

SERVICES

ABSTRACT

Traditional definitions of the “services industry” no longer capture the enormous range of non-manufacturing and non-agricultural activity occurring in the global economy. Fully 75 percent of the U.S. economy is now service-based, and 7 of every 10 employees are defined as service workers. Services are not restricted to any industry, but occur in all industries. They are anything that adds value, improves responsiveness, reduces cost, allows risk taking, and increases competitiveness. Global economic and quality competition, stockholder demands for increased profits, and pressures to reduce government spending have caused the service phenomenon. As corporations and government entities concentrate on core competencies, service providers perform those necessary services that are outside of core areas. A large segment of the services industry already supports the Department of Defense (DOD), and this will continue to grow. There are still significant challenges to the DOD in defining core competencies and overcoming a culture that is grounded in ownership, and in command and control of people and assets.

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PLACES VISITED

Domestic

Chamber of Commerce, El Paso, TX
Dallas Airmotive, Dallas, TX
Defense Logistics Agency, Ft. Belvoir, VA
Dyncorp, Ft. Worth, TX
EDS, Plano, TX
Fitting Out & Supply Support Assistance Center, Norfolk, VA
Marriot, Washington, DC
Military Traffic Management Command Transportation Engineering
Agency, Hampton Roads, VA
Southwest Airlines, Dallas, TX
Westat, Rockville, MD

International

Baltic Exchange, London, England
Bloemenveiling Aalsmeer (Flower Auction), The Netherlands
CGU Insurance, London, England
Damen Shipyards, Gorinchem, The Netherlands
Dutch Ministry of Defense, Amsterdam, The Netherlands
European Union, Brussels, Belgium
GM Delphi, Juarez, Mexico
Lloyds, London, England
Logistics Information Systems Agency (U.K. Army), Bicester, United
Kingdom
Oxford Economics, Oxford, England
Phillips Electronics, Juarez, Mexico
RAF College, Cranwell, England
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INTRODUCTION

Traditional definitions of the services industry no longer capture the enormous range of non-manufacturing and non-agricultural activity occurring in the global economy. Fully 75 percent¹ of the gross domestic product (GDP) in the United States is now service-based, and 7 of every 10 employees are defined as service workers.² Of the 20 industries studied by the Industrial College, 8 fall completely within the service sector, and the remaining 12 have large service components.

Exact definitions of service work are probably not important. Current workplace trends are almost certain to continue, regardless of terminology. The role that services play in economic productivity has forced a corporate restructuring, so the way that companies organize themselves to conduct business is undergoing a dramatic transformation. Corporate America, as well as government, is spending considerable time and resources determining what they do best, where they are most competitive, and how they add value to their activities.

The classic benefits derived from functional specialization and economies of scale only partially explain the incentive for this restructuring. Computerization and telecommunications are the new technology multipliers, leading to, until recently, unimagined levels of productivity and return on investment. The simple historical division of business activity into manufacturing and services categories is no longer adequate to capture the essence of a company's activities. Focused networks of specialized skills are the modern paradigm. Today, the concept of "core competency" defines a company. Activities that one company does not consider part of its core are outsourced to form the core of another company. Yet the various cores remain interlocked in a flexible, synergistic network that allows each to respond to the needs of the other. The sum of these new parts is greater than the original whole. In the broadest possible terms, the group of activities that enables this synergistic phenomenon is attributable to the services industry.

The services industry includes various sectors, such as problem solving, insurance, logistics, and base-operations support. Problem solving captures the consulting and research fields and is key to improved productivity through better operating processes. Insurance, generally defined as part of the financial services industry, serves as an economic stabilizer and can be viewed as the "outsourcing of risk." Logistics involves traditional supply chain operations and companies that serve as facilitators, bringing supply and demand into contact, and adding value to their processes through logistics services. Like base-

operations support, each of these areas constitutes an independent multibillion dollar industry sector.

These diverse sectors have common threads. Most pronounced is the strong and continual focus on defining and redefining core competencies and the subsequent use of mergers and outsourcing to create synergies that result in more efficient, productive organizations. Today's competitive environment almost forces outsourcing. Any service is likely to be available from a specialized firm that can provide better value at a more competitive cost than an in-house operation. The more specialized the product, such as research capability, process re-engineering guidance, or tax law advice, the more likely a candidate for outsourcing. Neither corporate walls nor national boundaries serve as restraints. Organizations relying on the services industry are increasingly demanding the highest level of services at the most competitive price.

The same forces pushing private industry toward service reliance affect government. It, too, is struggling to define its core competencies while finding the right synergistic mix of public and private sources to best meet its responsibilities. Senior government leaders recognize the changes occurring within industry and understand the need to compete in productivity and quality. Toward this goal, legislative and executive initiatives clearly seek a stronger public-private partnership.

THE SERVICES INDUSTRY DEFINED

The traditional U.S. Standard Industrial Classification defines *services* as the construction, transportation, communications, utilities, wholesale, retail, and public administration sectors, in addition to the specific *services industries* of amusement, personal services, social services, education, health, lodging, engineering, management, and legal services. The breadth and diversity of these classifications quickly demonstrate the need for a more focused view of the services industry if meaningful conclusions are to be drawn. The larger definition is primarily of interest to those concerned with the diminishing role of the manufacturing sector in the economy. Even within the traditional manufacturing sector, services such as human resources, product development, design, and marketing contribute substantially (85 percent in microchips) to the value added.

The services industry includes both traditional service providers and the portion of the services sector that is a direct outgrowth of core competency and outsourcing decisions. Companies are analyzing what they do best, calling the results of that analysis their core competencies. Functions that are not a part of their core, but are still needed to support

operations are outsourced to a “service provider.” Through this dynamic process, the services industry is in a continuous process of growth and change.

CURRENT CONDITION

Industry

The services sector is a dynamic element of the U.S. economy and has grown in recent years to account for 75 percent of the GDP. Fiercely competitive, the sector is better developed in the United States than anywhere else in the world. Markets for U.S. services are especially strong in Europe, and they are growing in other regions.

As *Business America* noted, “Service industries have become the engine of growth for the American economy, fundamental to the health and prosperity of almost every business, large or small....Companies engaged in every type of commercial activity—manufacturing, transportation, energy and utilities, retail and wholesale trade, finance and government—rely on the edge that services firms offer to be integral to their business success.”³

More than 72 percent of jobs, and approximately 90 percent of new jobs, fall into service categories; these jobs continue to provide employment for workers displaced from the diminishing number of manufacturing positions. Thirty percent of U.S. exports (as compared to 20 percent of total world trade) come from this sector.⁴ The service sector’s importance to the economic element of national power cannot be overstated.

Many converging trends have fueled the growth of services, but the information revolution is the dominant enabler. Alan Greenspan, the Federal Reserve Chairman, recently stated that the “leap in [information] technology is primarily responsible for the nation’s “phenomenal” economic performance.”⁵ The explosion of information and its access has transformed virtually all business processes, allowing much greater span of control, productivity, accuracy, flexibility, and customized operations. Greatly increased international competition, investor demand for high returns, and the balanced budget movement have also pushed both the private and public sector to improved levels of efficiency and subsequently higher growth.

Another key force influencing both the growth in services and improved efficiencies is outsourcing. When done correctly, outsourcing offers superior technology and better trained personnel. According to James Brian Quinn of Dartmouth College, “If you are not best-in-world

in doing something, and you're doing it in-house, you are giving up competitive edge. You could outsource to the best in the world, up the value and lower the cost."⁶

Studies indicate that outsourcing not only can result in improved efficiencies and/or effectiveness, but also can "free up the time and energies of management to focus on companies' core competencies."⁷ Outsourcing has progressed over time from physical activities such as cleaning, maintenance, and transportation support to "intellectually based service activities like research, product development, logistics, human relations, accounting, legal work, and marketing."⁸ The bottom line is that identifying non-core areas and then maximizing the effectiveness and efficiency of these areas through outsourcing increases profits and promotes business in the private sector. This same approach is available for public use.

Government

While accelerating under the pressure of reduced federal spending and the National Performance Review, streamlined and cost-effective government services are not new goals. In 1955, the Eisenhower Administration issued Bureau of the Budget Bulletin 55-4, which declared that the federal government "will not start or carry out any commercial activity or provide a service for its own use if such product or service can be procured from private enterprise through ordinary business channels." Although often ignored, this bulletin established an executive branch policy mandating a bias in favor of the private sector. This policy has led to extensive use of private contractors in meeting federal goals, particularly among agencies created in the past few decades, such as the Department of Energy, the National Aeronautics and Space Administration, and the Environmental Protection Agency. Contractors also have almost completely replaced federal employees in some functions, such as cleaning services, travel management, and personnel security investigations. As an indication of the degree to which the federal government uses the private sector, total civilian personnel costs for Fiscal Year 1997 were \$113 billion, as compared with \$110 billion that federal agencies spent on commercial service contracts.⁹

The issue of contracting out federal functions has always been challenging, contentious, and emotional, especially for agencies with existing workforces. In an effort to help standardize the decision-making process, the Office of Management and Budget (OMB) issued Circular A-76, which requires federal agencies to identify commercial activities

and then, with some exceptions, conduct competitions for the management and performance of these commercial activities.¹⁰ The Circular and its supplement provide a formal process for evaluating the cost-effectiveness of outsourcing. To win a competition, a private sector bid must be at least 10 percent lower than the public sector bid. In March 1996, the OMB revised the Circular A-76 process, providing for streamlined cost comparisons, a fixed 12 percent overhead rate for in-house estimates, and work descriptions in standard terms (i.e., full-time equivalents [FTEs]). While these revisions were intended to facilitate the use of Circular A-76 within the executive branch, Table 1 indicates that, with the exception of the Department of Defense, executive policy calling for reliance on the private sector continues to be largely ignored.

Table 1: Number of FTE Staff Years Studied under A-76¹¹

Fiscal Year	Total FTEs	DOD FTEs	Civilian Agencies FTEs
1988	17,249	12,000	5,249
1989	8,469	6,100	2,369
1990	9,547	6,989	2,558
1991	2,026	1,243	783
1992	564	496	68
1993	509	441	68
1994	1,691	1,623	68
1995	2,386	2,128	258
1996	5,267	5,241	26
1997	25,255	25,255	0

The reluctance of executive branch agencies to pursue public-private competitions has run counter to the general mood in Congress, which supports significantly increased levels of outsourcing.

In 1998, Congress passed the Federal Activities Inventory Reform (FAIR) Act based on its concern over the lack of governmentwide progress in Circular A-76 compliance. The FAIR Act directs agencies to submit a list to the OMB each year of all their non-inherently governmental activities and to review the lists within a “reasonable” time to decide whether to outsource the jobs. Similar lists have been compiled in the past, but the FAIR Act requires, for the first time, public disclosure of these activities and allows anyone, federal employees or private firms, to challenge agency decisions on what can be outsourced.

Although it is too early to predict the outcomes of this legislation, it is likely that the legislation will create a new battlefield as headlined in the May 10, 1999 *Defense News*: “U.S. Industrialists, Unions Clash Over A-76 Contract Process.”¹²

Department of Defense

As reflected in Table 1, the DOD remains the government leader in outsourcing. Although the DOD has broad experience in outsourcing work, it has never attempted the magnitude of outsourcing under consideration today. Even after contracting for 200,000 work years, the DOD is still a target-rich environment for additional outsourcing opportunities. Several independent commissions and private sector advocates have asserted that additional outsourcing within the DOD would save billions annually. The Commission on Roles and Missions of the Armed Forces (CORM) identified approximately \$120 billion per year that could possibly be outsourced. Using both the DOD and private sector experience, the Commission estimated potential savings from outsourcing these activities as high as \$36 billion per year.¹³ The Defense Science Board asserted, in September 1996, that the DOD had 640,000 federal workers involved in commercial activities (a term generally considered synonymous with outsourcing candidates).¹⁴ Recognizing the need for change, the DOD leadership in the mid-1990s began in earnest a series of reform efforts that included increased outsourcing.

An understanding of the DOD’s current outsourcing strategy requires a cursory review of its overall defense strategy. The DOD laid out its overarching strategy in the May 1997 Report of the Quadrennial Defense Review. The strategy requires the DOD to help shape the international security environment in ways favorable to U.S. interests, respond to the full spectrum of crises, and prepare now to meet the challenges of an uncertain future. These three elements—shaping, responding, and preparing—define the essence of the U.S. defense strategy between now and 2015.¹⁵ To ensure the DOD’s ability to execute this strategy, the Secretary of Defense established the following as one of six strategic goals: to “fundamentally reengineer the Department...by reducing costs while maintaining required military capabilities across all DOD mission areas.” To achieve this goal, the DOD implemented a program entitled the Defense Reform Initiative (DRI).

The DRI requires action, vice studies or planning, aimed at adopting business practices that U.S. industry has successfully used to become leaner, more flexible, and highly competitive in today’s global market.

Industry has used and continues to use outsourcing extensively to streamline operations and allow increased focus on core business processes. Private sector studies indicate companies often save 10–15 percent or more, in functions outsourced.¹⁶

This potential for significant cost savings resulted in outsourcing (called competitive sourcing within the DOD, since DOD teams can compete against the private sector under Circular A-76 procedures) and privatization as significant parts of the DRI program. Under the DRI, the DOD established the following competitive sourcing objectives:

- Evaluate all positions by 1999 to identify which functions are commercial in nature and could be opened to competition with the private sector.
- Conduct competitions for 229,000 positions between Fiscal Years 1997 and 2005 under the Circular A-76 process. This target represents more than one-third of the federal workers in the commercial activity area. The level will remain roughly equal, about 25,000 per year, during this 9-year period.
- Seek permanent legislative authority to privatize family housing construction.
- Initiate privatization of all utility systems by January 1, 2000, except those needed for unique security reasons or when privatization is uneconomical.

Within the DOD, the Services project that competitive sourcing saves an average of 20–30 percent. The General Accounting Office (GAO) reviewed these projections and concluded that “sourcing competitions are likely to produce savings.” Although the GAO warned against overestimating the magnitude of the savings likely to be achieved, it projected that “initial savings from recent competitions are expected to be substantial.” Currently, the DOD projects savings from Circular A-76 competitions will total approximately \$11.2 billion by 2005, whether they remain in-house or convert to contractors.¹⁷

CHALLENGES

The services industry faces a host of challenges as it operates in the private and public sectors. Some challenges are shared across these environments, while others are unique to particular sectors. Their impact on national security is manageable. Linked to jobs and education, however, the services industry takes on a more important role in sustaining the vital economic instrument of national power.

Private Sector

The top three challenges to the services industry in the private sector are “staying focused on the core business,” resolving the deficit of skilled information technology workers, and creating measurement tools that can demonstrate how much value is added by service providers in the synergistic environment of the industry.

Service firms report “staying focused on the core business” as an ongoing challenge. Core competencies for service firms often include the functions of communication, logistics, transportation, travel, information assurance, knowledge management, health affairs, network support, finance and insurance, and energy. The enormous growth rate of the services industry is due largely to the expanding capabilities and expertise held by the firms in the industry.

The services sector in the United States is projected to sustain steady job growth through 2005. Nearly two-thirds of new jobs worldwide will require the use of information technology. The scarcity of individuals skilled in information technology continues to be an issue in the industry. The demand for workers with leading-edge skills is so great that there is a worldwide deficit of 885,000 positions. Of the information technology positions available today, 10–20 percent are unfilled.

In the United States and abroad, job trends are moving toward those jobs that require knowledge workers. Furthermore, knowledge is now viewed as a resource that can be applied to many different jobs. This knowledge is constantly evolving through the frequent advancement of technology in three classes of knowledge work that have value: (1) creative knowledge work, which is based on innovation; (2) portable knowledge work, which is based on widespread, immediate utility; and (3) specialized knowledge work, which is based on narrow, but high-utility knowledge learned for specific products. Knowledge workers in all classes are required in the services sector to protect the political, economic, and military instruments of national power. Without a concerted effort to educate its citizens on the changing requirements for success in the job markets of the new millenium, the United States cannot remain competitive. The impact of services on elements of national power such as jobs, unemployment, and education demand the attention of decision makers.

There is a synergistic effect to business partnering that is responsible for the expanding growth of the services industry. The challenge is recognizing that synergy and putting it to use in decision making. Firms network for increased business opportunities as they partner and associate with one another. Some firms use a technique called “co-

sourcing,” which allows them to benefit from the process improvements that they secure for their customers to the extent that improvement increases productivity and revenue growth. The use of metrics that prove how service firms add value to their customers can be a helpful marketing strategy.

Public Sector—Specifically DOD

In order for the DOD to realize the projected outsourcing savings without harm to readiness, capability, identity, and morale, it must first overcome challenges created by its culture, the Circular A-76 process, and defined core competencies.

Within the DOD, the military services are the primary stakeholders in department-level outsourcing initiatives. Savings can be used to improve funding prospects for modernization and readiness, primary goals of each of the military services. Yet the Defense Science Board defined one of the primary impediments to outsourcing in the military as the “resistance of the military to fundamental change.”¹⁸ There are valid reasons to support cautiousness by the military services, but the biggest impediments appear to be military culture and past experience.

Military culture teaches its leaders that carrying out the mission comes first and taking care of their people is a close second. In the words of one senior officer, “Our job is to kick ass and not lose people!” The underlying belief is that effectiveness should not be risked for the sake of efficiency. Ironically, retired, high-ranking military officers lead many of the major service firms seeking DOD contracts. Now in the corporate world, some freely admit their opposition to outsourcing while on active duty. One former base commander acknowledged slow-rolling an A-76 study for his entire 2-year command. He cited the frequently raised concerns, such as loss of control of the workers, contractor incompetence, displacement of the current workforce, and morale problems. His service had provided no incentives to promote greater cooperation at the base level. Now pursuing DOD contracts, this former base commander rebuts each point. Senior leaders need to set the tone and establish a clear direction on the efficiencies that can be sought without affecting combat effectiveness.

The military’s distrust of private sector practices is rooted in past experience, especially during the Vietnam War. Robert McNamara and his civilian Whiz Kids were determined to reform the DOD and force private sector business practices on the military. Their roughshod efforts to impose efficiency on the military and disastrous attempts to apply Ford Motor Company style systems analysis to the war all worked to

reinforce the military's impression that private sector business practices are grossly inapplicable to armed forces.¹⁹

The impact of culture and experience is hard to decipher, but is reflected in the concern most commonly raised by commanders—loss of control, especially in a combat situation. Despite the fact that non-military personnel have been on the battlefield since the nation began, concern about their presence also arises frequently. Commanders fear that contractors may refuse to deploy as required or otherwise hinder readiness and/or capability. Industry again has its rebuttal. Just as retired military leaders head many of these firms, most of their employees are retired soldiers, sailors, and airmen. They are experts in the military environment and provide needed augmentation in the field. Although this may be true, the doctrinal aspect of contractors on the battlefield warrants further development to address both the real and imagined problems. Some of the known issues include physical protection, legal protection/status, tax status, and benefits. In addition, the DOD must include contingency requirements in outsourcing and privatization contracts that address deployment and emergency needs. Anticipation is as important to contractor-provided logistics as it is to military logistics in general. Consideration must also be given to the role of contractors in Status of Forces Agreements.

Organizational cultures can be changed, but require strong vision and leadership. Improvements to the Circular A-76 process, which has received universal criticism from both government and private sector sources, can facilitate cultural change. The outsourcing process has numerous problems, starting with the lack of accounting systems that capture the true cost of an activity. This information is vital in making outsourcing decisions and determining true comparability between proposals. Education and training on the Circular A-76 process are also inadequate. While the DOD has conducted numerous cost studies, few installations have conducted more than one or two. As a result, well intentioned individuals at the installation level are struggling through the complex process of developing a sound performance work statement and objectively evaluating proposals. Furthermore, poorly designed requests for proposals, especially those that do not allow bidders to benefit from economies of scale, can reduce competition by discouraging contractor interest. Finally, the process also creates an organizational conflict of interest in that one of the competing parties (the government) is also responsible for conducting the cost comparison. Several firms have recommended outsourcing the outsourcing process itself, handing the analysis, statement of work preparation, bid process, and possibly even the award decision to specialized consultants.

Although Circular A-76 attempts to establish an objective evaluation and decision-making process, these competitions may evoke a variety of emotions. Affected commanders fear a degradation of their workforce; workers fear displacement or reduced compensation, and private industry resents spending millions of dollars on contract proposals in competitions that they believe are often unfair. Winning contractors have sometimes found an in-place workforce that they must assume has been poisoned against them during the competitive process. These challenges all significantly reduce the potential for real savings, the original objective.

In an attempt to avoid the pitfalls of a Circular A-76 cost comparison, DOD organizations have struggled with definitions of “core competencies.” The reality is that the determination of a core competency is greatly influenced by one’s interest in the task examined. Politicians are influenced by their constituents and their political agendas. Private businesses are influenced by the desire to increase their profits. As a senior military leader observed, ensuring combat effectiveness and protecting soldiers on the battlefield equal profits for the DOD.

OUTLOOK

Private Sector

Consolidation is ongoing in the services industry. Companies consolidate to improve the economy of scale, increase market access, improve quality or service to their customers, widen the span of control, and spread expertise or best practices. Larger size gives service providers greater cost leverage with suppliers. Knowledge of business conditions or the market is also an important reason to consolidate.

Cultural fit is an important aspect of consolidation. This fit includes geographical position, finances, and management style. Differences in the corporate approaches to servicing customers impede the consolidation of those corporations.

Process improvement in the services industry affects productivity, cost, and quality of service to the customer. In the short term, much of process improvement will be the result of continued consolidation, the spread of existing technology, and the adherence to best practice. A basic characteristic of services is that they are people-oriented. If process improvement reduces the personal touch without adding personal assurances in other ways, there is significant risk that the customers will not accept the improvement.

In the short term, niche business in the services industry will continue to thrive. More niches will be found and exploited for competitive advantage. The danger of niche business is that it can be self-limiting.

International Sector

Clearly, the United States leads and will continue to lead its competitors in the services industry. Liberalization of the international services market began with the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) talks, and further negotiations are scheduled to begin next year in the World Trade Organization. As national restrictions on service-providing firms end, firms in the United States will be well-positioned to enter these new markets, especially in the fields of commercial consulting, information technology, and telecommunications. These firms will likely enjoy a short-term competitive advantage over European Union-based competitors because of more advanced development, but competition will be intense. Service opportunities in the Far East are more limited than in Europe due to different business philosophies; Asian businesses appear less willing to split support requirements from their core functions and prefer to control all aspects of production or establish very close association with support/supplier firms.

The global marketplace will continue to push world-class firms toward global presence. The result will be a series of linked individual operating units located wherever a competitive advantage can be found. For example, the concept of *maquiladoras* (i.e., offshore assembly or service activities) in Mexico is not new and initially offered lower wages with proximity to the U.S. market. As more and more maquiladoras were established, however, their comparative advantage diminished. They instead became a necessity to remain competitive, and only those able to improve upon the concept enjoy an advantage.

Some firms focus on taking care of their employees to achieve better results. Maquiladora benefits already offered include bonuses for longevity, transportation to and from work, two meals daily, and housing assistance. Many processes are still labor-intensive, even though additional automated or robotics-based assembly could also add quality, perhaps at a lower long-term cost. Good local managers earn competitive salaries in Mexico. Some firms are developing managers internally, but the increasing competition (with higher salaries) can draw these managers to other firms. As the full provisions of the North American Free Trade Agreement (NAFTA) take effect, the economics and resulting

roles of maquiladoras will change. The current benefit is a competitively priced assembly of U.S.-produced parts with resulting low tax on the added assembly value. Assembled goods must return to the United States or Canada for sales. Phillips, for example, makes television sets in Mexico for the United States and Canada, and it relies on televisions produced in Brazil for its share of the Mexican market. As the full provisions of the NAFTA are implemented, taxes will increase, but the restriction on end destination will disappear.

In the United Kingdom, the Thatcher government introduced a significant outsourcing effort called “contractorisation.” Efficiency (cost savings) and best industry practice remain the goals of this program, which also recognizes increased flexibility in levels of support. The U.K. outsourcing effort includes diverse areas such as information technology, base operating services and support, and government office space. Displaced employees are protected by Transfer Undertaken (to) Protect Entitlements (TUPE), which provides protection against loss of job, pay, benefits, and conditions when functions are outsourced. This program is continuing to expand and should improve as contract scopes and bids are fine-tuned to reflect actual needs more closely. Unfortunately, there has been a negative impact of outsourcing within the U.K. military services. Commanders report that outsourcing has led to a loss of esprit de corps. The team-building processes so vital to unit cohesion have suffered at many bases where there are no longer sufficient uniformed personnel to participate.

Department of Defense

Both reduced federal spending and the private sector’s demand for more DOD service contract opportunities ensure that the outsourcing trend will continue. Competitive sourcing efforts are an important part of the DOD’s strategic goals to re-engineer the department and generate savings to fund critical modernization requirements.

The DOD is in a unique position to benefit from the services industry and already has a number of successes that can be exploited. Verification of DOD savings through the Logistics Civil Augmentation Program (the outsourcing of contingency logistics—LOGCAP) and similar contracts should be convincing, as should lesser known successes such as U.S. Army Europe’s outsourcing of helicopter engine rebuild, Anniston Depot’s cooperative re-manufacturing of armored personnel carriers, and the public-private aircraft maintenance operation at Kelly Air Force Base.²⁰ In April 1997, Thomas G. McInerney, representing Business Executives for National Security, recommended outsourcing

several functions to the National Defense Panel.²¹ These functions included travel claims processing, military and civilian payroll administration, military family housing, inventory management, and defense depots. Contractor maintenance for weapons systems, including the Apache helicopter, Palladin and Crusader artillery systems should be considered. The expansion of transportation outsourcing (such as delivering repair parts or provisions from supplier to the user or maintainer) is already under way in the Defense Logistics Agency (DLA), Air Force, and Navy. The potential benefits are enormous and include more rapid delivery, improved operationally ready rates for supported weapons systems, drastically reduced cost, and less wear on strategic aircraft.

Efforts to further refine the Circular A-76 process will continue. Recently, the Deputy Under Secretary of Defense for acquisition reform indicated that the DOD will soon ask Congress to change the law governing public-private competitions to allow best value to replace best cost as the determining factor in job competitions.²² Other refinements will most assuredly be debated, and more radical changes may be possible.

With the reduction of weapons systems research, development, and acquisition, many defense contractors will continue to pursue opportunities to compete in the defense services sectors. Creative teaming arrangements are emerging within the private sector. An optimum outcome will see the lines between the public and private sectors continuing to fade, with greater use of partnering and other mechanisms that leverage competitive efficiencies and blend the strengths of industry and government in support of U.S. national objectives.

While a leader within the federal government, the DOD is behind the private sector, and behind state and local governments, in utilizing outsourced expertise. The bottom line—undoubtedly threatening to some in the DOD—is that others can do much of what the DOD currently does better and cheaper. Barring catastrophic world events, budget limitations will drive the DOD to more efficient approaches. Political opposition is declining, and the DOD has new authority to privatize installation utilities and family housing. The smoothness of the transition depends on the leadership commitment, not only with the DOD bureaucracy, but also at the military service level.

GOVERNMENT GOALS AND ROLE

Clearly, the DOD must improve its business practices as it moves forward with outsourcing and privatization. Best value must be the basis for contractor selection. True partnering must be the DOD's attitude toward its contractors. To achieve leverage and economy of scale, DOD agencies must seek joint ventures, both within and outside the department, and must consolidate needed services to take advantage of the full range of services available from a class of contractors. Contracts must also be written to require and facilitate transitions...transition to a new contractor, transition between contractors, and transition back to the government if necessary.

The following specific recommendations will help to smooth the transition to private sector service providers within the DOD and optimize potential cost savings. To ease the cultural change:

- Congress should pursue legislation to ensure portability of benefits for government employees facing privatization/outsourcing.
- Congress should authorize and/or DOD leadership should establish financial incentives to installations to outsource when it makes sense to do so. For example, installations could be allowed to retain 25 percent of the first 2 years' savings. This approach ties some positive incentives to outsourcing, countering what are now considered at the local level all negative incentives.
- The DOD should establish doctrinal guidance on the treatment of contractors in combat environments to remove existing fears of nonsupport and to guide commanders on their responsibilities to contractors while educating them on contractor limitations.
- Service Secretary and Chiefs should more aggressively commit to and support a transition to a greater reliance on the private sector.
- The DOD should develop and implement a commander's awareness program on their rights under contracts to ensure that commanders understand the considerable control that they retain over contractors.

To improve the Circular A-76 process:

- The OMB should eliminate the mandatory requirement for in-house bids for functions involving more than ten positions. Instead, a make-or-buy decision based on best value/best industry practice should be allowed, similar to the approach taken by the U.K. Royal Air Force.
- Competitions should be managed at a centralized level, such as the Major Command level. Learning will accelerate, improved performance work statements will result, and organizational conflicts of interest will be avoided.

- Competitions should cover multiple functions (vice single functions) to gain the advantage of economy of scale, to match capabilities of best practice contractors, and to reduce the turmoil on installation personnel.
- Regional outsourcing should be encouraged, when appropriate.
- Joint ventures with other government agencies can be used to achieve economy of scale regionally when appropriate.

To define the core business:

- The DOD should establish common, specific guidelines on what functions are considered core.
- The DOD must prepare for an environment of continuous change and ongoing process improvement.

CONCLUSION

The services industry will continue to grow as a strategic element of national economic development and power. As corporation and government employees concentrate on performing core competencies, service providers will continuously emerge to provide those services that are necessary, but lie outside the core areas.

A large element of the service industry already supports the DOD, and it continues to grow as DOD downsizes. For the time being, former or retired military personnel who are familiar with outsourced tasks often perform these functions for services industry firms. These tasks are performed at a savings to the taxpayer and allow the DOD to concentrate on maintaining national security, even with a downsized workforce. It is essential to ensure that the mechanisms to obtain the services required to support the national strategy and objectives will be available when and if required.

Careful government reliance on segments of the services industry will not jeopardize the national strategy. The challenge for the DOD will be defining core competencies and overcoming a culture that is grounded in ownership and command and control of people and assets.

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