

SERVICES

ABSTRACT

The services industry is the largest and fastest growing segment of the US economy, comprising three-fourths of the gross domestic product. Service providers create value through nonphysical products, accomplishing tasks ranging from accounting and engineering to health care. As individuals seek higher quality lifestyles, personal services will proliferate. As organizations seek greater efficiencies through restructuring, downsizing and outsourcing, the industry will continue to grow. The challenge for business and government alike will be to focus on their core competencies while finding world-class service providers to perform peripheral functions. Because of the diversity within the industry, this paper focused on four areas: information technology services, consulting services, base operations, and logistics. Although the services industry faces many future challenges, it is clearly poised to play a commanding role in the rapidly changing US and global marketplace.

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Domestic

Booz, Allen & Hamilton, Washington, D.C. area
British Embassy, Washington, D.C.
Brown & Root, Inc., Washington, D.C. area
CPCU Insurance, Washington, D.C. area
Defense Advanced Research Projects Agency (DARPA), Arlington, VA
Defense Logistics Agency, Ft. Belvoir, VA
Dyncorp, Ft. Rucker, AL
Edison Chouest Offshore , Washington, D.C. area
KPMG, Washington, D.C. area
Lear-Siegler Services, Washington, D.C. area
Logistics Management Institute, Mclean, VA
Naval Station San Diego Pierside Services, San Diego, CA
North Island Naval Air Station, San Diego, CA
SAIC, San Diego, CA
Space and Naval Warfare Systems Support Center, San Diego, CA
US Naval Base, San Diego, CA
USS CORONADO, San Diego, CA
USS KEY WEST, San Diego, CA
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International

5th Signal Command, Mannheim, Germany
21st Theater Army Area Command, Kaiserslautern, Germany
NATO Maintenance and Supply Activity, Luxembourg, Germany
US Army Europe, Deputy Chief of Staff for Logistics, Heidelberg,
Germany
Baltic Exchange, London, United Kingdom
“Flagship” Recruiting and Training Agency, Portsmouth, United
Kingdom
Fleet Support Limited , United Kingdom
Lloyds, London, United Kingdom
Logistics Information Systems Agency (UK Army), Bicester, United
Kingdom
Portsmouth Naval Base Command, Portsmouth, United Kingdom
RAF College, Cranwell, United Kingdom
RAF Maintenance Activity, Cranwell, United Kingdom
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INTRODUCTION

The services sector represents the largest, most diverse segment of the US economy. While estimates of the size of the sector vary, data from the US Bureau for Economic Analysis show that in 1996, sales of services accounted for 75% of the Gross Domestic Product (GDP). Employment in the services sector is estimated to be as high as 80% (Reich, 1992). Services are used extensively by individuals, businesses, and the government to accomplish tasks ranging from lawn care and accounting to engineering design for weapons systems. The rapid growth of the services sector is closely linked to several factors – the introduction of new technologies, corporate restructuring undertaken to respond to changes in the global economy, and government downsizing that forced civilian and military agencies to seek more efficient ways to operate.

Within private industry, firms recognized that they were performing functions in-house that would be more economical to contract out. The trend to contract out services or “outsource” spread rapidly as the efficiencies materialized. For example, rather than maintain expensive capabilities in market research or information management, many corporations eliminated these departments and bought the services from companies specializing in these areas. The practice of outsourcing has spawned a vast array of new service businesses that have emerged to take advantage of this trend, creating a symbiotic relationship between the service recipient and the service provider.

In response to budget cuts, the federal government has followed industry’s lead in outsourcing many functions. Congress and the executive branch have supported government outsourcing through legislation and executive orders. By contracting for services previously performed by government employees, the US government has met its targets for downsizing, realized budget savings, and still maintained key functions. The military is the single largest consumer of contracted services in the federal government. Contractors manage military bases, conduct training, and provide combat related logistics support. As pressure to reduce the federal budget continues, more government functions will be contracted out to private service providers.

The services sector is a strategic asset for the US in that it accounts for a large portion of the economy and plays an increasingly important role in conducting government and military functions. This report examines the diverse nature of the services sector and the essential role it plays in the national economy. It also analyzes the scope of

government outsourcing, especially by the US military. Particular emphasis is placed on four key subsectors of the services industry: information technology services, consulting services, base operations, and logistics. Finally, the report identifies some of the challenges that will confront government and industry as they continue to explore new ways to accomplish essential services.

THE SERVICES INDUSTRY DEFINED

Basic Economic Sectors

Economic establishments create value for consumers either by producing a physical product (e.g., aircraft, tires, towels, wheat, etc.) or by offering a service (e.g., the corner gas station, Internet service provider, security services, parcel shippers, etc.). Both physical producers and service providers combine labor, knowledge, equipment, and/or material in bringing their output to market.

Physical Producers

Agriculture
Forestry
Fishing
Mining
Construction
Manufacturing

Service Providers

Transportation
Public Utilities
Wholesale/Retail Trade
Finance/Insurance/Real Estate
Services (e.g., health care, legal)
Public Administration

Service Activity within Physical Producers

Not all service activity is conducted by service establishments. Services functions are often performed organically by physical producers. For example, an automobile manufacturer may provide its own plant custodial services by hiring custodians as employees. Often, service functions such as general accounting, custodial services, facilities maintenance, and information systems management are performed organically in large corporations. Alternately, these functions can be performed for the physical producer by a service firm. Because of the mechanics of economic data collection, service functions performed within establishments classified as physical producers are reported in the sector of the company in question. If General Motors (GM) employees provide plant custodial services, the custodians are

reported as manufacturing employees; however, should GM contract out custodial services to a service firm, the custodians are reported in the service provider sector. Economic data likely underreports service activity while overstating physical production activity.

Size of the Services Sector

Of the two basic sectors, the service sector dominates in terms of output and employees. In 1996, service providers accounted for three-quarters of the national economic output and employed 80% of US workers (see Table 1). (These statistics are based on current reporting methods, which as previously noted, may be underreporting service sector activity.)

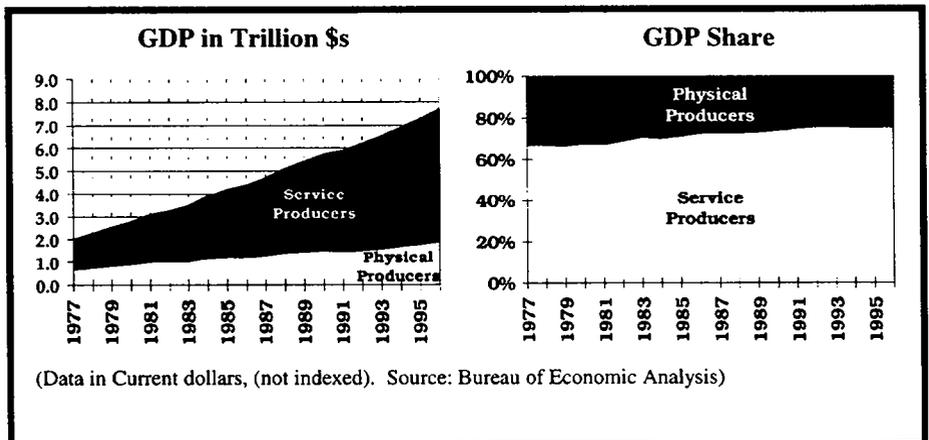
Table 1: Sector Output and Employees

Sector	Real Output (GDP, Billions)	Employees (Millions of Workers)
Services Producers	\$5,814	100.6
Physical Producers	\$1,882	26.9

Source: Bureau of Economic Analysis

The historical trend clearly shows that both services and physical production sectors are growing steadily. However, the services sector is growing at a faster rate than the rest of the economy (see Figure 1).

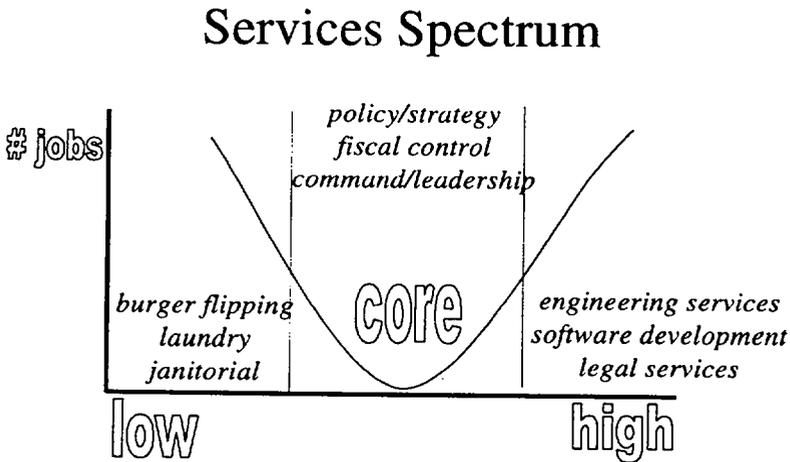
Figure 1. Sector Trends, 1977 to 1996



Services Spectrum

Figure 2 reflects the spectrum of services type jobs and the relative number of such jobs. Services cover a wide range of activities ranging from low-level, low-paying, labor-intensive jobs to high-end technical and professional jobs. Organizations tend to retain core functions such as policy and strategy, fiscal controls, and leadership positions. At the lower end of the spectrum, usually it is cheaper and more efficient to outsource the labor required to perform these tasks. For example, few organizations find that grass cutting is a core activity. At the higher end of the spectrum, it is often more effective to outsource specialized activities such as computer programming and legal services when this expertise is only needed sporadically or for a fixed duration.

Figure 2. Services Spectrum



As evidenced by the role of services in the overall economy, they are used extensively by industry and government. The primary focus of this industry study, however, has been the use of services by DoD.

Department of Defense (DoD) Service Functions Sector

Services activity is big business within DoD. The National Defense Panel estimated that DoD spends nearly 60% of its budget in the performance of service functions. In fiscal year 1997, the Department expended over one million work-years performing service functions — 853,000 work-years by DoD employees and another 207,000 by contractors (DoD, 1998). Only considering workers performing service functions, DoD would rank third in total employment in the US behind WalMart and GM (Taibl, 1997). The following reflects the major types of general services functions performed in support of DoD operations:

Social Services	Health Services
Education and Training	Base Maintenance
Installation Services	Intermediate Maintenance
Data Processing	Other (Non-Manufacturing)
Depot Maintenance & Repair	R & D Support
Real-Property Maintenance	

All these functions have equivalents in private industry. Accordingly, DoD is emphasizing “competitive sourcing” of these functions, subjecting more than 210,000 commercial activity positions to public/private competition from 1996 to 2003 (Cohen, 1997). Further, there may yet be room for expanding the list of DoD service activities that have private sector equivalents. Regardless, the predominant type of activities within DoD is service functions.

CURRENT CONDITIONS

There is a growing need for services. Households and firms are demanding more services and services of increasing quality and sophistication. The proliferation of services to support business and government is a natural adaptation to a requirement for greater efficiency and competition in both sectors. As competition has increased and markets have become increasingly global, efficient performance of service functions has become essential to managing costs and maintaining competitiveness. These trends are observed in much of the private and public sectors, both here and abroad.

Since the turn of this century, companies have been competing internationally in shipping, insurance, tourism, and many other service

industries. Still, nations differ markedly in their relative strengths in service industries, just as they do in manufacturing. Swiss firms are strong in banking, trading, logistics services, temporary help, security services, consulting, and training. British firms are influential in insurance, auctioneering, money management, and various types of consulting. Swedish firms specialize in shipping and environmental engineering. Singaporean firms are strong in ship repair, airlines, port and terminal services, and printing. American firms are leaders in hotel management, accounting, advertising, and a variety of other service industries. "As international competition in services grows and services become more sophisticated, national competitive advantage in services, or the lack of it, is assuming growing importance to firms and nations alike" (Porter, 1990).

Outsourcing Emphasis

Any current discussion of services leads to the subject of outsourcing. There is a whole spectrum of strategies that constitute outsourcing: contracting out, partnering, prime vendor, joint venture, employee stock ownership plans, and privatization to name a few. All have unique applications to the services sector, but are generically labeled as outsourcing strategies. The Defense Science Board defined outsourcing as "the transfer of support functions previously performed in-house to an outside service provider." Here, the service provider is usually given extensive flexibility regarding how it performs the outsourced function. Privatization is viewed as the most extreme kind of outsourcing where government assets, such as depots or data centers, are transferred to the private sector. Most DoD outsourcing initiatives do not involve privatization (Defense Science Board, 1996).

In business and government, organic service functions can be outsourced, that is, performed by people external to the organization via a contract agreement. However, outsourcing is not limited to service functions. End-item manufacturers regularly decide to stop building sub-components organically and acquire them from other, often very specialized manufacturers. Outsourcing generally results in improved focus, lower costs, often better subcomponents for the end-item manufacturer, and increased business and profit for the sub-manufacturer. Outsourcing therefore links the contracting company's competitiveness to the performance of domestic or global service providers.

The interest in outsourcing has shifted from cost containment and cost reduction to business growth and increasing market share. As more companies strive to be the best in their field, concentrate attention and resources on their core competencies, and move support activities to outside providers who can do them better or cheaper, outsourcing will grow. In many cases, even the threat of outsourcing can spur internal savings, improved performance, and increased productivity.

Because of the scope and overwhelming size of the services sector, this inaugural study effort was focused on four areas of concentration: information technology services, consulting services, base operations, and logistics. Each is examined below with a view toward outsourcing applications.

Information Technology Services

The information technology services sector is one of the most vibrant and fastest growing industry markets, accounting for \$379 billion in revenues in 1996 (EDS, 1998). Information technology has come to mean management information systems as well as telecommunications, and its scope is expanding. Information technology services are provided by a wide assortment of companies: those who own and operate data centers; those who use information technology to solve problems and perform business process engineering; and those who provide local and long distance telecommunications services. The US information technology service sector is the global leader and is poised to remain there.

Companies now provide information technology services as a complement to the sale of their products. This can be seen in telecommunication companies such as AT&T and Bell Atlantic that offer a wide range of services besides their core telephone service products. Similarly, Lucent Technologies and Nortel, the two largest telephone switch manufacturers, now offer a wide array of services to complement their core business lines.

The information technology sector popularized current business trends toward outsourcing. In the late 1980s and early 1990s, many companies determined that information technology was not one of their core competencies. These companies sought to buy capabilities from providers whose core competencies were indeed information technology services. Perhaps the most familiar example of this trend is General Motors, which selected EDS to perform its information technology functions. Information technology outsourcing is working so well that

sector growth has outstripped the supply of skilled information technology workers.

Business indicators reflect that the information technology service sector will continue to grow as more companies turn to outsourcing to keep up with technological advancement. Much of this growth is projected to apply to small and medium-sized companies that have not outsourced to the degree of their larger counterparts. These small and medium-sized companies are expected to turn to outsourcing information technology services as a means of staying competitive. Others are going beyond outsourcing, establishing strategic partnerships with information technology companies to give them access to specialized expertise in critical business functions. Most recently, corporate strategies embraced “virtual enterprises” that are dependent on effective information technology capabilities to allow staff reductions. The short history of the information technology services sector indicates it is a highly competitive industry that welcomes the opportunities for expansion.

Consulting Services

Within the fast-growing services sector, the consulting business has been one of its most phenomenal performers. Consultants, employed in both large and small firms, are hired for their unique experience, expert knowledge, or special ability to solve problems, and the ability to tap other corporate resources. The consulting sector includes management analysts and consultants hired to bring a particular expertise to bear on a client’s issues. Their work varies with each client and from project to project, but overall, consultants collect, review, and analyze information, make recommendations to management, and sometimes assist in the implementation of their proposals.

The growth in consultant services in the 1990s is very much a result of evolving management practices and economic conditions. Commercial restructuring, increased business complexity, and the desire to penetrate global markets have caused the demand for consultant services to skyrocket. On the other hand, government has increased demand for consultants because of constrained federal spending and military downsizing. In 1995, US consulting firms employed at least 100,000 people full time around the world and have been growing at more than twice the rate of the world economy for the past decade. In 1994, they generated about \$11.4 billion in fees. By 1999, consulting services revenues will almost double to more than \$21 billion (Micklethwait and Wooldridge, 1996).

In fiscal year 1996, government agencies spent \$1.5 billion on consultant services, and of that, DoD contributed nearly one third (Laurent, 1998). The use of consulting services will increase as DoD continues to downsize.

Base Operations

Support of military base operations might be the richest target for the services industry that US government has to offer. Military bases represent significant investments in infrastructure, require a variety of service support functions, and have little to do with the deployed wartime identity of the units. These three considerations indicate the potential for outsourcing to provide the necessary services to the military units "home-based" at these installations.

Typical support functions include transportation, building and vehicle maintenance, provision of utilities, water treatment, waste disposal, police protection, and many other types of support. All these activities have private sector counterparts ready to take on a larger market share. In fact, DoD is actively learning lessons from state and local government initiatives in outsourcing basic services.

Taking advantage of the outsourcing experience recently gained by the city of Indianapolis could significantly shorten the DoD learning curve. In that city, Mayor Stephen Goldsmith applied the "Yellow Pages" rule. If any service performed by city government is advertised in the Yellow Pages, it is considered a good candidate for outsourcing. The city has saved more than \$80 million since undertaking the program in 1993 (Reinventing Government, 1998). These savings have been realized not only from outsourcing, but also from "forced" efficiencies within the government structure. For this reason, the city of Indianapolis is consistently held up as an example of how competition can foster greater efficiency and more effective provision of government services.

Using the competitive marketplace to bring efficiency to military base support is the key to bringing about the best value for base operations. In-house operations will be forced to trim management and infrastructure to compete with outside agencies. If they are unable to become more efficient, they are likely to be replaced or closed.

Logistics

Throughout the commercial and military communities, logistics management has become a significant focus of business strategies as

organizations attempt to "do more with less," increase flexibility, and generate savings. To produce more value with limited resources, organizations are reengineering processes, consolidating functions, and reducing infrastructure. This transformation affects logistics management as business leaders look for better ways to accomplish essential logistics services. The corporate world has become more competitive by transforming and outsourcing certain logistics functions. Much of the same is occurring in the DoD as the military services embrace the concept of "Focused Logistics" in pursuit of a system that is more responsive, flexible, and precise (Hallin, 1998).

DoD leaders today recognize that the private sector can perform many logistics functions at lower costs. In addition to outsourcing, the military departments are revamping many logistics services with initiatives such as prime vendor concepts and streamlined acquisition processes. Two logistics areas that reflect many of these new initiatives involve depot-level maintenance and flight line maintenance.

Depot-level Maintenance and Repair: Because depot-level maintenance and repair of major weapon systems is essential to peacetime readiness and wartime sustainment, the military services have traditionally preferred to possess robust, organic (in-house) depot maintenance capabilities. Secondly, DoD depot maintenance is an important element of the defense industrial base. Depot-level maintenance and repair comprises repair, overhaul, and modifications for items ranging from complete weapon systems to component parts. It also includes limited manufacture of parts, technical support, testing, and reclamation as well as software maintenance. As DoD strives for business efficiencies in the depot arena, there are a number of unique challenges facing both government leaders and private industry. These include, but are not limited to, establishing a free market concept of public/private competition, outlining potential risks in privatizing military depots, and dealing with legal constraints imposed by public law that restrict the amount of privatization.

As the government increased the portion of depot maintenance that private companies could perform, from 40% to 50%, the latitude for competitive sourcing also increased. In this environment, DoD's biggest challenge is to define and justify the joint logistics core competencies. An unexpected outcome of the depot consolidation and competition plan was the ability and desire of the public sector to compete for the available work leading to a system that now includes both private and public sector competitors. The overall push toward outsourcing has

introduced realistic competition and subsequently caused performance to improve.

Flight Line Maintenance: Over the past few years, DoD leaders have struggled to strike the right balance between organic and commercial flight line maintenance, the organizational level of maintenance for aircraft. In the past, government leaders have set limits on outsourcing flight line maintenance to prevent undercutting force readiness. Looking to the future, DoD leaders are considering a different organic-commercial operation-level balance to save critical resources.

Like DoD, the commercial aviation industry has changed the way it looks at aircraft maintenance. Some commercial carriers have achieved significant savings by outsourcing intermediate and depot level maintenance. However, they have not turned to service providers for handling basic flight line maintenance. The results are similar from an international perspective as US military allies hold onto organic capabilities and carefully weigh the risks associated with outsourcing select aircraft maintenance functions.

To reduce support costs, government leaders are turning over nondeployable flight line maintenance to a civilian workforce. On the other hand, in deployable units the military services have maintained a high percentage of organic aircraft maintenance capabilities due to concerns about wartime readiness. As seen in the Gulf War, however, a large number of DoD civilians and private contractors supported operations at or near the front lines (Hyde, 1991). Civilian specialists did not supplant organic maintainers, but instead, filled a critical maintenance need. Therefore, an all or nothing approach for either combat or non-combat support is no longer a realistic picture.

In the future, the government will face continued pressure to make logistics support more cost-effective. Commercial contracts will provide an important part of the logistics strategy as the military seeks to maintain readiness while taking prudent outsourcing risks.

CHALLENGES

As the dominant and growing sector of the economy, opportunities and impediments loom large for services. The challenges include: a shortage of skilled workers; leveraging technology; resistance to outsourcing; effective government control; defining core competencies; and contractors on the battlefield.

The Skilled Worker Shortage

One dark cloud hovering over the burgeoning services industry is the dearth of skilled personnel to perform the jobs in this expanding sector. The lack of qualified people is especially acute in highly technical areas such as information technology and engineering. At present the information technologies (IT) sector of the services industry is facing the most severe shortage of skilled workers available. This shortage has resulted in pirating of staff by competitors and recruiting abroad. The problem of worker shortage is not unique to the information technologies sector. There is a similar scramble for engineers and business school graduates by consulting firms. The challenge of recruiting is only part of the task. Retaining employees is difficult in the present competitive environment, where high pay and easy entry into the consulting business is the norm.

Leveraging Technology

The world is changing fast and the good providers today will not be the preferred providers of tomorrow unless they stay ahead of the wave. Today's leaders in the services industries are the best at applying technology to provide innovative solutions and unique capabilities. Leading edge companies who use the latest technology to provide "integrated solutions" will be the customers' preferred providers. A good example is a retail business with systems and processes providing linked inventory stocking, store sales, ordering, distribution, and accounting. Service providers must constantly upgrade their own technological capacity to provide the most advanced services to their customers. By leveraging the advantages that technology provides, service providers can maintain their competitive edge.

Government Resistance to Outsourcing Service Functions

The movement to contract out certain government functions is taking on the characteristics of an irresistible force. Notwithstanding the promised increased efficiencies and savings, there is considerable resistance to this new approach to government. The resistance is coming from different quarters: Congressional antioutsourcing caucuses, government labor unions, and military commanders. Yet, the mandate to inject more commercial providers into government activities and

budgetary constraints will inevitably bring along even the most recalcitrant bureaucrat or commander.

Effective Government Control

If government does not need to perform many service functions, it still must find ways to control and ensure satisfactory performance. The first step in ensuring performance is to begin with adequately defined requirements. Then, the government must require the highest standards of performance and accountability and should exercise its right to terminate or modify the contract when appropriate.

Defining Core Competencies

Before deciding whether to contract out any of its activities, the first task facing an agency is to identify its core functions. Generally, core competencies are an agency's reason for existing. For DoD, most of these functions are regarded as inherently governmental and are thus "so intimately related to the public interest as to mandate performance by Federal employees (OMB, 1996)." To stay competitive, business and government leaders must have the courage to make the tough calls about what their core competencies are and focus their resources on those areas.

Contractors on the Battlefield (COTB)

The military departments have attempted broadly to define core competencies as combat and combat support functions that must deploy, together with a core sustaining infrastructure to ensure readiness projection to the battlefield. Most commanders prefer military personnel because of the flexibility offered by their presence in a fluid environment. Besides flexibility, commanders are concerned with the level of commitment that the civilian contractor may have for the mission. Most commanders want to know: will they be there when the shooting starts? This has been an issue for 200 years. History and anecdotal evidence indicate that this apprehension is largely unfounded and can be properly managed. Because contractors will be on the battlefield, the issue will be how far forward should they go. Today's military operations do not always have clearly defined lines of battle and contractors will be integrated throughout the theater of operations. The

best way to meet the challenge is to promote military and civilian integration through training and education.

OUTLOOK

There appear to be two trends occurring simultaneously which are affecting the services industry in America. First, there has been the transition in the latter half of the 20th century from an industrial to an information-based economy in which services derived from specialized knowledge have more value than manufactured goods. This trend has accelerated in the last decade as innovative technologies in the information, communications, and biotechnology fields have created a myriad of new business and employment opportunities. Most of these businesses sell high-value services or expert knowledge packaged to meet the specialized needs of a customer. The outlook for the introduction of more advanced technologies is extremely favorable. We can expect that the services industry will grow as new products are developed and markets are identified. Given the increasing complexity and uncertainty found in the global business environment, service businesses that effectively use new technologies to help industry and government solve problems will come out ahead.

As we have seen, the second major trend that has contributed to the growth of the services sector is the massive outsourcing being undertaken by large companies and the government at all levels. However, this represents illusory growth of the services sector as such outsourcing replaces in-house operations not before recognized as services. Nonetheless, as the private sector and government seek to focus on core functions and contract out peripheral activities, a host of service providers has sprung up to take advantage of the new business opportunities. Thus, a change in the way industry and the government conduct business has directly contributed to the growth of the services sector. We expect this trend to intensify. As medium and small-sized businesses turn to outsourcing to increase their productivity and efficiency, we can expect the services industry to expand to meet this new demand. Remaining competitive in the global economy will require that businesses of all sizes identify and focus on their core competencies. Noncore activities will increasingly be accomplished by outside service providers who will thrive in an environment that values innovation, interdependence, flexibility and best business practices.

Federal Government Direction

Within the federal government, the pressure to outsource activities will continue unabated. Leaner budgets dictate that government managers seek new ways to achieve cost and operational efficiencies. Already, the push for outsourcing has introduced realistic competition into the government environment and caused improved government and contractor employee performance. There are significant opportunities for additional outsourcing by civilian and military agencies. Examples of additional types of functions that could be outsourced include entire DoD installations management, legal and medical services, education and training, finance and accounting, and information systems.

Some resistance to greater use of contracted services is expected from government agencies and Congress. Still, with additional federal budget cuts likely in coming years and the desire on the part of many to reduce the size of government, the need to find greater efficiencies through outsourcing is inevitable. This trend will offer substantial opportunities to businesses in the services sector. It is conceivable that in the not-too-distant future many functions now considered as governmental will be performed by private sector service providers.

International Direction

The international outlook for the services industry indicates continued growth and diversification. Industries and governments in Europe and Asia are beginning a process of restructuring and downsizing that should result in business opportunities for service providers. Contractors are recognized for being better able to add and delete services much easier and quicker than government organizations.

In Great Britain, the government has undertaken an ambitious program to outsource and privatize many of its defense functions under the national policy label of "contractorisation." How far this should go is being debated healthily by the British. Since the bold start of this initiative, the thrust has moderated to include partnering, private finance, and public/private competition. Recent British efforts to use private contractors to restore the legitimate government in Sierra Leone caused the Parliament and media to question "why even war is being privatised" (Segal, 1998).

Changes in the way American and multinational companies conduct their businesses have already created business opportunities for service providers in Asia. For example, companies in India are providing

programming and other computer services to international firms eager to take advantage of India's skilled workforce and low wages. With the arrival of almost instantaneous communications and information systems, the services industry has become truly global in nature.

Some governments have been slower to privatize and outsource. France and China have been notably less active in this regard, owing perhaps to a different philosophy of what makes up a government's core competencies.

GOVERNMENT GOALS AND ROLE

By the 1950s the US federal government had grown in size, and expanded the scope and breadth of its operations to a level that would have astounded the founders of our nation. Government had become big and inefficient, bloated by functions that had nothing to do with governing and everything to do with routine business activity. The services industry, with so much to offer in experience, pricing, efficiency and flexibility did not yet provide significant support for government officials.

In 1955 President Eisenhower 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" (Rehfuss, 1989). Not until promulgation of the Office of Management and Budget's Circular A-76 in 1967, however, was the policy applied on a government-wide basis.

Within the federal government, DoD has been a leader in efforts to outsource and privatize functions that either are not inherently governmental in nature or are not core military competencies. The Departments of Transportation and Commerce and the General Services Administration have also been active in outsourcing, but DoD has outdistanced the other agencies by a clear margin. Meanwhile, the smaller government agencies have been active in outsourcing functions, but they have virtually ignored A-76 guidelines for doing so (Thomas, 1998). DoD's success was due largely to two factors. As the largest agency in government with the heftiest discretionary budget, DoD is an attractive target for congressional budget slashers and of all federal agencies, only DoD was allowed to retain savings that were traceable to A-76 measures.

The federal government is paying increasing attention to the impressive efforts that state and local governments have made to

privatize and outsource their operations. In 1996, the General Accounting Office undertook an exhaustive study of several state and local initiatives. Common threads connected these program initiatives, but most of them chose to avoid the pitfalls of legislating or reducing budgets to force change, concentrating instead on increasing incentives for managers and workers to restructure government willingly.

At present, Congress is considering new legislation to reinforce A-76 and commit it to law. While private sector business groups view this initiative as a small but significant step in the right direction, many government employee groups see it as a thinly-veiled effort to deny them the right to compete for contracts.

The federal government has set a course toward increased competition for performance of its nongovernmental functions, to include both public and private sector players. For the foreseeable future, the lines between the two sectors will continue to fade, with greater use of partnering, franchising, and other mechanisms that will leverage competitive efficiencies and blend the strengths of industry and government supporting US national objectives.

CONCLUSION

Services have become a strategic element of national economic development and growth. Service industry providers create value and increase productivity. They specialize in doing things at world class levels, which in the competitive global economy, is often the leveraging factor that determines the efficient from the inefficient producers. Services represent a substantial share of employment and economic output in most all nations, especially advanced ones. With new technologies creating business opportunities as well as lifestyle changes, the services industry will expand into areas yet unimagined. As businesses and governments seek innovative ways to be more efficient and competitive, the services industry will become an even more vital part of the economy.

Services are often sold to other producers through outsourcing. Organizations are redefining their core competencies and shifting noncore activities to specialized companies that have figured out the best ways to accomplish tasks. While outsourcing has been around a long time and currently enjoys almost faddish management popularity, it is expanding to include partnering, joint ventures, private finance initiatives and other competitive sourcing strategies.

Many of the restructuring, downsizing, and outsourcing initiatives applicable to the business world are also relevant to government. In a number of areas, maintaining governmental in-house capabilities is not the most efficient way to provide cost-effective services for the taxpayer. As a result, governments are expanding the use of service providers in many traditional in-house activities to include information technology services, base/city operations, consulting, and logistics services. The difficult and unique challenge for government, particularly military organizations, is to incorporate smart business practices without jeopardizing national security. Although finding ways to reduce costs is important for government, it is different from pursuing corporate profits. Government leaders must balance the application of business efficiencies against national security needs and never let the scale tip in favor of the former. Government can emulate improved business operations when practical, and the use of world-class service providers will be a key ingredient for future success.

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