businesses of Defense".

Rear Admiral Jim Davidson, a retired Navy Supply Corps Officer, served 35 years in a variety of acquisition and logistics assignments, including three sea tours on the destroyer DeHaven, and the carriers Oriskany and Nimitz. Admiral Davidson was the Executive Director of Operations at the Defense Logistics Agency from 1989 to 1991, during both Desert Storm and the Pentagon's Defense Management Review. He retired in 1996 and joined Litton PRC as Vice President for Strategic Logistics. Admiral Davidson brings a DLA perspective, as a customer and operations officer and now as a contractor.

Paul Strassmann is now President of his own publishing firm, The Information Economics Press. He served for more than 30 years as a top-level information executive in business and government, and as an independent consultant for another decade. During the 1960's Paul held the Chief Information Officer roles at General Foods and Kraft Corporation. In 1969 he joined Xerox, where he organized and ran an agency similar to the Defense Information Systems Agency.

In 1991 Paul was appointed to the newly-created position of Director of Defense Information, and assumed responsibility for DOD's Corporate Information Management Program. He is a prolific author, having written six books and over 200 articles on information management and information worker productivity. As a former Assistant Secretary of Defense for Special Operations in Low Intensity Conflict, I also must mention that Paul was engaged in World War II combat as a member of a Czechoslovak guerilla commando unit in 1944 and 1945.

I think you'll agree we have a great panel to examine the issue of formation of Defense Agencies. Dave?



Defense Agencies

David Graham, Stanley Horowitz, and Bob Fabrie

James Bell
Brad Bergmann
Robert Bovey
Jerome Bracken
Deborah Christie
William Cralley

Charles Hawkins
Robert Hilton
Edwin Hind
Julie Kelly

James Locher
Phil Lurie
Charles Lyman
Rob Mahoney
Michael Nash

Gene Porter
John Shea
Richard Van Atta
Richard Wright
Caroline Ziemke

February 12, 2002

Dave Graham: I've been asked to give a briefing that sets the stage for the panel's work. I will quickly go over some of the legal background and history that some of the other speakers have touched on already, describe what we mean by the Defense Agencies, and then provide an overall perspective on the issues, pros and cons, that are debated about the agencies.

The work I'm going to present is based on the IDA review that was performed in preparation for the QDR. I've included all the authors from that study, just to acknowledge the contribution that they've made to this work. The majority of the statistical and historical work that's in this briefing were prepared by Stan Horowitz and Bob Fabrie in particular.

Agencies & Field Activities Reviewed for the QDR

(Total of appropriated and working capital fund expenditures)

Common Support

- Defense Logistics Agency (\$16.5)
- Defense Info. Systems Agency (\$4)
- Defense Security Service (\$.5)
- Defense Finance and Accounting Service (\$2)

Contracting, Audit, & Legal

- Defense Contract Mgmt. Agency (\$1)
- Defense Contract Audit Agency (\$.4)
- Defense Legal Services Agency (\$.01)

Quality of Life

- Defense Commissary Agency (\$6)
- DoD Education Activity (\$1.5)
- Tricare Management Activity (\$17.4)

DoD-Wide Programs/Initiatives

- DARPA (\$1.9)
- Ballistic Missile Defense Org. (\$3.9)
- Defense Threat Reduction Agency (\$2)
- Defense Security Coop. Agcy. (\$.1)

Agencies shown in blue were formed to take advantage of economies of scale to be gained from consolidation

Not Reviewed:

- **INTEL:** National Security Agency, National Imagery and Mapping Agency, Defense Intelligence Agency
- **FIELD ACTIVITIES:** American Forces Information Services, Office of Economic Adjustment, Defense Prisoner of War/Missing Persons Office, Washington HQs Service,

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The agencies that we covered in the IDA review are shown here. The slide gives a partial answer to the question of why agencies were formed and what general functions they perform. We organized them into four groups here: Common Support, Quality of Life, Contract Audit and Legal, and DOD-Wide Programs and Initiatives, primarily in the technological area.

Many of the agencies were formed as Dr. Chu indicated, in search of economies of scale. Some were formed to provide a critical mass in an area, or to unify a policy in an area. As noted on the bottom of the slide, we didn't cover all of the agencies in our review. We didn't look at the intelligence agencies and certain of the field activities.

A “Fourth Department”

- Fourteen Agencies expend \$57 B or 19% of DoD budget
 - Appropriations \$32 B*
 - Defense Working Capital Fund 25 B**

- These are big businesses
 - Lockheed-Martin \$19.2 B (defense only)
 - Defense Health Program 17.4 B
 - Defense Logistics Agency 16.5 B
 - Boeing 14.8 B (defense only)

* TMA, DARPA, and BMDO appropriations fund Service activities.

** Four Agencies operate under the Defense Working Capital Fund: Defense Finance and Accounting Service; Defense Logistics Agency; Defense Information Systems Agency; Defense Security Service

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Why are these of interest? As Dr. Chu pointed out, if you add them all up, they are the size of a fourth department. The 14 we looked at account for about 20 percent of the DOD budget. The Defense Health Program and DLA are on the order of magnitude of some of our largest Defense contractors.

It's also interesting to point out that their expenditures, if you convert them into GNP, would put them on a par with Hungary or Finland or some other sizeable economies. So this is a major enterprise; it really deserves a look, and careful management.

Statutory Basis

- National Security Act

- 1958 Defense Reorganization Act

Whenever the Secretary of Defense determines it will be advantageous to the Government in terms of effectiveness, economy, or efficiency, he shall provide for the carrying out of any supply or service activity common to more than one Military Department by a single Agency or other such organizational entities as he deemed appropriate.

[Section 202]

- Goldwater Nichols Act

- Codified oversight by Principal Staff Assistants
- Created Combat Support Agencies

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The next several slides provide some historical background material. Again, as was pointed out by Jim, the legal basis for creating the agencies really lies with the 1958 Reorganization Act. Following that, the various project initiatives of McNamara were responsible for identifying and creating several of the agencies.

Management Reviews & Initiatives

Pre-1975	1975 to 1990	After 1990
<ul style="list-style-type: none"> • McElroy Review • 1958 Reorganization Act • Project 100 • Project 60 • Fitzhugh "Blue Ribbon Defense Panel" 	<ul style="list-style-type: none"> • Defense Organization Study (Antonelli) • Defense Organization—Need for Change (Locher) • Packard Commission • Goldwater-Nichols • G-N: "Reassessment of Agencies & Field Activities" • Defense Management Report to the President • Commissary Study 	<ul style="list-style-type: none"> • Bottom Up Review • Commission on Roles and Missions • Quadrennial Defense Review (1996) • Defense Reform Task Force • Defense Reform Initiatives

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When you look at the period from 1975 to 1990, again as Jim said, there was focus in the Antonelli study on the war-fighting support provided by the agencies. And then the focus through the Packard Commission, Goldwater-Nichols and so forth on Joint war fighting capabilities.

Beginning at the end of the decade with the DMR report to the President that Don Shycoff will tell us about, and a lot of ensuing activities, there really has been a lot of focus on the business management of the agencies. You find when you look at the records of when agencies were created and the justifications for creating them, the record really tracks quite well with that kind of legal history that I just presented.

Agency Origins

(Formation of an Agency or its Predecessor)

Pre-1975	1975 to 1990	After 1990
DARPA DISA DLA DTRA DSS DCMA DCAA DSCA [NSA] [DIA] [NIMA]	DLSA BMDO	DoDEA TMA DeCA DFAS + Revamped: DISA, DLA, DTRA, DCMA

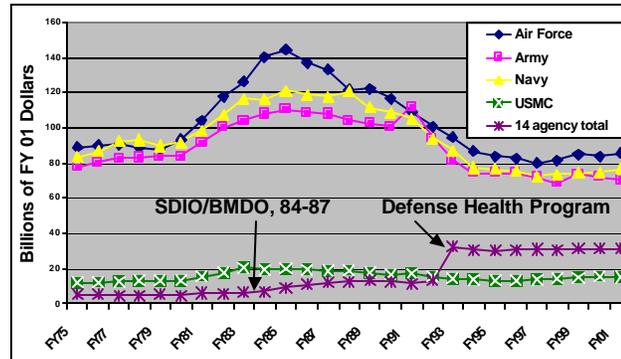
slide-10

Eight of the agencies we looked at were created mostly in the 1960s. Although we didn't look at the intelligence agencies, I added them to the chart just to indicate they had their roots going back to that period, also.

The 15-year period between 1975 and 1990 was one in which only two agencies were formed: BMDO to focus on strategic defense and DLSA, a very small legal support activity.

The third phase after 1990, actually, it began in 1989 - but if you look at the period after 1990 there was a lot of activity in consolidating support - the education area, TMA Health, DeCA is the commissaries, DFAS in finance. Then there were also significant additions for DSINT, DLA, DTRA, and DCMA. So there was a lot of activity with the agencies early in the 1990's.

Missions and Budgets



1984 SDIO (now BMDO) established, soon reached \$4B
 Personnel transfers to DLA:
 1990 consolidation of supply depots, 26,000 personnel
 1991-95 consolidation of consumable item mgmt., 11,000 personnel.
 1990 consolidation of contract mgmt. in DLA, 5,400 personnel
 1996 printing consolidated in DLA, 6,500 personnel

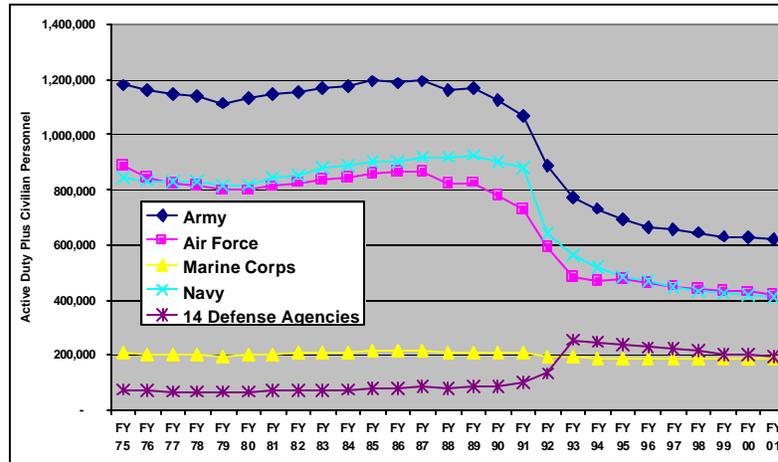
1991 DFAS established, 20,000 personnel transferred
 1992 Defense Commissary Agency formed, \$1B transferred
 1993 Defense Health Program established, \$18B transferred

slide-11

One of the issues of debate with respect to the agencies that we ran into right off the bat with our review involved why the agencies' share of the defense budget has been going up over the last ten years. People ask the question of whether or not that means they're not sharing in the kind of rigorous budget scrubs that are being visited on the Services?

One perspective on that is shown here. If you look at overall budgets, the agency budgets have indeed grown, but the growth in their budgets has coincided with a growth in the missions assigned to them. I just highlighted a couple of the key points here. One you added four or five billion dollars with SDIO, BMDO, in the mid-80's; and then DHP alone transferred 17 billion dollars from what had been service accounts into agency accounts.

Manning



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You get a similar perspective when you look at manpower. Again, with the DMR there were hundreds of thousands of personnel transferred out of the services into the Defense Agencies. So you had a tremendous spike in the early 1990s in Defense agency manning, as the services were drawing down.

DMR & DRI Initiatives

- DLA
 - 54% personnel reduction since '90 while adding major missions
 - 1990 consolidation of supply depots, 26,000 personnel
 - 1991-95 consolidation of consumable item mgmt., 11,000 personnel.
 - 1990 consolidation of contract mgmt. in DLA, 5,400 personnel
 - 1996 printing consolidated in DLA, 6,500 personnel
 - Distribution Depot Consolidation (30 =>21); 70% personnel reduction
 - DLA lauded in CINC assessments
 - Prime vendor program
 - Strategic Distribution Management Initiative
- DFAS
 - 30% personnel reduction since '95; additional 13% reduction already planned
 - Consolidated finance systems (127=>15)
 - Consolidated accounting systems (197=>53)
 - Cut cost of civilian payroll 50% (\$6.50 per account per month in '91 => \$ 3.20 in '01.)
 - A76 studies have cut costs; new process lauded by external critics (Business Executives for National Security).
 - Introducing Activity Based Costing and benchmarking
- DISA
 - 23% personnel reduction since '94
 - Consolidation of DoD mainframe computing operations(194 centers => 6 centers); costs down 70% since 1990; 947 billets returned to Services
 - New Director's "500 Day Plan"
 - CINC representatives assigned & positive CINC assessments
 - Two-tier pricing
- DeCA
 - 29% personnel reduction since '90
 - Strategic management system and metrics
- DCAA
 - 39% personnel reduction since '90
 - Benchmarking: rates = 15% below commercial
 - Strategic plan and metrics
- DCMA
 - 54% personnel reduction since 1990
 - Consolidated districts (12=>3) and offices (1200=>67)
 - Strong strategic management system and metrics in place
 - Leads DoD's paperless Single Procurement System initiative

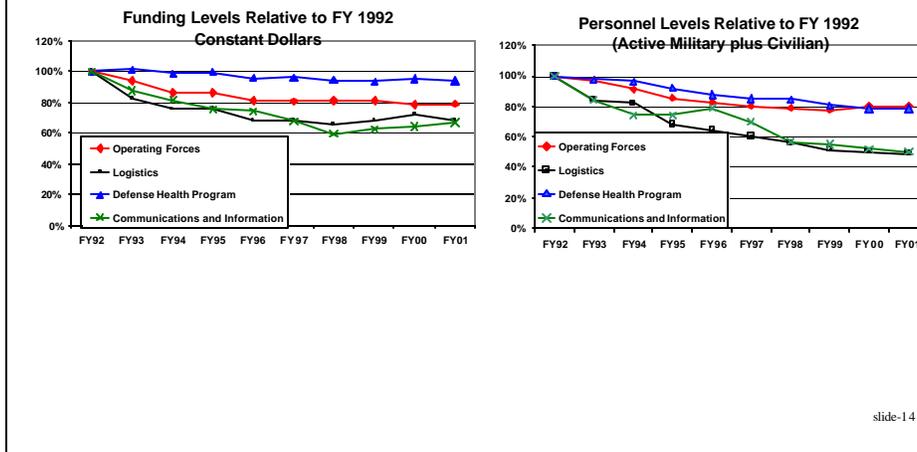
slide-13

There are two ways of looking at what the effect of the DMR and DRI was on the kind of overall efficiency of providing these support services. The first perspective is sort of the specific tales that the individual agencies have to tell about the economies that were achieved in their area of responsibility. So we've cited a lot of these things here. In fact, the record of the accomplishments of some of these individual agencies is pretty impressive and remarkable.

I don't think you can argue that they were standing still. In fact, quite the contrary. DLA has done a tremendous amount of innovation through the Prime Vendor Program and other kinds of innovative supply activities. They consolidated a lot of the depots.

If you look at DFAS there was a tremendous consolidation in the department-wide finance systems and accounting systems. They have targeted costs and cost reductions very severely in DFAS. DISA have also accomplished a lot of consolidation. So, the individual agencies have some pretty good tales to tell about the savings that accrued from the consolidation.

DoD-Wide Support Costs



Stan Horowitz prepared this DOD-wide look at support costs which lends credence to the notion that consolidation has achieved savings in some important support areas.

Now, these data are based on a PA&E's allocation of budget figures by functional areas. What we've shown in this chart is kind of an index beginning in FY92, because that's as far back as these data went.

You see that the operating forces are represented by the red line. We have the funding level on the left hand side, and personnel levels on the right hand side. What you see is that in fact the department has brought down funding and personnel for logistics and communications faster than they have the overall force levels.

In the health program area, the story is not quite so clean. Total medical spending has not come down as much as spending on forces. However, that's been an economy-wide issue. Personnel has come down, roughly in comparison with the total forces.

The argument this data makes is that the tooth to tail has gone up a little bit in some of these areas.

Next Steps Proposed for the QDR

Address Long-Standing Management Concerns

- Strengthen DoD-wide supervisory and investment mechanisms
- Accelerate high payoff end-to-end process initiatives
- Strengthen performance contracts, with improved metrics & benchmarking -- link them to program reviews
- Institute DLA & DISA pricing reforms
- Create privatization and outsourcing strategy--link to process initiatives

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I would like to conclude my presentation with this slide, which I think kind of anticipates a lot of the issues that we'll be talking about over the next day and a half. These are the five main points that were made in the IDA report. These are things that should be looked at, should have been looked at, and should be looked at in the QDR.

Basically, our conclusions were that a lot of what was intended by consolidating support functions in the defense agencies has been achieved. It has been the right way to go. However, this does not mean that things are rosy.

So we suggested looking at these five areas. The first really relates to the question Carl Dahlman raised to Dr. Chu. Is it appropriate to leave the day-to-day responsibility for the agencies with the PSAs, who are the Under Secretaries and the Assistant Secretaries? Or, do you need something above that?

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One of the issues that we saw, which is obvious when you think about it, is that the activities of the agencies, the support function activities, have to interface on a day-to-day basis with the Services. The chains of command between the Services and the agencies, since the agencies report up through the OSD staff, never really come together until you get to the level of the Deputy Secretary of Defense.

So you do run into the appearance that you have the OSD staff and the Agency on one side of the ledger, and the Services on the other side. It appears that that can sometimes inhibit collaborative solutions.

This brings me to the second point, which I thought was an important conclusion coming out of this study. The agencies need to interface with the Services in many different ways. Yet on a day-to-day level, we found that the hand-off between the Service-level activities and the agencies was often a significant problem.

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I'll give you one or two quick war stories to illustrate. DFAS has taken a lot of the central responsibilities from the services. To examine the pay area, we went down to the Norfolk Naval Base. They have an office that's responsible for collecting all the base-level information. The information then gets passed to Cleveland to the pay center up there.

They find they have a 7 percent error rate in the data. So they have a big office in Norfolk whose sole job is rectifying the errors in this automated system.

The problem that you run into is the service people are saying "Those damn guys in DFAS," and the guys in DFAS are saying "The damn guys in Norfolk." From what we saw, there is no real way for this to come together in the current organization.

We saw the same problem in the Defense Security Service. DSS has an automated system that was supposed to dramatically improve productivity. The service-level people do not have insight into the status of security clearances they are processing. One of the results of that is DSS receives a tremendous number of multiple applications for security clearances.

These are kind of mundane examples. However, all of you know that when you're trying to create automated systems, you've got to have that end in perspective to really make it work. We think that's a real big-ticket item.

The third one on our list -is really the business of creating expectations between the services and the agencies, meeting those expectations, and then tying that with the budget allocation process.

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I know that Secretary Rumsfeld has emphasized the need for metrics. We think the performance contract framework that PA&E has been trying to develop could be a very good way to go with that.

The fourth item here is pricing reforms. I think we have a whole session on that, so I won't talk about it. Finally, we agree also with a lot of critics that you really need to take a strategic look at privatization and outsourcing.

We think that it's not really just a philosophical matter of just getting things out of the government. We think there really are advantages to trying to look at the private sector for supporting these end-to-end process initiatives using the technologies and the skills available there.

Like a good economist, I'll conclude by saying that dealing with the agencies is an on the one hand, and on the other hand kind of endeavor. Like any really central support activities in any large organization there are certain benefits from consolidation. We're seeing those benefits.

But whenever you consolidate things, there's always the question of responsiveness to the operating organizations. How do you create the management structure that gives you the best of both worlds? That is really the way of looking at the challenge that the Agencies present.

Jim Locher: Thank you, David. Don?

Don Shycoff: After hearing the first two speakers, I'm not sure where I want to start. In terms of what I agree with and what I disagree with. So, I won't agree or disagree with anything. As somebody who participated with the DMRs, I think it's important to emphasize that I looked at Defense as kind of a business.

I said what was the output of our business? The output of our business was the operating forces. The Defense Agencies, if you will, were the supporting activities of those operating forces. But I tried not to forget that we were really looking at how we support the operating forces.

My experience in DLA, after having spent 16 years in OSD in the Operations and Working Capital Fund Directorate, gave me kind of an insight, which I was able to use when I came back to Defense in '89. Because what I noticed about DLA, was their devotion and the leverage that the services had in DLA.

There were an awful lot of people in DLA who spent their lives satisfying the services. In fact, as a budgeter, I couldn't stand those people. Because there was nothing the services wanted that they didn't get. I look at clothing - the only thing a Chief of Staff or a service can do is produce a new uniform. We got a lot of those.

So, with that background, I came in when the DMR report had been written. We had a license to propose some changes. I remember when we were proposing them, people would say to me, "You're going too fast. You're going too fast. Slow down." I would say, "You only do this every 25 years. You had McNamara, and now you have Don Atwood. But in another 10 or 15 years you'll find the next one that comes along. And we'll make some decisions."

So, during our time, Dave has just outlined those decisions that were made. Let me talk about a couple of them. One was the Supply Depots. At the time, there were approximately 30 - my numbers aren't too good anymore - of which DLA had six. While Dave Chu talked about the emphasis on cost, I will tell you there was an emphasis on performance.

As a matter of fact, if you will recall the decision initially, they were going to run a test in the Bay area. One day I called out to the Bay area, got some numbers, and took them to Mr. Atwood. I showed him just on a PCL, on the yellow worksheet, this was the effectiveness of supply depots - which can be measured in terms of the line items in and out of a building. This is what it was, and this is what it is now.

We went forward and made that decision. Everything I've heard since I retired was that the DLA has done a very good job in maintaining that effectiveness and in reducing costs.

We made others that are not as easy to measure and they are taking longer. One of those I'll switch on to DISA. We had an activity in the Department of Defense called the Defense Communication Agency. Paul Strassmann convinced me, because I'm not a techie, that communications was now taking place with a computer.

I became convinced that you could not separate communications from computing. Therefore you had to get them together organizationally. I'm not sure how well it has worked since then, because unfortunately Paul left and we didn't get it - and I don't think they've got there yet.

People were coming to me and saying "You cannot do that. DCA doesn't have the same outlook as the DLA people in terms of their responsiveness to customers." But I said "You have to do it." And so I will leave to others how well it has worked, and whether it will - and when it will finally get some success. I think we've had some cost savings.

Let me switch a little bit. The most significant savings that's come from these consolidation, we've hardly talked about yet. And that's single systems. There is no way you will get a single system with five organizations.

When we started this, we had 27 civilian pay systems. Most of us, if not all of us, get paid under the same law. Every time the law changes, 27 central design activities had to go out and make changes.

You'll only get to a single system by having a single organization. I used civilian pay as an example, but the real one is in the inventory management. That was one of the consolidations we didn't get. Jim Davidson is replacing one of the big protagonists on that, Ed Straw, in terms of a very articulate spokesman for the other side.

But we spend billions - I don't want to say millions - we spend billions on designing inventory management systems. Look today at what's going on with the enterprise systems. We're not going to one. How many enterprise contracts are there today?

I am convinced you won't get to a single system, no matter what leaderships or organization you have. It will only happen when you have one person doing it, or one organization doing it. We did not achieve the success we wanted with inventory management. We did get some consumable items transferred. That one didn't take place.

Jim Davidson: While we're setting up here, first of all, thank you for allowing me to join this distinguished panel. I'm pinch hitting for Vice Admiral Ed Straw. For those of you who know him, he's up in New York on his second career, or third job. He's had trouble keeping a job - he's gone from Rider to Compaq. He's now President of Estee Lauder's operations. So he has a perspective from a commercial logistics that I don't have. I have still been in Defense in terms of Litton, PRC, and Information Technology.

As was mentioned earlier on, I spent 35 years in the Navy. I entered in 1961, which so happened to be the year that DLA or then DSA was created by General McNamara, or Mr. McNamara. Those of you who have had an opportunity to meet Gen. McNamara, he's a delightful gentleman.

He would tell you he got what was left over from the services. All those depots, those six depots Don mentioned, were well within the boundaries of the United States. Certainly not a Navy supply center on the coast.

So, I grew up then, 35 years. Fortunately I had an early tour in 1968. In fact it was Lieutenant Ed Straw and me in Philadelphia. We were provisioning the A-7 aircraft. It was the A-7E aircraft, which was really a Navy aircraft. Somebody in OSD had forced it upon Air Force, so it was A-7D and A-7E, which made it a Joint airplane.

This really caused trauma. The rules then were that if an item was used by two services it had to go to DLA, or then DSA. Of course, we in the Navy didn't want anything to go to DSA.

So Lt. Ed Straw and I went up to our boss, who was a crusty old Navy Captain named Gene Grinstead. We said "Captain, we've got this problem. We've got to transfer these to DSA according to the rules, but we know that's the wrong answer." He said, "Young man, you're wrong. You ought to transfer those to DSA because those guys don't have to consult with the Service Secretaries. To get the spare money at the bottom of the budget, they go right to the top to OSD. So the Navy readiness is really better." I said "Oh, okay, Captain, I got that."

And that stayed with me for another 20 years. Later I had a boss in OSD. Not according to the wiring diagram, but in fact. The Comptroller - that was Mr. Don Shycoff. And he directed that we consolidate these depots, and I'll talk more about that as we go through.

- What is DLA
 - \$16.B Commodity wholesaler and a
 - Combat Support Agency...in theatre
- What were the benefits the past 41 years
 - To the warfighter...better
 - To the taxpayer...cheaper
- What are the issues/problems
 - Service perceptions...cost... focus
 - OSD...management oversight
- What should SECDEF do now?

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But for my mission today, what is DLA? What are the benefits, what are the issues, and what should be done now? As mentioned, it is a \$16 billion dollar commodity wholesaler and a combat support agency. They're in theatre today. DLA goes to war with the CINCs, and I think the CINCs would tell you that.

By the way, about \$8 billion of that is fuel, right, Don? About half of that is fuel. The rest: a billion in food, a billion in clothing, a billion in medical, and a couple billion for parts.

So, what are the benefits? I think they're obvious, as I've had the opportunity to read the reports that say the war fighter is really better off because there's more stuff for the war fighter. To the taxpayer it has been cheaper in the last 41 years. I'm delighted to read those reports that document those savings. There are some issues and problems I'll get into. Then we'll talk about SECDEF.

- **DLA today:**
 - *The DOD primary* inventory manager for consumables
 - 100% of Food, Fuel, Drugs, Clothing
 - 83% Class IX repair parts
 - *The DOD retail direct maintenance* provider for
 - Some bench stock at some depots
 - Pilot Class IX...for some Navy sites ...soon Army/AF
 - *The DOD requisition processor* all services
 - *The Federal Stock Number Data repository* for all DOD and NATO (DLIS formerly DLSC)
 - *The DOD distribution depot* system
- Bottom Line... Foundation of DOD logistics today!

slide-25

We mentioned DLA today has 100 percent of the food, fuel, drugs, and clothing. To give you an idea, ten years ago when I was in DLA, we had milcon to build a warehouse for food. We never put any food in it. This is because DLA, to its credit, as Don suggests, got with the food industry and made that prime vendor or direct vendor delivery.

Today, food does not go through a government warehouse. Even in Afghanistan, the food is coming out of Europe. It does not go through a DLA warehouse and saving receipt, stow, and issue costs. So those savings are real. There's no question about it.

Most of the issues center around repair parts. Weapons system support. I'll get into that because there are some problems there from time to time. What's exciting to me right now is DLA is moving beyond being a wholesaler to being a retail provider beyond food, drugs, or I might add drugs - the pharmaceutical trucks back right up to the hospital. The inventory is in the truck.

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- Bottom Line... Foundation of DOD logistics today!

slide-26

That's pretty exciting compared to what it was in Desert Storm when we had IV solution in 15 warehouses getting ready for Desert Storm. By the way, we had as we know, Desert Shield, Desert Storm, and Desert Surplus - that was the rest of it.

There were a lot of lessons learned in those days. Despite all of that, DOD - all of the requisitions for all of the services go through DLA activity. Some of you don't realize it, but that is incredible the capability that we just take for granted. Now, it's gotten modernized and there may be some little problems here and there, but that's all the requisitions from all the services.

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- **Bottom Line...** Foundation of DOD logistics today!

slide-27

The DLA runs the Federal Stock Numbers. Now, some people will criticize the Federal Stock Numbers and say we should go to UPCs. Mr. Strassmann can talk much more about that, about what the industry practices. In the end, it's the repository for all DOD and NATO. There's five million stock numbers; four million of them managed by DLA. By the way, DLA runs the DOD distribution system.

My point is the DLA today, right or wrong and I think it's right, is the foundation for logistics. It's what enables Secretary Rumsfeld or Chairman Meyers to execute, to get logistics there, hopefully just before the troops get there.

- DLA Benefits
 - Single buyer for common items for DOD
 - Single wholesale distributor for DOD
 - Economies of scale vs. service managed
 - Surge capability
 - Inventories more flexible and agile
 - Easy to use for Soldiers, Sailors, Airmen, Marines
 - Leader in outsourcing and privatization
 - Support tailored to market ...one size does not fit all

- Bottom Line: Taxpayer wins!...*More Effective for the readiness of the warfighter...at less cost than the alternative*

slide-28

The benefits, obviously the single buyer and the wholesale distributor. But the economies of scale is saying, what is the alternative to it? Let the services manage it. I think it's clear that there are obvious benefits in economies of scale.

More importantly almost is the surge capability. Particularly in this day and age of war fighting where it's asymmetric threat. Where is it going to happen? The ability to move inventories to the new point of need is absolutely a war fighting capability.

I can recall again, Desert Storm, when we looked up and said "How many chem suits do we need, and where are they?" Oh, my God, they were in the POM stocks in Europe, and they were in Korea.

There's much more to that story, but that's an example of who owned the inventory and who could move it, as compared to today as we move forward, that with DLA's ownership of the inventory, up to point of consumption, allows that flexibility and agility of the inventories to be a war fighting enabler. You don't have to say "Mother may I?" and go through three staffs to get something if it makes sense to the national command authority.

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slide-29

In that regard, it's really easier for soldiers, sailors, airmen and marines. They can point, click, order it, and it comes. They don't have to go through the yellow pages to find something.

Even though there are people out there that will say "We ought to get rid of this arcane system and go to FedEx to the foxhole and do it like Wal-Mart does." I would argue that DLA is doing that, where it makes sense. It's an evolution, by commodities that lend themselves to a commercial marketplace. In the end, in weapons systems support, frequently there's only one producer and one user. There's not many commercial activities that are interested in funding that \$60 billion dollar inventory.

So the point being, on a bottom line basis, the taxpayer wins. It has been more effective for the war fighter, including Vietnam when I got parts on the Oriskany in the Tonkin Gulf within three days if I needed it. The same forward through Vietnam days all the way through Desert Shield, Desert Storm, Kosovo, Bosnia, and today in Enduring Freedom. It's certainly at less costs than the alternatives so that's been demonstrated. So that's great. Now what?

- **DLA Problems**

- Actual shortfalls in local supply availability in support of service managed weapon system maintenance and sustainability
- Perceived lack of focus on customer...the warfighter
- Perceived inefficiency... high cost
- Inconsistent inventory investment
- Outdated information systems
- Current OSD policy encourages Weapon Systems Program Managers to free lance outside DLA.

- **Bottom Line...Can do better...with help!**

slide-30

There are problems. There actually are shortfalls in supply availability. A couple of years ago, or certainly last year, there were a lot of articles in the press about "Oh, my God, the hollow force; we're going back; readiness is going down." In the Navy we talked about it and talked about it. Stay behind readiness. That we were okay with the deployed forces, but the squadrons came back and they had airplanes down for parts. That was also true in the Air Force and the Army.

Frankly, what happened then was there were big studies, at relatively high levels with people who had not been around the business very much. They came away, they said "Ah, the parts are the problem." They pointed the finger at DLA and say "See there - DLA screwed up. We ought to give it back to the services."

Well, the truth of the matter is, and I think you can find out, that DLA did screw up a little bit. Some of these charts and studies will show you that it was substantial decrease in the funding of inventory.

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- **Bottom Line...Can do better...with help!**

slide-31

Just like everybody else that manages scarcity, you figure out how to prioritize the money and DLA in the middle 1990s bought a lot of cheap stuff and filled the shelves and made the availability look better. It was better, on a percentage basis. They didn't buy the high-cost items.

So statistically it wasn't bad, but in fact it hurt readiness planeside. And that's not talking out of school, that's been fixed. They threw \$100 million dollars at it. My point is that this has been happened before. In my career, we would underfund the spares and have a crisis, get everybody excited, and they'd throw a bunch of money at it. I'm saying it's an inconsistent inventory management investment process. It's a bureaucratic process. It's not anything other than that.

But, outdated information systems, as Don alluded to, that the consumable items are okay, but we never standardized the systems. That's true. DLA today is modernizing their SAMS system with what's called BSM - business systems modernization - with a commercial COTS product.

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- **Bottom Line...Can do better...with help!**

slide-32

That's great. But so is the Navy - it has four different pilots for commercial COTS. Army has one great big program. Air Force is doing what they call spiral development.

In the end, there is a lot of money being spent. Hopefully more productively than it was spent in the first five years of the 1990s on JLSC when we tried to standardize it and put \$1.8 billion dollars down the tubes with nothing out of it.

So there's been problems. There's still problems in information systems. I would argue that there's also a little bit of a problem in OSD from a policy perspective, in that the acquisition side not only encourages, it practically directs program managers to go out and develop their own logistics system. That is, to freelance and to go around DLA and quote "save the surcharge". Which gets into the pricing issues that will come up this afternoon, I hope.

So, bottom line, DLA has done great, but they can do better. However, they need some policy help.

- What should SECDEF do about DLA?
 - Modernize the information systems
 - DLA the defacto foundation of service logistics IT systems
 - BSM the sixth try in last 20 years
 - Accelerate implementation of PBD 422...management of Retail inventories... better readiness through better visibility
 - Direct Weapon Systems PM's to use the DLA system *interactively*...take advantage of scale while exchanging logistics info...tech data, maintenance and reliability data...inventory availability... for service and DLA decision support systems
- **Bottom Line: *Make DLA better...more effective...higher readiness for warfighter...more efficient for taxpayers***

slide-33

So what should SECDEF do? As I alluded to, I believe going after modernizing the information systems is the key, as Don alluded to. The de facto foundation of service logistic systems is in fact the DLA system. And we think DLA is on track with BSM now, business systems modernization. But it is the sixth try in the last 20 years to modernize that system.

There is a PBD out, 422, that says DLA ought to take over management of retail inventories. I totally agree. It's a great idea. They're moving forward on it. It'll get better readiness and better visibility. It's not easy. Because it has DLA pushing material to a variety of stock points, all the way down to point of consumption. Whether it's in a depot or plane side at an air station, or on a post dealing with some combat support environment.

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slide-34

That's a good idea. Meanwhile in the new systems, I believe that the policy ought to be torqued just a little bit to allow, or to not direct PMs to use the DLA system interactively. Today's technology ought to be able to exchange the information on both the program manager, the operator, and DLA in terms of a decision support system.

The bottom line is, DLA can be better. It can be more effective. There are lots of measures - metrics to measure it. But in today's readiness it's better for the war fighter than it otherwise would have been without DLA. It's also more efficient for the taxpayers than it otherwise would have been without DLA.

Background

- Starting in 1960's U.S. corporations create "Services Divisions."*
- Starting in 1970's DoD creates "service" Agencies.
- Objectives:
 - Realize economies of scale;
 - Consolidate scarce resources;
 - Permit performance measurement.

* Strassmann, *Managing the Costs of Information*, Harvard Business Review, 9/1976 slide-35

Paul Strassmann: It's a pleasure to be here. I will concentrate on one issue, and one issue only. That is, measurement of performance. In a hierarchy of requirements to run an agency, the question of performance and particularly of productivity, is the one that has to be answered before you can get into subordinate issues which are equally important, but nevertheless subordinate. Such as quality, availability, readiness, the war fighting conditions, and so forth. I will narrowly concentrate on money and money only.

The reason I will concentrate on performance measurement is that you should appreciate the fact that in 1961 the General Foods Corporation created a DLA kind of distribution services organization. I was involved as an analyst in that venture. As the distribution services organization grew, management became increasingly concerned about the kind of issues that you pointed out. Namely cost, responsibility, hand over, systems compatibility, and so forth. I was particularly working the piece of interoperability between plants and distribution.

Background

- Starting in 1960's U.S. corporations create "Services Divisions."*
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- Objectives:
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* Strassmann, *Managing the Costs of Information*, Harvard Business Review, 9/1976 slide-36

In 1970, I became the founder and general manager of a DISA-like organization of Xerox Corporation, where I owned the data centers, telecommunication, programming, management services, and so forth.

After the first two years of jubilation, the questions started coming up, "Well, how well are you performing?" I got thrown out of a meeting with the Board of Directors because I did not have adequate, verifiable indicators of performance.

I will be specific - I will show you how you assess Defense Agency performance. I will concentrate entirely on Defense Agencies.

I will then concentrate on performance measurement, recognizing that there are other issues.

How to Prove DoD Productivity Gains from Agencies?

	1990 Manning	2001 Manning
Army	1,200,000	61,000
Air Force	820,000	405,000
Navy	920,000	405,000
Marine Corps	205,000	198,000
Total Services	3,145,000	1,069,000
Total 14 Defense Agencies	100,000	200,000
Agency-to-Services Ratios	31.5	5.3

Note: Manning approximate, scaled from IDA graphics

slide-37

This is an example of the kind of newspaper, Washington Post stuff that gets thrown at you sometimes. The agency to service ratio going from 31.5 to 5.3 saying "Well, what in the world is going on? The services are going down by almost two million, and you guys are doubling."

Performance Results Act Requires Measurement

- Sect 1115;(6): Describe the means to be used to verify and validate measured values.
- Sect 1116; (2): 'Outcome measure' means an assessment of the results of a program activity compared to its intended purpose;
- Sect 1116; (5): 'Performance indicator' means a particular value or characteristic used to measure output or outcome;

slide-38

The next slide is even more sort of scurrilous. You pick a certain number. Then you quote the number. That is supposed to then act as a way of discrediting the whole program.

Why Total Performance Measurement is Important

- The CORM also observed that 21,000 are employed by Defense Agencies to administer the Department's contracts with industry. Such administration was estimated to increase the cost of products by 18% .*

* [Commission on Roles and Missions \(CORM\), 1994](#)

slide-39

The next slide is more serious. I will try to address the issue David Chu pointed out this morning, performance measurement - how do you measure output?

Proposed Measure of Productivity

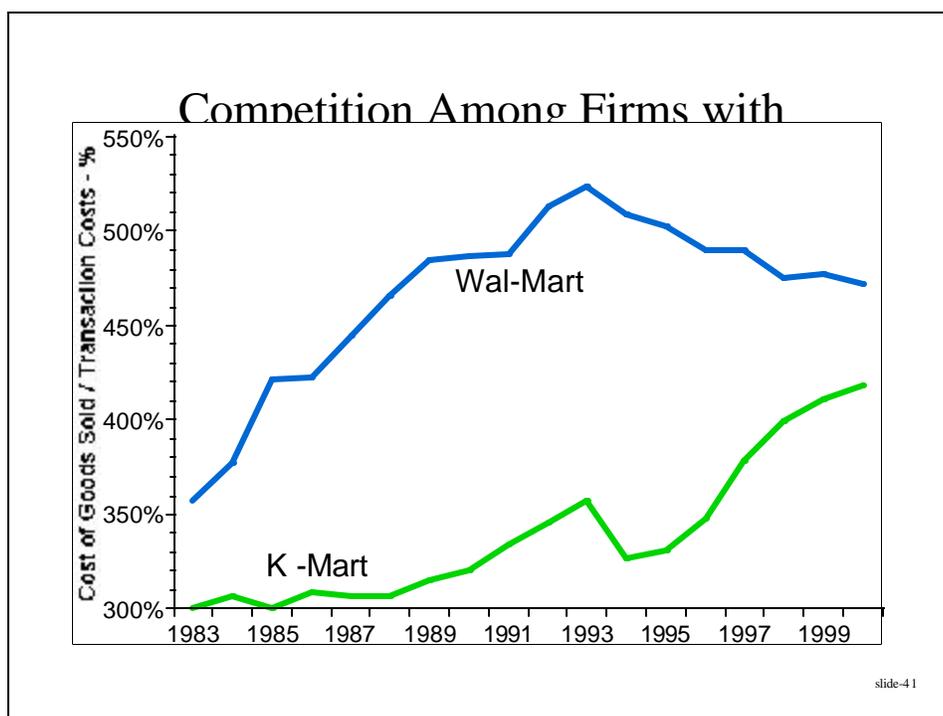
$$\text{Transaction Productivity} = \frac{\text{Output}}{\text{Input}}$$

$$\text{TP} = \frac{\text{Cost of Goods}}{\text{Cost of Transactions}}$$

Note: © Information Productivity is a Registered Trademark of Strassmann, Inc.

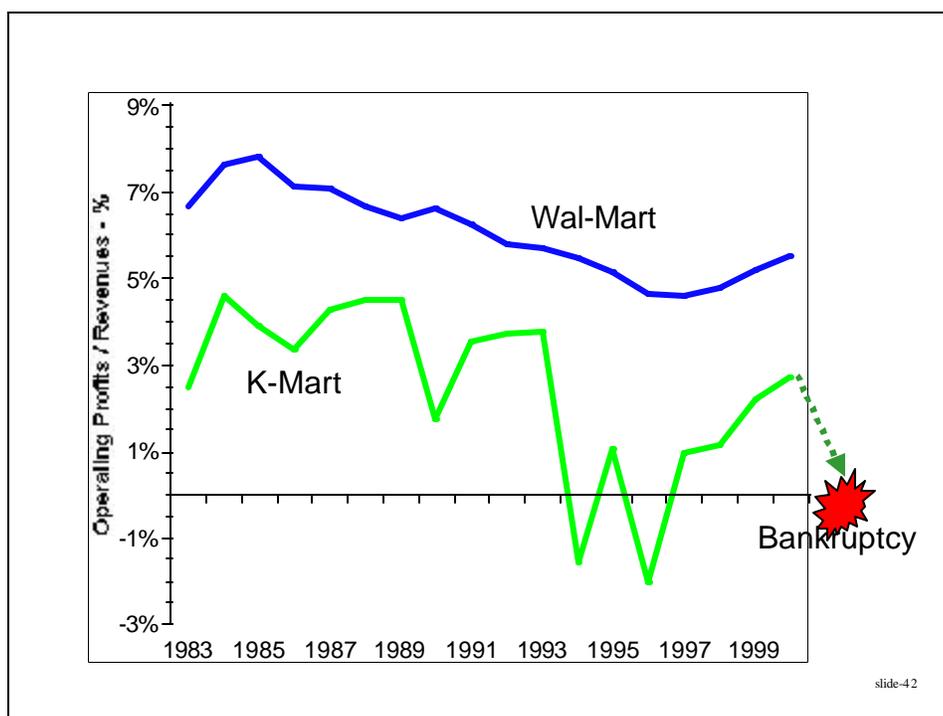
slide-40

What I will propose to you today, is a measure that I've successfully used for almost 20 years, called transaction productivity. By the way, this has been presented to the Board of Governors of the Federal Reserve. I just published transaction productivity ratings for over 2,000 U.S. corporations and over 500 European corporations. So this is something that is well-documented. It's something that I do continually.



What I will show to you is what the thing really looks like from a top level standpoint as seen from a commercial environment. I will compare the transaction productivity of Wal-Mart versus Kmart. As you may recall, Kmart was much bigger than Wal-Mart, and presumably was benefiting from economies of scale.

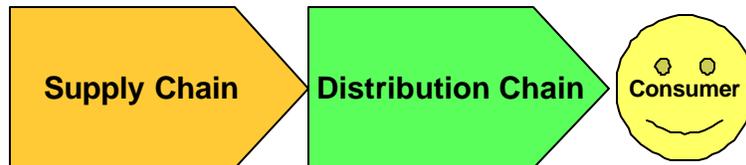
Meanwhile, these guys from Arkansas were just driving their transaction productivity until finally in 1995 Kmart woke up to the fact that their transaction productivity was lagging Wal-Mart's.



By the time Kmart tried to improve their transaction productivity by spending DLA kind of money for improving information systems, they just ran out of cash and crashed.

The lesson here is that I've now been tracking this transaction productivity like phenomena at the top level for a large number of corporations and organizations. I'm convinced that at the top level the ability to look at transaction productivity is the first indicator that a company or an organization like DFAS, DLA, or DISA really have to respond to.

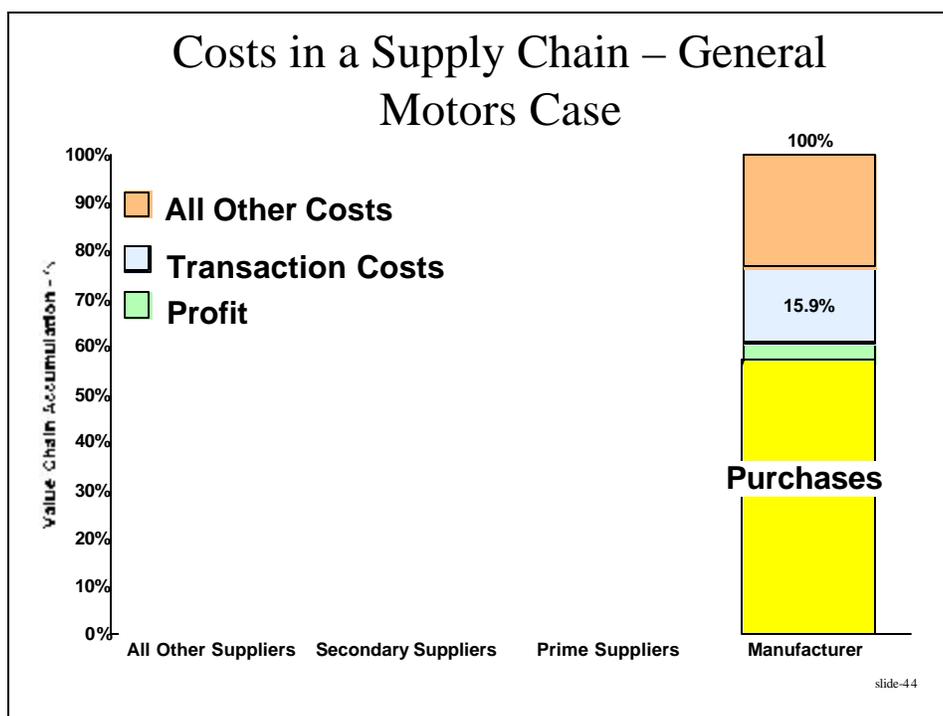
How to Measure Transaction Costs in the Value Chain



slide-43

Why this is important. I will now demonstrate to you by looking at the problem that has been hinted here a number of times, namely, can you look at transaction productivity in isolation? In other words, can you look at DLA and say "What is the transaction productivity of DLA?".

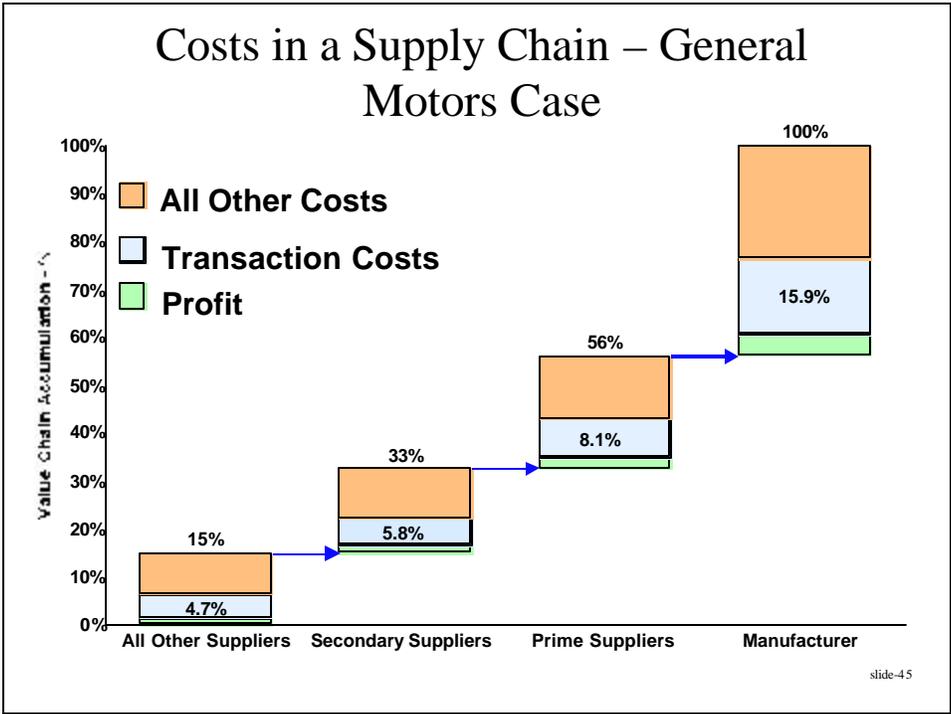
I'll submit to you that it is not possible. I will show you why it's so, and what should be done about it. So I will start with what's called a supply chain, then a distribution chain which is the feed all the way down to the consumer, and show you what are some of the cost ratios.



Now I'm going to look at General Motors. These are real 1998 GM numbers. When you look at GM, they buy 57.5 percent of goods in parts and materials from others. They have all other costs which are called organic costs. Then they have transaction costs. That's what General Motors looks like.

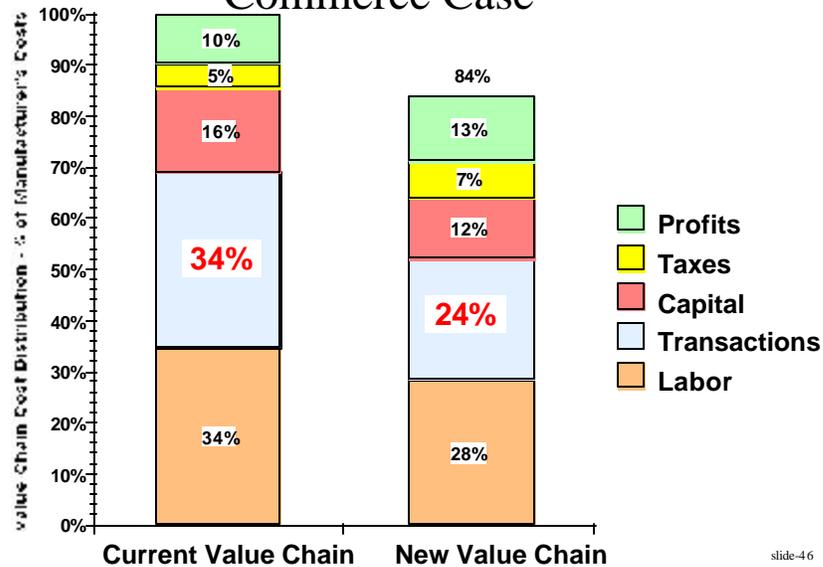
Can you evaluate General Motors on this basis? The answer is no. General Motors purchases are really the result of a supply chain that cascades in and that has to fill out forms and has to do all sorts of unnatural acts to comply with General Motors stock keeping units. This gets into the whole issue of coding, record formats, and so forth. This is what the e-business is trying to address with a great deal of pain.

But you see that the transaction costs are not just General Motors' transaction costs. Everybody else is adding their transaction costs, which ultimately has to be paid for.



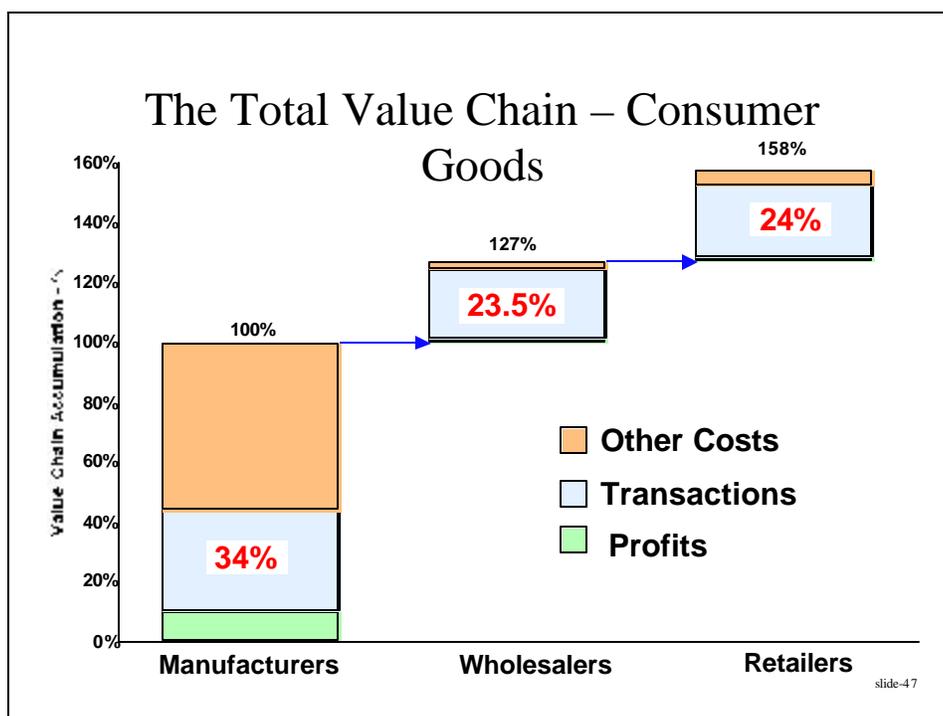
So that when you sum it up, actually, the General Motors supply chain has transaction costs which are equal to their costs of goods. By the way, I have companies where transaction costs exceed that. There are companies that have a sufficient number of lawyers and acquisition personnel - that sort of paper shufflers - to account for the money. And doing a very good job, following existing procedures.

Potential Supply Chain Gains – Best e-Commerce Case



slide-46

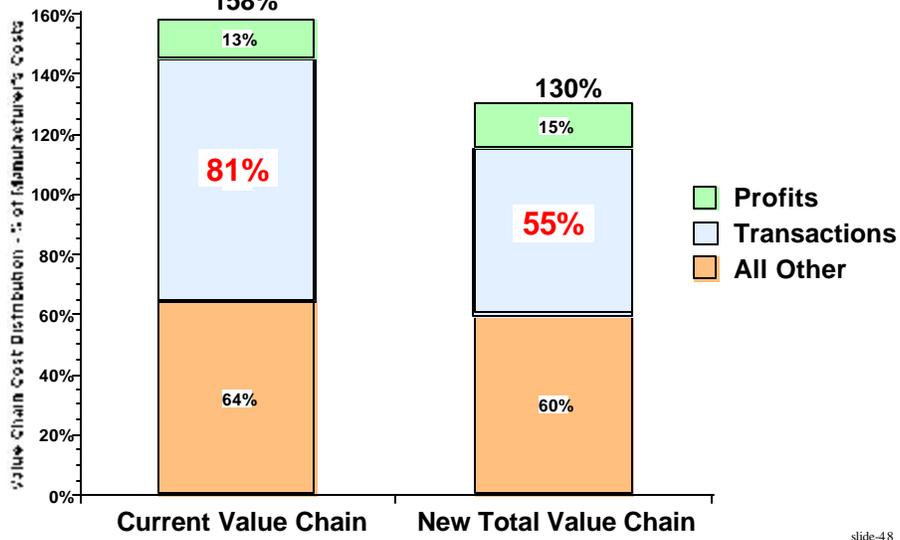
I have now looked at the automobile industry, and I see that there is an enormous possibility to change the transaction costs. This is an e-commerce case. So, what I suggest to you is a starter. For instance, for DISA, you would have to look at your current value chain, with all the subcontractors, contractors, outsourcing, and telephone company purchases and what have you. Then look at what's called the best e-case. Then compare yourself - how close you are to the e-case, before you could stand up before a Congressional committee, and demonstrate best practices.



Let's now look at the downstream thing, which is the consumer goods side. There, almost everything downstream is transaction costs. So that when you look at the U.S. manufacturing corporations - and by the way, this is a summary of over 2,000 corporations - what I see in the next 20 to 30 years is a massive reduction in transaction costs as e-commerce kicks in.

As the direct linking between the point of consumption to the point of supply, subject to integrated control, allows enormous reductions in costs. Delivered costs and also increasing profits.

Potential Total Gains for Consumer Goods



Different Measures of Transaction Productivity

	Cost of Goods	Transaction Costs	Transaction Productivity
Corporate (Agency) Case	79%	16%	497%
Supply Chain Case	34%	34%	100%
Supply + Distribution Chain Case	64%	81%	79%

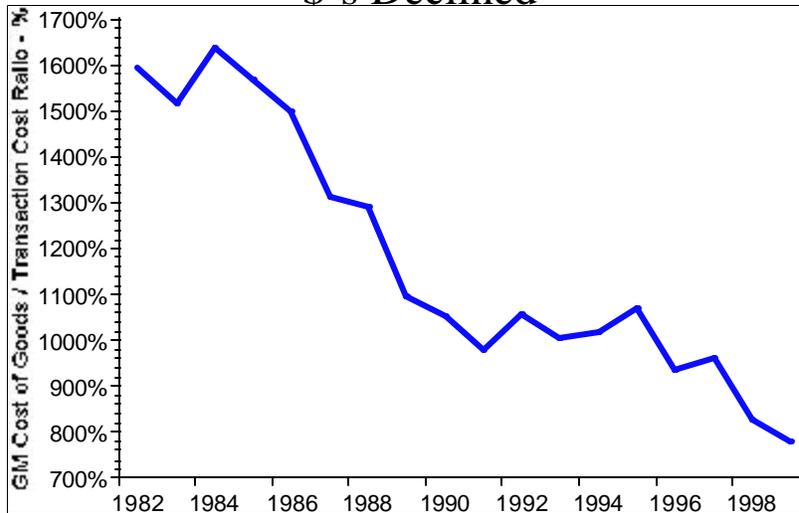
slide-49

Let me show you some of the calculations of how you can fake things with numbers. You can look at the cases I gave you, and say, "Well, I'm only going to look at DLA in isolation. I'm only going to look at design isolation. I'm surely only going to look at DFAS in isolation." I'm going to run Strassmann's numbers through. As you could see here, I can show that my transaction productivity in isolation is 497 percent.

On the other hand, I have to submit to you that I can make those numbers come out any way I want by outsourcing, or by hiring contractors. If you take what's called the total supply chain costs, your productivity goes down 200 percent. Then when you include the distribution which is end-user, the payroll check delivery without errors, corrections, and without adjustments to somebody - the number is 79.

The issue as I see it in the future will be the negotiation as to what are the appropriate metrics for agency performance? It will vary from 497 to 79 and all numbers in between.

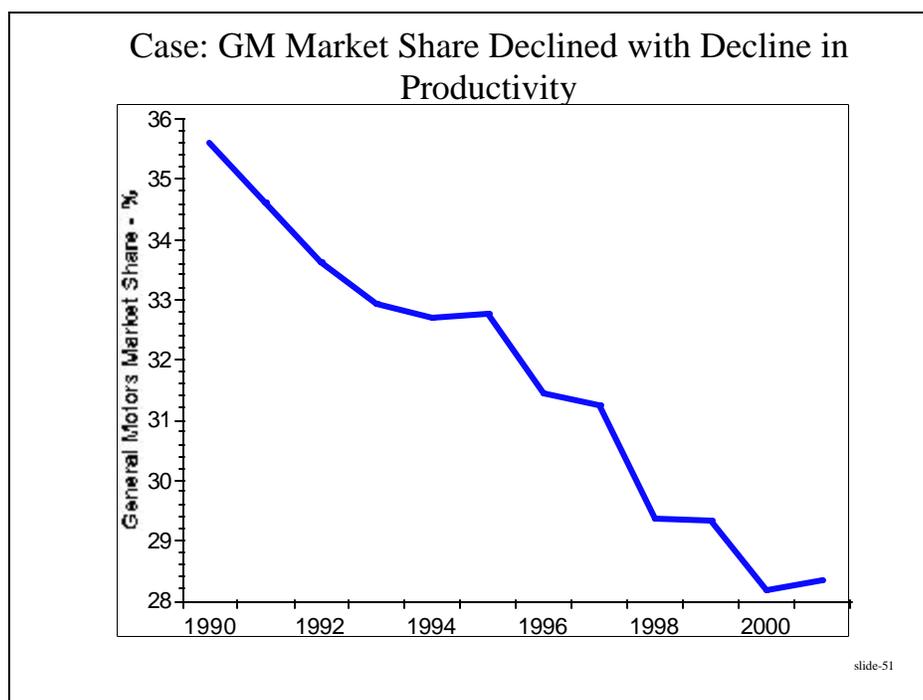
Case: GM Cost of Goods per Transaction \$'s Declined



slide-50

Let me now conclude with a case that I've been tracking now, and writing about, which is a dismal case. This is General Motors, the largest corporation in the United States. Presumably, the largest user of information technology in the area of logistics. Subject to a number of articles, particularly by computer vendors, showing how wonderful General Motors is.

I want you to see this is the declining transaction productivity of General Motors. As the transaction costs increased faster than the cost of goods, there has been a halving of their transaction productivity. This is bad news for America. This is bad news for General Motors.



When you look what has happened to General Motors particularly on the impact of Honda and Toyota, is that the slope of the market share almost coincides with the slope of the decline in transaction productivity.

Let me come to a conclusion. At this meeting devoted to the issue of the future of DOD agencies, may I suggest to you that the number one issue that will be emerging over the next decade will be a question of agency performance.

The GAO is just looking for this sort of thing. Congress will be looking for it. Again, we are dealing with enormous operations, enormous enterprises. I submit to you that without verifiable performance measures as to the ratio of output to input, the future of DOD agencies will remain questionable. With those kind words, I'm sure that my totally non-controversial remarks will be subject to some questions. Thank you.

Summary

- *Transaction Productivity* can be used to measure DoD Agency performance.

slide-52

Jim Locher: Thank you, Paul. Now, before we turn to questions, I would ask any of the panel members if they have an additional comment they would like to make in response to another presentation or something that has come to mind? If not, we're ready to take your questions. Yes?

Q: Mr. Strassmann, it was a very interesting presentation. Could you tell us a bit more about how you define the transactions expenditures you're talking about? Also, could you tell us how easy it would be to measure those with current government cost accounts?

Paul Strassmann: Answering the first question, it is for purposes of large sample analysis I use the cost of goods, COG, by FASBE standards: good, bad, or indifferent; sufficiently large sample, eliminating some of the cheating that's going on.

COG, which is a standard line item on any financial report filed with the SEC is the cost of goods. Transaction costs are then SG&A, sales general and administrative costs.

Now, to answer your second question, the accounting system in DOD is hopelessly inadequate to even approximate such a calculation.

Q: Do you have any suggestions on how the department could move in the direction you're suggesting, short of changing our cost accounts, which is always the first answer to everything.

Paul Strassmann: I have very little hope for change of the cost accounting system in DOD. What really has happened is that I encountered similar situations both in General Foods and in Xerox. What has ultimately happened, management just threw up their hands. Because there was squabbling between operating

divisions and the service divisions. They just outsourced the whole thing. They said "Get rid of this thing."

By the way, very often it was very bad, mixed results. But in desperation and under pressure for profits, outsourcing is the answer to the inadequacy of the accounting system in American corporations. Regrettably so.

Jim Locher: Some additional questions?

Q: This is for Mr. Shycoff or Mr. Graham or whoever wants to answer it. You talked a little bit about the need for better supervisory mechanisms at the OSD level. And since so many of the Defense Agencies use revolving funds, can you talk a little bit about what kinds of tools might be available at the OSD level, and what kinds of information might be needed there to do a better job of supervising?

Don Shycoff: Well, the use of revolving funds is, in my mind, used basically to make the customer the supervisor. If it works right, the pricing mechanism and pricing should equal costs. So that's one answer, ultimately you have to work for the customer.

Otherwise, as some of you know, I wrote a book on Defense Agencies. I proposed a Secretary equal to the Secretary of the Services, to manage the Defense Agencies, and not to have the management in the policy offices of OSD. That's what I would do.

Q: For the supervisor - what role would there be?

Don Shycoff: No, the customer would not be the supervisor. The customer is a service, buying something from DLA. They put a lot of pressure on DLA. The Service is buying from DFAS or buying from DISA. As Paul says, and as we see, we often say, "Well, this isn't any good, so let's go to another source." Or as Dave Chu said, "Let's build our own capability here."

I know for a fact the Air Force and Navy have depot systems that were set up because they didn't trust the DLA depots. So, you're always going to get that.

In my mind you have to get the prices right and have the customers pay. Hopefully you will get a system in which the customer finally realizes that what he has set up as an alternative is costing too much. To reduce his overall budget he'll get to the point of buying from DLA, or buying from whoever.

Debby Christie: A brief comment on something Don said. I think one of the problems we'll probably talk about this afternoon is that the customer frequently does not know his true full cost. They simply can't see it. They know what price they're paying the agency, but they have no idea of the alternative cost. In fact, it frequently appears free to the customer, which is one of the big problems I think we have.

Don Shycoff: I think you're right in that he doesn't know his total costs. Many times he knows what he's paying, but he doesn't know what it costs him to produce. From time immemorial, since we've had industrial funds, we've had customers objecting to the costs of industrial funds. Mainly because all these military people they have doing things, they're free to them. In fact that's probably the most significant costs that they don't incur, or don't get charged for.

Dave Graham: We talked about a couple of models for the top levels of management. One that Dr. Chu mentioned would be to create a super-agency, roll a lot of these activities under a new Deputy Secretary or something like that.

We also talked about another model, which I think also has a lot of merit. That is to really strengthen the staffing support to the Deputy today and have them focus on really a couple of things. One is establishing a set of performance metrics. I would think the current PSAs would be able to administer - would be part of that mechanism.

I think that what Mr. Strassmann is talking about is right on the mark. How do you really look at these end-to-end processes and begin to understand whether they're working well?

The second big thing that really needs to be done was pointed out by Adm. Davidson's comments on DLA. That is, you are working on an end-to-end distribution initiative to try to unify that. But look at the big players. You have DLA answering to OSD; you have TRANSCOM; and then you have the CINC commanders who have responsibility for logistics and for theatre.

Where does that come together? How do you get the leadership that really drives the kind of end-to-end solutions that you're talking about? I sort of see somewhere, and as I said earlier, it really doesn't come together until you get to the level of Deputy and Secretary.

You've got to create the horsepower that is able to ask the questions, to drive the creation of metrics, and also address these end-to-end process issues. Somebody who can break the ties and get away from weak compromises if the system might drive you that way. So that has been our thinking.

Jim Locher: One of the problems you have with the OSD staff supervising the agencies is you end up with ownership behavior - the staff versus line distinction. You have the corporate headquarters that owns part of the business.

In talking to Deputy Secretaries of Defense, they find the principal staff assistants often come forward as advocates and do not provide them an unbiased view. Deputy Secretaries of

Defense have had to go off and create their own capability to provide some independent examination of the agencies.

The agencies grew up, initially as small Mom and Pop kinds of organizations. They eventually reported through an OSD principal staff assistant. Now that they're so large, the fundamental question of whether assigning a line responsibility to a staff organization continues to make sense.

Q: From your perspective on how this went forward, did OSD provide the type of arrangements that you liked, or were there other arrangements that would have made more sense to you? Given your experience having done this ten years ago, how would you do this differently to get better OSD oversight?

Don Shycoff: I mean, we were so perfect, how could you do it better, right? Ha, ha. I'm not sure how to answer that question. A lot of it has to do with individuals as well as institutions. It's where the power is located. I don't see anything in the OSD organization that affected the results. Or, not necessarily the results, but what we established, getting to the decision of what we established. That was individuals more than it was any organizational setup. If I could answer it that way.

I will say that one of my frustrations more as a DLA person who had worked in OSD, is what we call a PSA. That policy person in OSD doesn't usually have a lot of influence over the Service. Many times they manage the hell out of the Defense Agencies because they can't manage the Service. DLA found that.

There were things that happened in DLA out of the lowest levels of OSD because they couldn't get into the Services. So there was this one place where they really had influence. The one place. I would go to the Director of DLA and say "Go over their heads. They're nothing." Or they were afraid to take them on. So some of that goes on too.

Q: At a meeting I was recently at in Oklahoma City, the issue came out that it was not possible to perform the needed number of aircraft reworks because we couldn't get the support we needed from DLA for things like nuts, bolts, washers and spacers.

So, we're holding up production of PDMS for aircraft on the basis of these little items being missing. Couldn't make them ourselves? Yes, we could, but we're too busy. Can we outsource it downtown to a Mom and Pop shop? Yes, but we're not allowed to because DLA would sue us.

It is on the basis of such anecdotes that you see the hostility towards the central management of DLA.

It's nuts. We can't go on that way. We need better metrics, better service metrics.

The next issue is that in the Air Force now, through some research that they're doing , they are to manage the whole supply chain in a different way, and centralize the repair of parts in the depots. This would be done on the basis of a centralized algorithm which is based on a system called drive and express.

The metrics they want to use there is - will be things like cannibalization rates and sortie capability. I think the last one is quite a good one.

But the point is that we often use flawed metrics. Examples are full mission capable rates and time waiting for parts to arrive. These are seldom related to actual requirements.

You can actually often meet the sortie requirement of a particular weapons system at rates that are lower than those set for mission capable rates.

And so today we are moving toward being able to manage the supply system using intelligent models that include costs and allocate scarce time, scarce people, and scarce assets to repair those items which give the highest output in terms of marginal contributions to some metric. We've got to get those metrics. And they've got to reflect real operational requirements. But we're not there.

It's a very important topic.

Jim Davidson: May I respond to that?

Jim Locher: Yes.

Jim Davidson: You hit several subjects, but the one that you describe as people rolling in and saying "Oh my God, I can't do the KC-135 PDM line because I don't have nuts and bolts." Ironically enough, I can make another argument that they have nuts and bolts from three different sources. They have a program manager that has a PBL type of contract, that's going to fill up the nuts and bolts. They have an inventory DLA out buying the same nuts and bolts that they may have the PDL contract on. And oh by the way the PM for the KC-135 thinks he's in charge because OSD told him he was in charge.

I would argue we're providing the same item from three different directions today, at the depot in North Island and other places around DOD. I continue to have that conversation. So there's a lot of flak in the air.

More importantly, I completely agree with your point that in my experience we never fully solved getting the right parts for depot maintenance. So you had backlogs of airplanes, backlogs of engines. It became a jobs program for the analyst to try and figure out, you know, how many parts and how many dollars are going to fix this thing.

So we outsourced it. In the case of the F-18 engine, GE can do it. I can remember frankly GE coming in and telling me they can do it better than we can. Results were the same. We've still got bare firewalls, engines backlogged because of the difficulties in predicting the next part.

Having spent a lot of money and a lot of years trying to buy, in some cases with unlimited funds in some years, to throw everything that somebody thinks they might need, and we still missed it. So I'm interested in these exotic new models, but I know that they'll have to be based on data. The quality of the data and what goes on at the depot, what goes on at the field level, and what goes on in the aircraft carrier. Those systems are not in place today. The Air Force and the Navy do not have it. They may have systems, but they don't pull it all together.

Then you have a 1.5 hour sortie for a Navy airplane, for years, until last month or two months ago. Six hour sorties or these 14 hour sorties. Back to your arithmetic of your model. If you're going to measure sorties, you're going to measure flight hours, and it's a simple "gozinta" - how many parts goes into how many hours?

The sophistication of the model does not matter. While I've got the floor, one final thing. Don alluded to this. He mentioned that little war story as the Pentagon wars or the DMR when he went to the Secretary and said "Look at how screwed up they are with this prototype out in the Bay area." That was a little personal, because that was my prototype.

Don Shycoff: No, I said they were better.

Jim Davidson: There was an Army facility at Sharp and a Navy facility at Oakland and the Air Force's was Sacramento. It was a 60 mile triangle. We could have tested anything, got the real metrics, and gone forward to convince the Services that this was a good idea and that really we're going to be better off. Because we knew it.

But it didn't happen. We had this emotional outburst in the Pentagon. They said, "Oh my God, the Services are building a case against us. By God, 1 February 1990, all depots, all 30 of them, go to DLA." It was arbitrary, capricious, I would argue communistic. Ha, ha. The Wall had come down. But the result is why I'm going through this anecdote. The Army, Navy, Air Force and DLA focused on how are we going to make this work.

If you'll recall history, 1 February 1990 was kind of during Desert Storm. Or, 1991 was when we did it. I said 1990, meant 1991. Because it was right during Desert Storm. And Desert Shield had occurred before that. At New Cumberland Army Depot, there was a parade of trucks going around trying to get into the new facility.

And they were out there what, Don - ten, twenty, thirty days trying to get in to offload? So that we could offload the trucks and then load the trucks to go the other way to Dover to fly it to Desert Shield.

So the lesson learned was when you make the decision, make the decision rather than drag it out. If we would have done it the other way, we'd have had the prototype in the Bay area and then we'd have gone piecemeal across the country.

The energy in defense and offense and which side of the table you're on and where you see is where you sit, is a lot of wasted effort that never gets measured. So my message is, make a decision now. That's what OSD should do. Go for it and get the attention on that. Including parts, nuts and bolts, for engines.

Jim Locher: Mike?

Q: Thank you. I'd like to offer a question as sort of a devil's advocate, and push back a little bit on some of the solution sets offered. Just to sort of promote discussion a little bit.

I've been involved with some work over the years which confirms some of the observations made by the panel this morning. It is consistent with the idea that yes, when you have Defense Agencies under principle offices in OSD you do get ownership behavior out of that. That's sort of a downside that comes with that approach.

But in considering alternatives to that, what's the rationale for sort of the higher level decision to move to a new super agency or something like a military department that has responsibilities for so many disparate agencies?

Would they still have oversight? Maybe not hands-on line management oversight responsibilities, but wouldn't you still expect the Comptroller to oversee DFAS, to set policies for the department, which govern DFAS operations? How would that work?

Don Shycoff: Well, the same way the Comptroller has some responsibilities today. Looking over the financial systems of the Army, Navy and Air Force. It's more in the dispute resolution that I look to trying to equalize the Secretary of the Air Force speaking to the Deputy. I would see somebody as a Secretary of the Defense Agencies, at that level.

You would still have the same structure within DFAS or DLA. It's the resolution of those higher disputes that I'm more looking at. The logistics operations would still be supervised at all levels, as it is today. I think it's the resolution of disputes that we're more talking about.

Jim Locher: If you look at this issue, the Defense Agencies have very diverse responsibilities. If you put them all together into

one fourth department, their responsibilities aren't anymore diverse than the responsibilities of the military departments.

If you were concerned about the problem of having the agencies grouped, you could put them into some natural groupings. The medical and personnel, the intelligence, the logistics and acquisitions things. Then you would not have one super agency, but rather, you would have three or four agencies. The role you would then have for the OSD person is the role that they play for military departments. They don't own the business. They can step back, they can do that policy job, and be independent in their perspective; unbiased, hopefully.

Especially as we start thinking about these issues of horizontally. How are we going to go end-to-end process? That OSD official has the responsibility for overseeing that functional area. He has a tendency to have limited push in the military departments. We would expect much more of a horizontal push coming out of OSD to take on some of these fundamental disconnects.

Jim Locher: This is going to have to be our last question.

Nancy Spruill: Okay. And I am sorry, I did come in late, so maybe this has already been said. One of the things that the Defense Agencies, at least for AT&L, say is a concern is that there are already too many cooks in the kitchen. They get direction from the Comptroller to do certain things, they get direction from OSD to do certain things, and they get overviewed by the Joint Staff in their combat support roles and reviews.

We get OSD to tell us as the principal staff assistants. What I hear you saying is that you're going to put another cook in the kitchen, rather than skimming down the number of people that are giving them direction. I guess my thinking would be to tell the PSA to get everything lined up, rather than to put another cook in the kitchen. I'd like to hear your thoughts.

Don Shycoff: Well, maybe instead of another cook, it's a spokesperson. I would argue that the Defense Agencies don't always have somebody speaking for them. They may have a lot of cooks, but who speaks for the Defense agency?

Nancy Spruill: Well, for all our five agencies, it's the PSA who worked - who that agency reports to. For example, on the DLA it's the Deputy Under Secretary for Logistics and Material Readiness. They speak for and give direction to the Defense agency.

Don Shycoff: She doesn't always get to the Deputy.

Nancy Spruill: They may have not done it as well as they should. However, I'm not sure the solution isn't asking them to do it better and helping them do it better. One of the things they're

working on is trying to have a board of customers which they would chair. I think there are some things going on to have them do a better job. I agree they should do a better job.

Dave Graham: Yes. I think Nancy raises really great points. When we looked at the issues in the agency review, the PDR, I think what we started was with the observation that historically when a Deputy Secretary or the Secretary gets engaged in these things, they really have made a difference. So that's good.

But the problem is that they've got so little time and resources available to devote to anything, much less the Defense Agencies, that there really is not enough horsepower at that level to engage on these things.

So, we looked at alternative models. We never really came down hard one way or another. We were really looking more at the pros and cons. How do you get stronger DOD-wide focus on these things?

One way to do it would be to assist the Deputy within the current structure to weigh in on things. Support the collaboration of the PSAs and the Services on DOD-wide issues. So that's one way to go about it.

The other stems from the belief that the Deputy is just not going to have the time to really get involved in these things. So then that leads people to the idea that you really need a third person at that level who focuses on these management issues.

If they're just another voice, another player, then that wouldn't accomplish what people have talked about. It would have to be a heavyweight who is on the level of a Deputy or a Secretary, who really looks at the DOD-wide issues. But again, we didn't come out hard on either one of those.

Nancy Spruill: Sure. I would just ask which Deputies say they are not willing to step up to it? I've seen a change over time, at least in AT&L, where there really is an attempt to stand up to the problem. Especially in the last year or so.

Dave Graham: Well, I may be speaking out of turn, this is history. The term, "Mouse Olympics" comes to mind. I don't know if anybody here knows that. But we were told at one point an attempt was made to bring these sort of things to that level. And they didn't want to get into the details. So those are the issues you face.

Jim Locher: We'll let that be the last comment. That leads into the first panel this afternoon, which is going to address this issue of management and oversight of Defense Agencies. On behalf of the panel, we appreciate your attention. Thank you.